UNITED STATES OF AMERICA
DEPARTMENT OF ENERGY
BEFORE THE
BONNEVILLE POWER ADMINISTRATION

Fiscal Years 2018-2019 Proposed	**)**	**BPA Docket No. BP-18**
Power and Transmission Rate	**)**	
Adjustment Proceeding	**)**	

DIRECT TESTIMONY OF:
Public Power Council
Northwest Requirements Utilities
Pacific Northwest Generating Cooperative
Idaho Falls Power
Snohomish County Public Utility District No. 1
Eugene Water & Electric Board
Cowlitz County Public Utility District No. 1

as

JOINT PARTY 5

SUBJECT:
Financial Reserves Policy

WITNESSES:
Michael Deen
Megan Stratman
Scott Russell
Greg Mendonca
Kevin O'Meara
Christopher Weber

January 31, 2017

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SECTION 1: INTRODUCTION AND PURPOSE

Q: Please state your name and qualifications.

A: My name is Michael Deen. My qualifications are shown at BP-18-Q-PP-03.

A: My name is Megan Stratman. My qualifications are shown at BP-18-Q-NR-01.

A: My name is Scott Russell. My qualifications are shown at BP-18-Q-PN-02.

A: My name is Greg Mendonca. My qualifications are shown at BP-18-Q-PN-01.

A: My name is Kevin O'Meara. My qualifications are shown at BP-18-Q-PP-01.

A: My name is Chris Weber. My qualifications are shown at BP-18-Q-PP-04.

Q: What is the purpose of your testimony?

A: The purpose of our testimony is to respond to BPA's efforts to adopt a policy to provide comprehensive guidance in the management of BPA's financial reserves. We explain that because we are invested in the agency's long-term health and viability, we can support BPA adopting a financial reserves policy but only if it is transparent, minimizes rate instability, is equitable between Power Services and Transmission Services, and has a strong business case with benefits that exceed costs. We explain why BPA staff's financial reserves policy proposal fails to meet these goals, would result in unwarranted rate pressure on BPA customers, and would undermine BPA's goal of being cost-competitive and the future power supplier of choice for preference customers. Finally, we propose an alternative policy that addresses the concerns of BPA staff but avoids the intolerable consequences likely to result from BPA staff's proposal.

Q: What is your interest in BPA's policies regarding the level and use of financial reserves?

A: We represent a broad and diverse coalition of public and cooperative preference customers that purchase both wholesale power and transmission services from BPA. As such, we have a direct and material interest in the cost and terms of BPA's power and transmission products, which we rely upon to provide our consumers reliable and economic electricity service. Taken together our organizations and utilities comprise 94.6 percent of BPA's Tier 1 power load.

SECTION 2: POLICY CONTEXT

Q: Please describe the context in which you are evaluating potential financial reserves policies.

A: First and foremost, we are dedicated to the effort to achieve cost-competitiveness for BPA in both the short and the long term. The expiration of power sales contracts with BPA's preference customers in 2028 has rightly caused the agency to assess its long-term competiveness, given the low market prices for electricity and the unsustainable trajectory of BPA's rates. This dynamic has caused BPA's power customers to wonder about BPA's ability to be their provider of choice upon expiration of the current contracts.

Therefore, both the Administrator and the customers recognize that BPA is at a critical juncture to demonstrate its commitment to control the trajectory of its costs and rates. The fundamental financial strength of BPA is its relationship and its contracts with the preference power customers, and nothing is more important to the long-term solvency and health of the agency than remaining the power provider of choice for those customers.

To that end, BPA and its preference customers must work collaboratively to achieve delivery of cost-effective products and services. The preference customers succeed when BPA succeeds and vice versa. BPA should not adopt any policy that is detrimental to its commitment to control costs and offer stable, competitive rates. To do so would undermine crucial competitiveness efforts and damage the business relationships that are the key to the agency's long-term health.

SECTION 3: NEED FOR A FINANCIAL RESERVES POLICY

Q: Why are BPA staff proposing a financial reserves policy in this rate case?

A: Currently, BPA does not have a consistent definition of acceptable financial reserve levels for each business line and for the agency as a whole. This is of particular importance to BPA staff because financial reserves levels and financial reserves policies "have a direct effect on BPA's credit rating, which is determined at the aggregate BPA level."[1] Staff assert that the lack of a consistent policy across the business lines and for BPA as a whole "allows for *ad hoc* financial reserves decisions and different treatment for each business line."[2] Staff state that establishment of a financial reserves policy will help to maintain BPA's credit rating, solvency and rate stability.[3]

Q: How do you respond to BPA staff's rationale for adopting a financial reserves policy in this rate case?

A: We could support adoption of a consistent and prudent policy to manage financial reserves at the business line and agency level. Because rating agencies evaluate BPA's creditworthiness at the agency level, management and use of reserves within one business line inherently affects the other. Further, we agree that maintaining BPA's liquidity, rate stability, and credit rating is important. Regrettably, BPA staff's proposal fails to meet this need in a cost-effective manner.

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[1] Harris *et al.*, BP-18-E-BPA-17, Appendix A, at A-1.
[2] *Id*.
[3] *Id*.

Q: How does BPA staff's proposal affect maintenance of BPA's liquidity, rate stability, and credit rating?

A: Staff's proposal is neutral to BPA's maintenance of liquidity, undermines rate stability, and is focused mostly on addressing credit rating support. Starting with liquidity, we address each of these in turn.

Q: How does BPA staff's proposal address liquidity?

A: To address BPA's liquidity needs, BPA staff's proposal incorporates BPA's existing practice of meeting or exceeding the 95 percent Treasury Payment Probability (TPP) standard.

Q: Briefly explain what the TPP standard is.

A: The TPP standard requires that rates are set such that there is at least a 95 percent probability that the U.S. Treasury payments in a two-year rate period will be made on time and in full.[4] Because obligations to the Treasury are subordinate to other obligations, the 95 percent TPP standard ensures an extremely high likelihood for payments to third parties.

Q: Why do BPA staff believe that a financial reserves policy is needed in addition to the existing TPP standard?

A: BPA staff state that while the TPP standard ensures a high probability of BPA having enough financial reserves to pay its financial obligations, it does not establish a target amount of financial reserves for either business line or the agency.[5] In addition, BPA staff express concerns about pieces of credit agencies' reports. For example, BPA staff

[4] Harris *et al.*, BP-18-E-BPA-17, at 6, lines 15-20.
[5] *Id.* at 11, lines 1-11.

cite a Fitch report that notes that the "maintenance of strong reserves is essential" to BPA's credit rating.[6]

Q: *How do BPA staff incorporate the TPP standard into their Financial Reserves Policy proposal?*

A: Staff incorporate the TPP standard, BPA's existing primary risk mitigation mechanism, by setting a financial target based on the higher of 90 days' cash on hand or what is necessary to meet the 95 percent TPP standard.[7]

Q: *Please clarify the interaction between the TPP standard and ensuring BPA's liquidity needs are met.*

A: BPA staff state that it is the TPP standard that addresses BPA's need for sufficient liquidity. According to staff, BPA's 95 percent TPP standard assesses "the amount of liquidity necessary to ensure short term solvency."[8] They clarify that it is the TPP standard, and not the days' cash on hand metric, that addresses hydrological conditions, market price volatility and contractual uncertainty.[9] In short, regardless of whether staff's proposal is adopted, BPA's liquidity needs will continue to be assessed and met entirely through its existing practices.

If in the future there is a concern that BPA may have a liquidity issue within a rate period, then that issue should be both modeled and addressed directly and not through generalized reserves targets that do not address BPA's particular financial situation and tools.

Q: *How do BPA staff assert that their proposal addresses rate stability?*

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[6] Harris *et al.*, BP-18-E-BPA-17, at 14, lines 20-24.
[7] *Id.* at Appendix A, at A-2.
[8] Response to Data Request PP-BPA-26-16.
[9] Response to Data Request NR-BPA-26-19.

A: According to BPA staff, financial reserves that accumulate when financial performance is better than expected and are not obligated for a future specific purpose may allow BPA to forgo a rate increase that would otherwise have been necessary.[10] They also state that rates receive the benefit of interest income from holding financial reserves in interest-bearing investments, and saves interest expense by deferring borrowing. In the BP-18 Initial Proposal, BPA is forecasting $7.7 million interest income for Power Services and $9.9 million for Transmission Services over the rate period.[11]

Q: How do you respond to this assertion?

A: BPA staff's statements are factually correct. However, under staff's proposal, the likelihood of financial reserves being used to forgo a rate increase for Power Services would actually decrease compared to status quo. Under staff's proposal, financial reserves that accumulate when financial performance is better than expected will be used to increase the Cost Recovery Adjustment Clause (CRAC) threshold until Power reaches the proposed lower threshold. Therefore, those reserves will not be available to offset a potential rate increase. Only when both Power and the agency are above the upper thresholds could excess financial reserves be used to offset a rate increase, and then only if the Administrator chooses to use excess reserves for a dividend distribution instead of some other purpose. Finally, using interest income or interest savings as part of the rationale for holding financial reserves is unsound. While it is appropriate for BPA to place cash in interest-bearing investments, using interest income as a rationale to hold financial reserves is not compelling because (1) they yield extremely low earnings (2) and customers could otherwise put these funds to productive use.

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[10] Harris *et al.*, BP-18-E-BPA-17, at 19, lines 13-20.
[11] *Id.* at 20, lines 4-6.

Q: Please discuss credit support, the third reason staff cite for their proposal.

A: As discussed above, BPA's liquidity needs are sufficiently met through its existing practices (*e.g.*, the TPP standard) and staff's proposal actually worsens rate stability. This leaves the support of BPA's credit rating as the primary reason for the adoption of a financial reserves policy.

BPA staff state that "[r]ating agencies have made very clear the importance of financial reserves for BPA."[12] The rating agencies have noted both BPA's "weakening reserves" and its lack of a minimum financial reserves policy.[13] BPA staff are concerned because BPA has an intensive capital program, and BPA's credit rating affects the interest rate BPA will pay on the debt it incurs.[14]

Q: Have you read the credit rating agency reports cited in BPA staff's testimony?[15]

A: Yes. As a matter of context it is important to note that BPA is rated at an extremely high level by all three credit rating agencies with a stable outlook. Specifically, BPA is currently rated "Aa1" by Moody's,[16] "AA-" by Standard & Poor's ("S&P"),[17] and "AA" by Fitch.[18] These ratings indicate that BPA has strong financial health and is very high in the category of investment grade debt.

Moody's defines obligations rated Aa "to be of high quality" and "subject to very low credit risk."[19] S&P describes an AA-rated obligation to be different "from the highest-rated obligations only to a small degree. The obligor's capacity to meet its

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[12] Harris *et al.*, BP-18-E-BPA-17, at 14, lines 20-21.
[13] Fitch Ratings New Issue Report, 17 March 2016, at 1 and 3.
[14] Harris *et al.*, BP-18-E-BPA-17, at 13, lines 15-25.
[15] *Id.* at 15.
[16] Moody's Investor Service Credit Opinion, 14 June 2016, at 1.
[17] Standard and Poor's Credit Rating Report, 14 March 2016, at 2.
[18] Fitch Ratings New Issue Report, 17 March 2016, at 1.
[19] Moody's Rating Symbols and Definitions 2016, at 5.

financial commitment on the obligation is very strong."[20] Finally, Fitch defines credit rated as AA as, "Very high credit quality. 'AA' ratings denote expectations of very low default risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events."[21]

Q: *Do you agree with BPA staff's interpretation of the credit agencies' reports?*

A: Not entirely. We do not disagree that the credit agencies are likely to view a prudent and comprehensive financial reserves policy as a benefit. For example, Fitch says that it views "the initial steps toward the development of more formalized [financial] policies and forward-looking [rate] forecasts as positive."[22] Therefore, it is reasonable to conclude that BPA's adoption of some sort of financial reserves policy will be considered an improvement over status quo. In addition, BPA staff have developed a Long-Term Reference Case, which further bolsters BPA's response to the rating agencies' guidance.

But, we disagree with how BPA staff are interpreting certain parts of the rating reports. For example, BPA staff justify the establishment of the lower threshold to be 60 days' cash on hand "so the CRAC will begin to replenish financial reserves before they fall to the level at which rating agencies have warned us there would be a significant risk of a credit rating downgrade, which is 30 days' cash on hand."[23] However, Moody's report uses very different words. In its lists of "Factors that Could Lead to a Downgrade," Moody's simply notes that "BPA's rating *could be negatively pressured* if BPA's internal liquidity drops below 30 days cash on hand *on a sustained basis*."[24] (Emphasis added.) Moody's report does not "warn" about a "significant risk of a credit

[20] Standard and Poor's Rating Definitions, 20 November 2014, at 5.
[21] Fitch Ratings Credit Rating Scales 2017, Public Finance Obligations.
[22] Fitch Ratings New Issue Report, 17 March 2016, at 4.
[23] Harris *et al.*, BP-18-E-BPA-17, at 32-33, lines 23-1.
[24] Moody's Investor Service Credit Opinion, 14 June 2016, at 3.

downgrade" but simply says that BPA's rating "could be negatively pressured" if liquidity drops below 30 days' cash on hand "on a sustained basis." By BPA staff's own admission, "sustained basis" is an undefined term that "likely mean[s] longer than a period of a few months but shorter than a period of many years."[25] We must be careful to not overreact and adopt a costly policy based on a vaguely-worded phrase within an otherwise very positive multi-page report.

Additionally, the credit rating agencies define "days cash on hand" to the exclusion of other sources of liquidity available to BPA, primarily its $750 million revolving line of credit from the U.S. Treasury. One must be careful to overlay BPA's unique mechanisms and authorities to manage liquidity when attempting to compare BPA's days' cash on hand to other so-called comparable entities. It is not prudent to establish a threshold based on the financial reserves of entities that do not share BPA's unique characteristics. Among other factors, BPA enjoys underlying support from the U.S. Government, a $750 million revolving line of credit from the U.S. Treasury, and the ability to defer payments to the U.S. Treasury.

The above examples emphasize why it is important to read the credit agencies' reports comprehensively. In developing a prudent policy to manage financial reserves, one must consider *all* factors considered by the rating agencies. In addition to financial reserves, the rating agencies list others factors such as service area economic strength and customer base stability; willingness and ability to recover costs with sound financial metrics; and rate competitiveness.[26] Indeed, as discussed in detail below, these factors

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[25] Response to Data Request PP-BPA-26-41.
[26] Moody's Public Power Rating Methodology, 1 March 2016, Appendix A.

underscore the need for BPA to ultimately adopt a financial reserves policy that supports its initiative to become cost-competitive and improve its cost trajectory.

Q: Please briefly summarize the key observations made by the rating agencies about BPA's creditworthiness.

A: The key strengths of BPA noted by all three rating agencies include: BPA's relationship with the U.S. Government and U.S. Treasury; BPA's competitive rates and low-cost hydro power; and BPA's long-term contracts with its Power customers. S&P says that "Customers demonstrated their commitment to the agency's system by entering contracts with BPA that extend from 2008-2028."[27] Fitch has a slightly different perspective on BPA's contracts with its Power customers, referring to them as "medium-term." Fitch goes on to say that the "contract terms limit Bonneville's financial exposure. However, the contracts expire in 2028 and customers are not obligated to continue to purchase from Bonneville if new contracts are not signed."[28] It is evident that long-term power sales agreements are considered to be a major strength by the rating agencies, both because they provide revenue certainty and because they demonstrate a positive and collaborative relationship between BPA and its customers.

Areas of concern noted by the rating agencies include potential decreases in BPA's reserves, although the rating agencies recognize that BPA's reserves are linked to seasonal hydrological conditions and power market prices.

Q: Does BPA staff's proposal address the points made by the credit rating agencies?

A: Staff's proposal appears to have focused on only one aspect of the reports: the amount of financial reserves held. However, in response to a data request, BPA staff acknowledge

[27] Standard and Poor's Credit Rating Report, 14 March 2016, at 5.
[28] Fitch Ratings New Issue Report, 17 March 2016, at 1.

that "cash on hand is not the only factor [the rating agencies] consider. Rating agencies also assess other factors to determine BPA's creditworthiness, including but not limited to BPA's overall liquidity, BPA's financial policies, and management's willingness to raise rates to support financial integrity."[29]

Perplexingly, BPA staff's proposal barely touches on one of the key risks noted by the rating agencies, that of hydrological and market price risks. Currently, BPA mitigates risks associated with uncertainty and volatility in hydrological conditions and wholesale market prices through the TPP standard. The "TPP captures hydrological conditions, market price volatility and contractual uncertainty"[30] and assesses "the amount of liquidity necessary to ensure short term solvency."[31] Thus, some of the major risks noted by the rating agencies – financial liquidity, hydrological conditions and market price volatility – are mitigated by BPA's existing practices (*e.g.*, the TPP standard).

Further, BPA staff's proposal actually undermines several of BPA's strengths: cost-competitiveness and strong relationship with its customers.

Q: Please elaborate on your assertion that BPA staff's proposal actually undermines some of the strengths noted by the credit rating agencies.

A: BPA staff's proposal is counter to the agency's ongoing effort to be cost-competitive and to position itself to be the power supplier of choice for preference customers post 2028. For example, in the 2016 Integrated Program Review (IPR) close out report, the Administrator stated that being cost-competitive "is essential to maintaining our position as the wholesale provider of choice when our long-term contracts are up for renewal in

[29] Response to Data Request PG-BPA-26-2.
[30] Response to Data Request NR-BPA-26-19.
[31] Response to Data Request PP-BPA-26-16.

the next decade."[32] The credit agencies have echoed this sentiment in their credit reports by noting that two of BPA's biggest strengths are its cost-competitiveness and long-term contracts with customers. As the contracts get closer and closer to expiration, their weight in BPA's credit assessment diminishes, and already the rating agencies have taken notice (*e.g.*, Fitch referring to these contracts as "medium term").

With customers already questioning BPA's ability to be the power provider of choice post 2028, BPA cannot adopt policies that will lead to unnecessary rate increases and make customers question the agency's commitment to cost-competitiveness. This would undermine two of the weightiest factors in BPA's excellent credit rating and potentially result in far greater harm than the absence of a comprehensive policy on reserves. Thus, the financial reserves policy BPA ultimately adopts cannot increase costs to customers without commensurate benefits so as to undercut the relationship BPA depends upon for its credit worthiness. Unfortunately, as we discuss more below, staff's proposal is likely to add to customers' concerns about the trajectory of BPA's rates and further undermine BPA's ability to be cost-competitive.

Q: What are the purported benefits and costs of BPA staff's proposal?

A: Staff's proposal is intended to support BPA's credit rating – that is, to avoid a downgrade. Staff cite statements in the rating reports that warn about the potential for a downgrade in the event of a sustained and sizable reduction in financial reserves.

BPA staff have estimated the potential cost of a downgrade. Staff estimate that a credit rating downgrade would increase BPA's borrowing costs on newly issued non-federal debt by approximately 50 basis points. Based on the planned amount of non-

[32] 2016 IPR/CIR Close Out Report, October 2016, at 2.

federal debt issuances over the next 10 years, staff estimate that a 50-basis-point interest rate increase could increase revenue requirement costs by as much as $33 million for Transmission Services and $22 million for Power Services per year.[33] Notably, the actual average impact of such a downgrade would be $22.5 million for Transmission Services and $16.1 million for Power Services per year from FY2018 through FY2027.

Regardless, this analysis is useful because it provides a maximum amount a business line would want to pay to avoid a potential downgrade. For Power Services, even if a downgrade was otherwise certain, any cost associated with a financial reserves policy should be below $16 million, and certainly below $22 million per year. We recognize that a potential downgrade could affect the number or diversity of potential bond purchasers in addition to increased interest expense. However, we also recognize that BPA's credit rating is inherently linked to the credit rating of the U.S. Government, over which BPA has no control. These qualitative factors must be considered along with the quantitative factor of the actual potential cost impact. We developed our counterproposal to balance these costs and benefits.

Q: Who benefits from BPA's credit rating?

A: Both business lines benefit from BPA's credit rating. For example, Energy Northwest issues debt on behalf of BPA related to Power Services. Transmission Services uses third parties to finance transmission construction through the lease purchase capital program.[34]

SECTION 4: BPA STAFF'S PROPOSED POLICY FAILS TO MEET OBJECTIVES

Q: Do you support adoption of some sort of a financial reserves policy?

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[33] Harris *et al.*, BP-18-E-BPA-17, at 17, lines 8-14.
[34] *Id.* at 13-14, lines 15-5.

A: Yes, we support adoption of a financial reserves policy that links the costs and benefits of supporting BPA's credit rating; establishes the minimum level of reserves to trigger replenishment and specifies the mechanism and timeframe for such replenishment; establishes the maximum level of reserves before using them for other purposes; and is equitable between Power and Transmission business lines.

Q: In your opinion, does BPA staff's proposal accomplish these goals?

A: No, BPA staff's proposal does not accomplish these goals.

Q: Please explain how BPA staff's proposal fails to meet these objectives.

A: First, BPA staff's proposal does not align costs with benefits. As explained earlier, sustaining BPA's current credit rating relative to an immediate downgrade is projected to save Power customers an average of $16 million, and possibly up to $22 million, per year in interest expense over 10 years. Staff's proposal ignores the level of potential benefits and proposes to increase Power's CRAC threshold from $0 to over $300 million over 10 years. This is the equivalent of an average impact of at least $30 million per year, which well exceeds even the maximum potential cost savings of $22 million per year.

Second, we disagree with the lower threshold proposed by BPA staff. Staff's proposal sets the lower threshold at 60 days' cash on hand to allow the CRAC to "begin to replenish financial reserves before they fall to the level at which rating agencies have warned us there would be a significant risk of a credit rating downgrade, which is 30 days cash on hand."[35] We have already discussed why we disagree with staff's interpretation of the Moody's report. Nonetheless, we do support BPA staff's desire to adopt a financial reserves policy that does not intentionally contradict advice from the rating

[35] Harris *et al.*, BP-18-E-BPA-17, at 32-33, lines 23-1.

agencies. Therefore, we propose a threshold that is greater than 30 days' cash on hand in our proposal.

Third, we disagree with BPA staff's proposal to set the upper threshold at 120 days' cash on hand because there is no sound rationale for this level. Staff's rationale is that 120 days' cash on hand is a "safe place" because it equates to roughly "four times the absolute minimum level of days' cash on hand required by Moody's."[36] Again, we disagree with staff's characterization that Moody's has asserted a requirement that 30 days' cash on hand is the "absolute minimum level." When asked to provide further explanation on why they chose 120 days' cash on hand, BPA staff responded that they performed a historical analysis of how often the Reserves Distribution Clause (RDC) would have triggered since 2004. Analysis indicates the RDC would have triggered 25 percent of the time over the last 12 years, which "properly balances the need for BPA to hold reserves to support its credit rating and financial health, while also allowing the reserves to be repurposed with appropriate frequency."[37] No justification was provided as to why 25 percent is the appropriate frequency for the RDC to have triggered over the last 12 years. And this analysis ignores other factors, such as major contractual changes over this 12-year period (e.g., the start of long-term, take-or-pay Regional Dialogue contracts in 2012), which may affect the amount of reserves BPA needs to hold.

BPA staff's analysis also ignores other – and likely more impactful – aspects of BPA's financial health, such as its take-or-pay contracts, debt-to-asset ratio, and power rate increases totaling 27 percent since FY2009. This rate trajectory clearly shows BPA's willingness to raise customers' rates to recover agency costs. In fact, when presented

[36] Harris *et al.*, BP-18-E-BPA-17, at 33, lines 20-22.
[37] Response to Data Request NR-BPA-26-16.

with a compelling business case, customers have been willing to pay higher short-term rates to enhance BPA's financial health for the longer-term (for example, transitioning financing of the energy efficiency program from debt to expense financing).

Finally, we disagree with BPA staff's proposed mechanisms to phase in Power's lower threshold. First, the Incremental Rate Pressure Limiter (IRPL) ensures the non-Slice rate increases will be at least three percent until Power's lower threshold is met. Guaranteeing continued rate increases undermines BPA's initiatives to become cost-competitive and conflicts with competitiveness, one of BPA's key strengths identified by the rating agencies.

Second, the Good Year Ratchet creates excessive and unwarranted rate instability. The Good Year Ratchet usurps any amounts of financial reserves above the current CRAC threshold and uses them to increase the CRAC threshold even higher until it reaches the proposed lower threshold. This contradicts one of the fundamental mechanisms underlying BPA's net secondary revenues methodology, which sets rates based on the *expected value* of net secondary over a wide range of hydrology and price scenarios. By definition, actual net secondary revenues could be either above or below the expected value, but should average out over time. Staff's proposed Good Year Ratchet undermines the basis of BPA's net secondary revenue credit and risk mitigation framework.

Third, the Good Year Ratchet largely negates the primary benefit for power customers of BPA having financial reserves. The primary benefit of addressing bad operating results with previously accumulated cash instead of relying on existing credit lines is that the timing for repaying credit lines is determined externally by the credit terms, whereas the timing for restoring accumulated cash used to meet adverse developments can be determined based on the exercise of judgment informed by the surrounding circumstances. BPA staff's proposal, however, would remove BPA's ability to use reserves flexibly to mitigate adverse business results by dictating restoration of reserves the next year via a CRAC. The repayment terms of the Treasury Note are more flexible than the terms than BPA staff would impose on customers for restoring cash reserves accumulated for the purpose of credit support. Specifically, the Treasury Note provides for a one-year repayment, plus a one-year extension, whereas BPA staff's proposal would mandate recovery in a single year. We also question the use of the CRAC mechanism for the purpose of accumulating funds for credit rating support. The CRAC is intended for the recovery of actual operational costs, not raising cash for the purpose of avoiding potential future interest expense.

SECTION 5: JP05 PROPOSED FINANCIAL RESERVES POLICY

Q: Given the foregoing analysis, do you support BPA's Financial Reserves Policy as proposed?

A: No, we do not. While we understand the goals and objectives for the policy, the proposed implementation is fundamentally problematic. As described above, the policy would create significant rate volatility and has substantially negative financial impact on Power Services' customers without clear benefits. It also does not promote equity between business lines. Given these considerations, we do not view the proposed policy as being in the business interest of customers or promoting BPA's efforts towards cost-competitiveness.

Q: Do you support BPA adopting a financial reserves policy in this proceeding?

A: Although we do not support the version BPA staff have proposed, we would support a policy that has tangible benefits, outweighs costs, and meets BPA's staff's objectives, including supporting BPA's credit rating and maintaining equity between business lines.

Q: Have you developed such a policy proposal?

A: Because we value BPA as a business partner and want to work collaboratively with the agency in its effort to be cost-competitive and the power supplier of choice, we have developed a counterproposal. The full proposal is attached to this testimony as Exhibit A.

Q: Please describe the basic structure of your proposal.

A: At a basic level, our proposal includes upper and lower thresholds for financial reserves for BPA as a whole, as well as an allocation of those amounts between the Power and Transmission business lines. It also includes actions to be taken once reserves are projected to fall outside of the thresholds, and designates responsibility to the appropriate business line(s).

Q: Please describe the upper and lower reserves thresholds for BPA's total financial reserves.

A: We propose a lower threshold of 35 days' cash on hand and an upper threshold of 95 days' cash on hand.

Q: Please describe your proposed method for allocating the agency reserves thresholds between business lines.

A: We propose to allocate responsibility for agency total reserves as the proportion of each business line's forecasted contribution to BPA's overall planned capital expenditures on a rolling 10-year basis. For example, consider a case where heading into a rate period

BPA's forecasted capital expenditures for the agency for the following 10 years totaled $10 billion, and Power Services' planned investments (including Columbia Generating Station) totaled $4.5 billion and Transmission Services' totaled $5.5 billion. In this instance, the financial reserves allocation would be 0.45 (or 45 percent) for Power and 0.55 (or 55 percent) for Transmission.

Our estimate of these factors based on BPA's initial Capital Investment Review materials is approximately 0.456 for Power and 0.544 for Transmission. Unfortunately, BPA's "Integrated Program Review and Capital Investment Review: Close-out report, October 2016" does not contain sufficient detail to update these values for final decisions in that document. In any case, BPA should update these values in its final rates proposal to reflect the most recent final information.

Q: *Please describe how your proposal operates.*

A: During the rate-setting process, BPA would establish upper and lower reserves thresholds for the agency as a whole, as well as for each business line. The business line upper and lower thresholds will be equal to the agency upper and lower thresholds multiplied by the business line reserve allocation factors.

If BPA projects as part of its final rates proposal that agency reserves as a whole will start the rate period above the agency minimum threshold but below the agency upper threshold, then no action is taken under the financial reserves policy. This applies regardless of the distribution of financial reserves between business lines.

If BPA projects agency reserves will start the rate period below the agency lower threshold, a check is performed to determine whether Power, Transmission, or both are below their respective business line lower threshold. If a business line is below its threshold in this scenario, then BPA could add planned net revenues of up to one percent incremental rate pressure per year during the rate period to increase reserves.

If BPA projects agency reserves will start the rate period above the agency upper threshold, a check is performed to determine whether Power, Transmission, or both are above their respective business line upper thresholds. Under the circumstance that both the agency as a whole and an individual business line are above the relevant reserve thresholds, then the Administrator shall consider using the projected surplus during the rate period for other business line specific purposes including, but not limited to, debt retirement, incremental capital investment, or rate reduction. In making this determination, the Administrator will consult with customers and take comments on the proposed course of action.

Decisions to either increase or decrease expected reserve levels would only be made during the rate-setting process. There would be no adjustment of rates during the rate period solely to achieve a target level of reserves, although a mid-year period CRAC to meet the TPP standard would be possible as is the case under BPA's current policy.

Q: Can you provide some illustrative examples to further clarify the operation of your proposed policy?

A: Yes. Several examples are provided as Exhibit B to this testimony.

Q: How does your proposal interact with the TPP standard?

A: Our proposal is intended to be independent and supplemental to the TPP standard. BPA would continue to implement the TPP standard as under current practice and then layer in the financial reserves policy. If a business line would otherwise consider a distribution of reserves, but a higher level is needed for TPP support then TPP would take precedence.

SECTION 6: BENEFITS OF JP05'S FINANCIAL RESERVES POLICY

Q: Which aspects of your proposal are enhancements relative to BPA staff's initial proposal?

A. Our proposal addresses the fundamental issue that BPA staff's financial reserves proposal is a poor business proposition for power customers. Simply stated, risking a downgrade would be financially preferable for power customers relative to BPA staff's proposal. BPA projects a maximum impact of $22 million per year and an average of $16 million to Power Services due to an immediate downgrade over the next 10 years. Contrast this to BPA staff's proposal, which would have a cost to power customers of greater than $309 million over approximately the next 10 years. BPA's net secondary revenues experience significant natural variability due to both hydrological and market price conditions. The Good Year Ratchet ensures that money from "good years" will no longer be available to mitigate results from "bad years," necessitating CRAC events or other rate actions that would not have been necessary in the absence of the policy. Indeed, under BPA staff's proposal, BPA might find itself having to choose between two undesirable options: (1) implement a large CRAC for credit support when its costs are already pushing rates to unacceptable levels; or (2) violate its own policy, which might be worse than having no policy at all.

Conversely, the maximum benefit to Power is to avoid the potential for a $22 million cost. It is worth emphasizing again that this cost is "potential." Neither a downgrade nor the extent of a downgrade would be of any certainty. As discussed above, the credit rating agencies view BPA to be in strong financial health as reflected by BPA's excellent credit ratings. Further, that $22 million per year is a peak value and is significantly lower in many years of BPA's analysis. The actual average between FY2018 and FY2027 is $16 million per year. It would take until FY2035 for the benefits of avoiding a downgrade in FY2018 for Power Services to exceed $300 million.

Altogether, our proposal puts the costs of implementation much more in line with the potential benefits and also allows customers to benefit from accruing reserves.

Q: How does your proposal meet the objectives set out by BPA staff for a financial reserves policy?

A: BPA staff laid out six objectives for a financial reserves policy. These objectives are:

- Maintain sufficient financial reserves levels to support BPA's credit rating.
- Ensure adequate liquidity throughout each rate period.
- Maintain equity between business lines.
- Establish prudent lower financial reserves thresholds and actions supporting objectives 1 and 2.
- Establish prudent upper financial reserves thresholds so that financial reserves are efficiently redeployed for other high-value purposes.
- Be compatible with BPA's existing 95 percent TPP standard.[38]

Our proposal meets all of these criteria and in some cases is a substantial improvement over both the status quo and BPA staff's proposal.

Q: How does your proposal meet the objective to "Maintain sufficient financial reserves levels to support BPA's credit rating"?

A: Our lower end threshold of 35 days' cash on hand is based on the explicit guidance from Moody's that it could be concerning for BPA to fall below 30 days' cash on hand on a

[38] Harris *et al.*, BP-18-E-BPA-17, at 24, lines 6-15.

sustained basis, but with recognition that reserves should not decline fully to that level on a projected basis before action is taken. However, consistent with the goal of the most competitive possible rates we do not propose to collect more funds than necessary for this purpose.

Q: How does your proposal meet the objective to "Ensure adequate liquidity throughout each rate period"?

A: Our proposal ensures adequate liquidity throughout the rate period by being supplemental to BPA's implementation of the TPP standard. As discussed previously, the TPP currently ensures adequate liquidity.

Q: How does your proposal meet the objective to "Maintain equitable treatment between business lines"?

A: This is one of the most important aspects of our proposal. Because the TPP standard already ensures that each business line has adequate liquidity to meet its operational risk, one of the main benefits of a more comprehensive financial reserves policy is to help avoid a credit downgrade. Benefits would accrue in the form of avoiding higher costs of debt for investments financed with the support of BPA's credit rating. Therefore, our proposed approach is more in line with cost-causation principles because it associates the cost of maintaining the credit rating with the benefit of borrowing lower-cost money realized by the business line borrowing the money. Our allocation proposal is based purely on the future capital needs of each business line. By taking a long-term and balanced view of aligning costs and benefits, the proposal acknowledges that both business lines benefit from BPA managing its access to capital and debt portfolio on an integrated basis. BPA should continue to take advantage of the best available financing options available at the time capital is raised, but it is not possible to know today what the least-cost source of future capital will be.

That said, it is worth emphasizing that for the foreseeable future our proposal is conservative in allocating a relatively high proportion of the responsibility for reserves shortfalls to Power Services relative to the benefits of avoiding a downgrade. BPA's analysis shows that over the next 10 years the maximum annual cost of a downgrade would be borne approximately 60 percent by Transmission and 40 percent by Power.[39] Additionally, much of the potential cost to Power is for refinancing transactions over the upcoming rate period, meaning the exposure for Power to a credit downgrade is diminishing over the coming years.

Q: *How does your proposal meet the objective to "Establish prudent lower financial reserves thresholds and actions" to support adequate reserves for credit rating support and liquidity?*

A: We previously described how our proposed lower threshold is prudent for the purposes supporting BPA's credit rating. In terms of actions, our proposal establishes clear and concrete actions to take when reserves are projected to be below targeted levels for the agency in a rate period. Our proposed actions also have the benefit of being fully transparent and known during the course of a rate period as well as decreasing the likelihood of a CRAC, thereby enhancing rate stability at the same time as taking action to support BPA's credit rating.

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[39] *See* Response to Data Request PP-BPA-26-6.

Q: *How does your proposal meet the objective to "Establish prudent upper financial reserves thresholds so that financial reserves are efficiently redeployed for other high-value purposes"?*

A: The upper threshold of 95 days' cash on hand is set to allow adequate flexibility for financial variability without rate actions to adjust the level of reserves. We agree with BPA staff's proposal that a "deadband" of 60 days' cash on hand appears reasonable and results in an upper threshold adequately higher than the lower.

Q: *How does your proposal meet the objective to "Be compatible with BPA's existing 95 percent TPP standard"?*

A: As previously described, our proposal is supplemental to the TPP standard and therefore fully compatible.

Q: *Please summarize how your proposal is an enhancement to BPA staff's initial proposal and why it should be adopted by the Administrator over BPA staff's proposal.*

A: Our proposal aligns responsibilities with benefits of the policy and also addresses the core gap between benefits and costs, which is particularly large for power customers. It promotes rate stability by reducing the likelihood that rates would need to be raised for either business line for purposes of supporting BPA's credit rating and also because additional revenues collected to enhance reserves would be known at the beginning of a rate period and be available for risk mitigation. Our proposal accomplishes these enhancements while fulfilling all of the objectives laid out by BPA staff for a financial reserves policy.

Q: *Are you aware that BPA has recently released an updated forecast of the end of year financial reserves available for risk for FY2017?*

A: Yes. We have conducted a preliminary review of BPA's Quarterly Business Review materials, which were made publicly available on January 27. These materials show a substantial decline in financial reserves available for risk. The materials do not, however, provide information on Accumulated Calibrated Net Revenues (ACNR), which may show important differences in the lower point forecast of reserves due to short-term lags in timing between accrual and cash flow. This highlights the value of using ACNR for decisions triggered off of financial reserves levels.

Q: Does this information affect your recommendations in this testimony?

A: No, it does not. Any forecast of BPA's net revenues for FY2017 at this point is subject to a high level of variability as the year progresses. More generally, however, our proposal is a long-term policy that is not subject to change based on the results of a single year. As such, our recommendations will not change based a changing forecast or a singular financial outcome.

Q: Does this conclude your testimony?

A: Yes.

EXHIBIT A
TO DIRECT TESTIMONY OF JP05 ON
FINANCIAL RESERVES POLICY

1. Background and Purpose

The Financial Reserves Policy (Policy) provides a consistent, transparent, and financially prudent method for determining BPA's levels of financial reserves available for risk (financial reserves). The Policy establishes upper and lower financial reserves thresholds for Power Services, Transmission Services, and the Agency as a whole. The Policy also describes the actions BPA may take when financial reserves levels either fall below a lower threshold or exceed an upper threshold. The Policy supports BPA's objective to provide competitive, reliable, and low-cost wholesale power and transmission services to its customers while promoting the agency's financial health.

Prior to the Policy, BPA did not have a consistent way to establish financial reserves thresholds for each business line and BPA as a whole. This is of particular importance because financial reserves levels and financial reserves policies and practices have a direct effect on BPA's credit rating, which is determined at the aggregate BPA level. BPA, however, sets rates to recover costs for each business line individually. The lack of a consistent policy across the business lines and for BPA as a whole allows for ad hoc financial reserves decisions and different treatment for each business line.

Establishing prudent financial reserves lower thresholds over time helps to maintain BPA's credit rating. Establishing prudent financial reserves upper thresholds for the business lines and BPA as a whole ensures that financial reserves do not grow to unnecessarily high levels, but rather are invested back into the business or distributed as rate reductions, both of which lower revenue requirement costs.

2. Scope of the Financial Reserves Policy

The Policy affects financial reserves available for risk (financial reserves) attributed to Power Services (Power) and Transmission Services (Transmission).

The Policy establishes lower and upper financial reserves thresholds for Power Services, Transmission Services and for the Agency at the start of each rate period. The Policy also provides guidance on the actions BPA should take when financial reserves are forecasted to be below the lower threshold level(s) or above the upper threshold level(s) at the start of a rate period.

The Policy does not preclude or hinder in any way the Administrator's authority to use financial reserves for purposes deemed necessary by the Administrator.

The Policy is intended to provide a consistent framework within which BPA can manage its financial reserves. To that end, the Policy will constitute precedent that BPA will adhere to in future rate cases absent a determination by the Administrator that the Policy must be modified to meet BPA's changing operating environment.

3. Financial Reserves Targets and Thresholds

3.1 Definitions

Financial reserves available for risk. Financial reserves available for risk (financial reserves) consist of cash, market-based special investments, and deferred borrowing, all of which are highly liquid and unobligated for BPA to use to mitigate financial risk.

Days' cash on hand. Days' cash on hand is a measure of the number of days a business can continue to operate using its own cash on hand with no new revenue. Days' cash on hand is a common industry liquidity metric that captures the relationship between the amount of cash and the amount of average daily expenses required to operate a business.

3.2 Financial Reserves and Risk Mitigation Tools for Treasury Payment Probability

Each business line will continue to independently establish necessary reserves and risk mitigation parameters to meet the Treasury Payment Probability (TPP) standard each rate period.

3.3 Financial Reserves Allocation Factors

During the rate setting process for each rate period BPA will calculate a "Financial Reserves Allocation Factor" for both the Power and Transmission business lines. The allocation factor for each business line shall be its proportion of BPA's total projected capital spending over the following ten years (upcoming rate period plus the following eight years) that is intended to be debt financed, as published in the Capital Investment Review or successor process.

3.4 Lower Financial Reserves Threshold

During the rate setting process for each rate period BPA will calculate a lower target threshold for financial reserves on the basis of 35 days' cash on hand for the agency as a whole. The lower financial reserves threshold for each business line will be equal to the total agency threshold multiplied by the business line allocation factor. To the extent that BPA as a whole and an individual business line are projected to be below the target threshold, rate action will be taken to accumulate reserves during the upcoming rate period.

3.5 Upper Financial Reserves Threshold

During the rate setting process for each rate period BPA will calculate an upper threshold for financial reserves on the basis of 95 days' cash on hand for the agency as a whole. The upper financial reserves threshold for each business line will be equal to the total agency threshold multiplied by the business line allocation factor. To the extent that BPA as a whole and an individual business line are projected to be above the threshold heading into a rate period, the Administrator shall consider the above-threshold financial reserves for investment in other high-value business line specific purposes including, but not limited to, debt retirement, incremental capital investment, or rate reduction.

3.6 Calculation of Financial Reserves Thresholds and Allocation Factors

3.6.1 Agency Total		
Agency lower reserves threshold	=	35 days * ((Power Operating Expenses + Transmission Operating Expenses) / 365 days)
Agency upper reserves threshold	=	95 days * ((Power Operating Expenses + Transmission Operating Expenses) / 365 days)
Where:		
Power Operating Expenses	=	Power Total Expenses – (Power Depreciation and Amortization + Power Net Interest Expense + Power Non-Federal Debt Service + Power Purchases) Power Operating Expenses will be calculated as the annual average over the upcoming rate period.
Transmission Operating Expenses	=	Transmission Total Expenses – (Transmission Depreciation & Amortization + Transmission Interest Expense) Transmission Operating Expenses will be calculated as the annual average over the upcoming rate period.

3.6.2 Business Line Allocation Factors		
Power allocation factor	=	Power Capital Requirement / Agency Capital Requirement
Transmission allocation factor	=	Transmission Capital Requirement / Agency Capital Requirement

Where:		
Power Capital Requirement	=	Total projection of capital investment to be made during the following 10 years (that will be allocated to Power Services, debt financed, and ultimately recovered through power rates)
Transmission Capital Requirement	=	Total projection of capital investment to be made during the following 10 years (that will be allocated to Transmission Services, debt financed, and ultimately recovered through transmission rates)
Agency Capital Requirement	=	Total projection of BPA capital investment to be made and debt financed during the following 10 years
Note: the "following ten years" means the upcoming rate period plus the following eight years.		

3.6.2 Business Line Thresholds		
Power lower reserves threshold	=	(Power allocation factor) * (Agency lower reserves threshold)
Power upper reserves threshold	=	(Power allocation factor) * (Agency upper reserves threshold)
Transmission lower reserves threshold	=	(Transmission allocation factor) * (Agency lower reserves threshold)
Transmission upper reserves threshold	=	(Transmission allocation factor) * (Agency upper reserves threshold)

4. Implementation

The Policy will be implemented on a rate period basis through the Power and Transmission rate schedules. The financial reserves allocation factors and thresholds for each business line and the agency as a whole will be re-calculated each time BPA establishes new Power and Transmission rates. Financial reserves allocation factors and thresholds will remain constant throughout the duration of each rate period. The financial reserves lower and upper financial reserves thresholds will be computed using forecast rate period average operating expenses from the Power and Transmission revised revenue tests. The business line allocation factors will be calculated using the most recently available final capital investment forecast from the Capital Investment Review or successor process.

As part of its final rate proposal in each rate period, BPA will evaluate its projected levels of reserves for the agency as a whole and for each business line. If BPA's reserves as a whole are above the agency lower threshold and below the agency upper threshold, no action will be taken in that rate period pursuant to this Policy.

If BPA's reserves are projected to enter the rate period below the agency lower threshold, rate action will be taken to increase reserves on an expected basis. In this circumstance, if a business line is projected to start the rate period below its threshold, BPA will add up to one percent of incremental planned net revenues for that business line for each year of the rate period as necessary. For Power Services, this will be calculated as a one percent average rate impact to the Non-Slice Tier 1 rate.

If the projection of a business line and the agency's reserves are above their respective upper thresholds going into a rate period, and such reserves are not needed for TPP purposes, then the Administrator shall consider the above-threshold financial reserves for investment in other business line specific purposes including, but not limited to, debt retirement, incremental capital investment, or rate reduction. During the consideration process, the Administrator will consult with customers and take comments on the proposed course of action.

This Policy is supplemental to the TPP standard, which will remain in place to address operational risk and liquidity issues during each rate period. This Policy will in no way inhibit BPA's discretion regarding TPP implementation.

EXHIBIT B
TO DIRECT TESTIMONY OF JP05 ON
FINANCIAL RESERVES POLICY

Examples of JP05 Financial Reserves Testimony Implementation

The purpose of this exhibit is to provide illustrative, hypothetical examples of how JP05's proposed Financial Reserves Policy would be implemented.

Assumptions

1 days' cash on hand for BPA	=	$7 million
1% rate impact for Power Non-Slice Tier 1	=	$15 million
1% rate impact for Transmission	=	$10 million
Agency capital requirement (10 years)	=	$10 billion
Power capital requirement (10 years)	=	$4.5 billion
Transmission capital requirement (10 years)	=	$5.5 billion

Calculation of Agency and Business Line Thresholds

Agency lower threshold	=	$245 million (35 days * $7 million per day)
Agency upper threshold	=	$665 million (95 days * $7 million per day)
Power allocation factor	=	0.45 ($4.5 billion / $10 billion)
Transmission allocation factor	=	0.55 ($5.5 billion / $10 billion)
Power lower threshold	=	$110 million (0.45 * $245 million)
Power upper threshold	=	$299 million (0.45 * $665 million)
Transmission lower threshold	=	$135 million (0.55 * $245 million)
Transmission upper threshold	=	$366 million (0.55 * $665 million)

Process

Going into each rate period, BPA will make a projection of reserves for day one of the rate period as part of its final proposal and take action, if necessary, as prescribed by the Financial Reserves Policy.

Examples of Implementation

Example 1

Agency reserves	=	$450 million
Power reserves	=	$150 million
Transmission reserves	=	$300 million

Agency as a whole is between upper and lower thresholds as are both business lines. No action is taken.

Example 2

Agency reserves	=	$500 million
Power reserves	=	$100 million
Transmission reserves	=	$400 million

One business line is above its upper threshold, and one business line is below its lower threshold. However, the agency as a whole is between the upper and lower agency thresholds. No action is taken.

Example 3

Agency reserves	=	$800 million
Power reserves	=	$400 million
Transmission reserves	=	$400 million

The agency as a whole and both business lines are above their upper thresholds. Unless needed for TPP support (see Example 4), Power receives a distribution of $101 million and transmission receives a distribution of $34 million (totaling $135 million), leaving the agency as a whole at the upper threshold of $655 million.

Example 4

Agency reserves	=	$800 million
Power reserves	=	$400 million
Transmission reserves	=	$400 million

The agency as a whole and both business lines are above their upper thresholds. However, in this specific example, Power services needs at least $400 million to meet the TPP standard. In this case TPP takes precedence and power receives no distribution of reserves. Transmission receives a distribution of $34 million.

Example 5

Agency reserves	=	$200 million
Power reserves	=	$50 million
Transmission reserves	=	$150 million

The agency as a whole is below the lower threshold. Power services is below its lower threshold while transmission is above its lower threshold. In this case an additional 1%, or $15 million, of planned net revenue per year is added to power rates for the upcoming rate period. No action is taken with regard to transmission rates.

EXHIBIT C
TO DIRECT TESTIMONY OF JP05 ON
FINANCIAL RESERVES POLICY

Responses to Data Requests Cited in BP-18-E-JP05-01

Response To Data Request PP-BPA-26-16

Request Detail

Request ID: PP-BPA-26-16
Page Number: 35
Line Number: 14-20
Exhibit Filing: BP-18-E-BPA-17

Technical Contact Name: Michael Deen
Technical Contact Phone: 503.595.9774
Technical Contact Email: mdeen@ppcpdx.org
Legal Contact Name: Irene Scruggs
Legal Contact Phone: 503.595.9779
Legal Contact Email: iscruggs@ppcpdx.org

Request Text: Does BPA believe that that there would be an issue meeting all of its non-Federal financial obligations during the upcoming rate period under status quo financial policy? If so, please provide any analysis to support this conclusion along with supporting documentation and workpapers.

Response Detail

Date Response Filed: 12/8/2016 3:41:31 PM
Contact Name: Marcus Harris
Contact Phone: 503.230.5931
Contact Email: maharris@bpa.gov
Response Text:
BPA's modeling of liquidity over the rate period does not suggest there is an issue meeting non-Federal obligations. However, the amount of liquidity necessary to ensure short term solvency, which the status quo TPP policy assesses, is generally a lower requirement than the amount of liquidity that would need to be maintained to support BPA's credit rating.

Response To Data Request NR-BPA-26-19

Request Detail

Request ID: NR-BPA-26-19
Page Number: 28
Line Number: 15-18
Exhibit Filing: BP-18-E-BPA-17

Technical Contact Name: Megan Stratman
Technical Contact Phone: 503.233.5823
Technical Contact Email: mstratman@nru-nw.com
Legal Contact Name: Betsy Bridge
Legal Contact Phone: 503.233.5823
Legal Contact Email: bbridge@nru-nw.com

Request Text: The testimony states that "Days' cash on hand is a common industry measure of liquidity and is useful because it is a ratio that scales to businesses of different sizes, allowing businesses with any amount of annual operating expenses to be compared under the same metric." (a) Please describe how the days' cash on hand metric accounts for the uncertainty of hydrological conditions and market price volatility. (b) Please describe how the days' cash on hand metric reflects the risks and uncertainties associated with contractual terms BPA has with its Power or Transmission customers.

Response Detail

Date Response Filed: 12/16/2016 9:36:03 AM
Contact Name: Marcus Harris
Contact Phone: 503.230.5931
Contact Email: maharris@bpa.gov
Response Text:
The days' cash on hand metric is a ratio, measuring an entity's daily operating expenses relative to unrestricted cash and investments; a full description can be found in BP-18-E-BPA-17, at page 28-29, lines 19-16. The ratio aspect of the metric allows entities of different sizes to be compared. The days' cash on hand metric does not capture uncertainty; it is static. However, its appropriate use is not as a stand-alone metric, like TPP, but as a means of comparison to 'similar' entities. 'Similar' entities will have similar risk profiles because of their resource mix, e.g., Chelan PUD, or because of their contractual relationships, e.g., Lower Colorado River Authority, or both, e.g., New York Power Authority. BPA describes its perspective on what makes an entity 'similar' to BPA in data response NR-BPA-26-13. Thus, for example, comparing BPA's number of days' cash on hand to the days' cash on hand of a company like Microsoft, would for the most part be nonsensical because the entities have few similarities. Comparing BPA's day's cash on hand to the New York Power Authority's days' cash on hand, however, can provide a useful relative comparison, because the entities are both wholesale utilities with similar resource mixes and risk profiles. Thus, the risk profiles, contractual uncertainties and other factors not included in the day's cash on hand metric are not disregarded; rather they are accounted for because BPA is comparing itself to entities that are similar. This type of comparison highlights which entities within the group have more or less cash on hand given similar characteristics. It is also important to note that BPA's proposal explicitly captures the uncertainties in both (a) and (b) through the TPP requirement – the proposed policy calls for the reserves target to be the higher of the day's cash on hand target or the amount necessary to meet TPP. TPP captures hydrological conditions, market price volatility and contractual uncertainty.

Response to Data Request PP-BPA-26-41

Request Detail

Request ID: PP-BPA-26-41
Page Number: 14
Line Number: 24-26
Exhibit Filing: BP-18-E-BPA-17

Technical Contact Name: Michael Deen
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Technical Contact Email: mdeen@ppcpdx.org
Legal Contact Name: Irene Scruggs
Legal Contact Phone: 503.595.9779
Legal Contact Email: iscruggs@ppcpdx.org

Request Text: Please provide your understanding of the term "sustained" in this context along with any available supporting documentation or analysis. P 14 24-26

Response Detail

Date Response Filed: 12/16/2016 1:54:36 PM

Contact Name: Marcus Harris
Contact Phone: 503.230.5931
Contact Email: maharris@bpa.gov
Response Text:
BPA interprets “Sustained basis” to likely mean longer than a period of a few months but shorter than a period of many years.

Response To Data Request PG-BPA-26-2

Request Detail

Request ID: PG-BPA-26-2
Page Number: 32
Line Number: 25
Exhibit Filing: BP-18-E-BPA-17

Technical Contact Name: Jimmy Lindsay
Technical Contact Phone: 503.464.8311
Technical Contact Email: jimmy.lindsay@pgn.com
Legal Contact Name: Doug Tingey
Legal Contact Phone: 503.464.8926
Legal Contact Email: doug.tingey@pgn.com

Request Text: a) Please confirm that credit rating agencies have warned BPA that less than 30-days’ cash on hand of financial reserves would jeopardize BPA’s credit rating. b) Has BPA discussed with credit rating agencies whether BPA’s proposed ‘Accumulated Calibrated Net Revenue’ (ACNR) metric is a suitable substitute for cash on hand when assessing the Agency’s credit worthiness? If so, please detail the credit agencies’ feedback. c) Does BPA expect credit rating agencies to evaluate BPA’s cash-on-hand or ACNR when assessing the credit worthiness of the agency? d) Please explain why ACNR is a suitable metric to assess adequacy of BPA’s financial reserves as opposed to cash reserves.

Response Detail

Date Response Filed: 1/10/2017 3:16:38 PM
Contact Name: Marcus Harris
Contact Phone: 503.230.5931
Contact Email: maharris@bpa.gov
Response Text:
a) Please see BPA’s testimony [BP-18-E-BPA-17, at page 14-15, lines 21-3]. b) No. BPA is not proposing that ACNR be a substitute for cash on hand to assess BPA’s credit worthiness. Credit rating agencies will continue to assess BPA’s credit rating considering, among other factors, BPA’s Financial Reserves Available for Risk. ACNR is a cash measuring construct that, while not reflecting instantaneous fluctuations in financial reserves, closely tracks Financial Reserves Available For Risk for Power and Transmission. We believe it is a better metric for determining whether a CRAC or RDC triggers for the reasons we note in subpart d). ACNR is thus a way of measuring BPA’s cash position for purposes of the CRAC and RDC triggers, and not a replacement or substitute for Reserves Available for Risk (cash on hand) for purposes of evaluating BPA’s credit worthiness. c) BPA expects rating agencies to consider BPA’s sustained Financial Reserves Available for Risk (cash on hand) position as a factor in BPA’s credit rating. However, cash on hand is not the only factor they consider. Rating agencies also assess other factors to determine BPA’s creditworthiness, including but not limited to BPA’s overall liquidity, BPA’s financial policies, and management’s

willingness to raise rates to support financial integrity. d) ACNR does not assess the adequacy of BPA's financial reserves. Rather, ACNR measures real gains and losses of financial reserves over the rate period without the 'noise' of natural ebbs and flows of differences between accruals and cash flow. Thus, ACNR more closely captures BPA's sustained financial reserves position rather than BPA's instantaneous financial reserves position. During each rate case, ACNR is recalibrated to correspond closely to reserves levels.

Response To Data Request NR-BPA-26-19

Request Detail

Request ID: NR-BPA-26-19
Page Number: 28
Line Number: 15-18
Exhibit Filing: BP-18-E-BPA-17

Technical Contact Name: Megan Stratman
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Legal Contact Name: Betsy Bridge
Legal Contact Phone: 503.233.5823
Legal Contact Email: bbridge@nru-nw.com

Request Text: The testimony states that "Days' cash on hand is a common industry measure of liquidity and is useful because it is a ratio that scales to businesses of different sizes, allowing businesses with any amount of annual operating expenses to be compared under the same metric." (a) Please describe how the days' cash on hand metric accounts for the uncertainty of hydrological conditions and market price volatility. (b) Please describe how the days' cash on hand metric reflects the risks and uncertainties associated with contractual terms BPA has with its Power or Transmission customers.

Response Detail

Date Response Filed: 12/16/2016 9:36:03 AM
Contact Name: Marcus Harris
Contact Phone: 503.230.5931
Contact Email: maharris@bpa.gov
Response Text:

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Response To Data Request PP-BPA-26-16

Request Detail

Request ID: PP-BPA-26-16
Page Number: 35
Line Number: 14-20
Exhibit Filing: BP-18-E-BPA-17

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Legal Contact Name: Irene Scruggs
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Request Text: Does BPA believe that that there would be an issue meeting all of its non-Federal financial obligations during the upcoming rate period under status quo financial policy? If so, please provide any analysis to support this conclusion along with supporting documentation and workpapers.

Response Detail

Date Response Filed: 12/8/2016 3:41:31 PM
Contact Name: Marcus Harris
Contact Phone: 503.230.5931
Contact Email: maharris@bpa.gov
Response Text:
BPA's modeling of liquidity over the rate period does not suggest there is an issue meeting non-Federal obligations. However, the amount of liquidity necessary to ensure short term solvency, which the status quo TPP policy assesses, is generally a lower requirement than the amount of liquidity that would need to be maintained to support BPA's credit rating.

Response To Data Request NR-BPA-26-16

Request Detail

Request ID: NR-BPA-26-16
Page Number: 33
Line Number: 20-25
Exhibit Filing: BP-18-E-BPA-17

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Legal Contact Phone: 503.233.5823
Legal Contact Email: bbridge@nru-nw.com

Request Text: Please provide any and all research, analysis or other documentation underlying BPA's staff conclusion that 120 days' cash on hand is a "safe place," other than it being "four times the absolute minimum level of days' cash on hand required by Moody's," and that "using cash in excess of what would be needed to run BPA's business for 120 days would likely have a negligible effect on BPA's credit rating."

Response Detail

Date Response Filed: 12/15/2016 2:07:37 PM
Contact Name: Marcus Harris
Contact Phone: 503.230.5931
Contact Email: maharris@bpa.gov
Response Text:
In addition to considering that 120 days is four times the amount Moody's has warned would result in downward rating pressure, BPA also considered its historical reserves levels and historical reserves volatility in setting the upper threshold. Specifically, BPA looked at how often an RDC would have triggered historically given the proposed upper and lower thresholds. If the proposed thresholds were in place since 2004, an RDC would have triggered 25% of the time, that is, 3 out of 12 years. In our judgment, an upper threshold that would have triggered 25% of the time over the last 12 years properly balances the need for BPA to hold reserves to support its credit rating and financial health, while also allowing the reserves to be repurposed with appropriate frequency.

Response To Data Request PP-BPA-26-6

Request Detail

Request ID: PP-BPA-26-6
Page Number: 17
Line Number: 8-14
Exhibit Filing: BP-18-E-BPA-17

Technical Contact Name: Michael Deen
Technical Contact Phone: 503.595.9774
Technical Contact Email: mdeen@ppcpdx.org
Legal Contact Name: Irene Scruggs
Legal Contact Phone: 503.595.9779
Legal Contact Email: iscruggs@ppcpdx.org

Request Text: Please provide all supporting workpapers, documentation, and analysis in native electronic format to support the referenced impacts of a credit rating downgrade.

Response Detail

Date Response Filed: 12/8/2016 3:13:11 PM
Contact Name: Marcus Harris
Contact Phone: 503.230.5931
Contact Email: maharris@bpa.gov
Response Text:
Please see the attached spreadsheet.

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing on the Bonneville Power Administration's Office of General Counsel, the Hearing Clerk, and all litigants in this proceeding by uploading it to the BP-18 Rate Case Secure Website pursuant to BP-18-HOO-02 and BP-18-HOO-05.

DATED: January 31, 2017.

s/ Irene A. Scruggs

Irene A. Scruggs
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