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	)	

INITIAL BRIEF OF

Public Power Council
Northwest Requirements Utilities
Pacific Northwest Generating Cooperative

as

JOINT PARTY 7

SUBJECT:
Financial Reserves Policy

May 2, 2017

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I. INTRODUCTION

Pursuant to the applicable rules of procedure,[1] Public Power Council ("PPC"), Northwest Requirements Utilities ("NRU"), and Pacific Northwest Generating Cooperative ("PNGC"), together designated as Joint Party 7 ("JP07") file this Initial Brief to address the proposal of BPA Staff that BPA adopt a comprehensive financial reserves policy. Members of JP07 previously filed direct (BP-18-E-JP05-01) and rebuttal (BP-18-E-JP05-02) testimony on this topic as members of Joint Party 5. All members of PPC, NRU, and PNGC are preference customers of BPA that purchase both wholesale power and transmission services from BPA. Taken together, JP07's member utilities comprise approximately 87 percent of BPA's Tier 1 power load and pay the vast majority of BPA's power costs.

Power customers have consistently supported a comprehensive reevaluation of BPA's financial policies. The focus here is on BPA's treatment of financial reserves, but it is just one piece of the agency's commitment to overall sound financial policies and management. To that end, the Administrator should adopt a financial reserves policy that will promote the agency's financial health, support its competitiveness efforts, and incent the power customers to sign long-term sales contracts. A financial reserves policy that is equitable between business lines, minimizes rate instability and rate shock, and presents a solid business case for customers is likely to meet these objectives.

The financial reserves policy BPA Staff advanced in their initial proposal is contrary to the agency's competitiveness efforts because it would create significant rate volatility, have substantially negative financial impact on Power Services' customers without clear benefits, and would not promote equity between business lines. Therefore, the Administrator should reject it outright. However, with one further modification, the "alternative option" financial reserves

[1] BPA Rules of Procedure Governing Rate Hearings at § 1010.13(c); BP-18-HOO-03.

proposal that BPA Staff advanced in their rebuttal testimony could make for a more judicious and broadly supported financial reserves policy.

II. ARGUMENT

A. BPA Must Not View the Adoption of a Financial Reserves Policy in Isolation; a Financial Reserves Policy Should Help, Not Hinder, BPA's Cost-Competitiveness Efforts.

BPA's power costs represent the majority of power supply costs for the members of JP07, making it essential that BPA considers how a financial reserves policy might impact its financial health and cost-competitiveness. BPA's stability is critical to not only its power customers but also the region, and BPA's stability is driven by its competitiveness. Both the Administrator and BPA's 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 long-term contracts with its preference customers. However, the expiration of these preference power sales contracts in 2028 has rightly caused the agency to assess its long-term competitiveness, given the low wholesale market prices for electricity and the unsustainable trajectory of BPA's rates in recent years. The long-term solvency and health of the agency is contingent upon it remaining the power provider of choice for its preference customers. A well-designed financial reserves policy will allow BPA to build and maintain a healthy level of reserves while sustaining competitive power and transmission rates, which will benefit BPA's customers and the region. Conversely, an ill-designed financial reserves policy that creates significant rate volatility, or has negative financial impact on power customers without clear benefit, or fails to promote equity between business lines will undermine BPA's efforts towards competitiveness.

This is not the first time in its history that the agency has had to prove its commitment to competitiveness. A similar situation occurred in the 1990s when wholesale market prices were

plummeting and the agency faced an increasingly competitive market.[2] At that time, "[n]ew market entrants, low gas prices, and surplus supplies of short-term capacity and energy in California and the Inland Southwest . . . led to steadily falling prices."[3] BPA's customers urged "BPA to take the actions, consistent with its statutory obligations, that [were] necessary to become more competitive," and to "think in terms of short-term and long-term consequences."[4] In the 1996 ROD, the Administrator observed that, "[i]n a competitive market, BPA's sales are no longer guaranteed, but rather must be earned through competitive prices and quality, reliable service."[5] A similar threat looms again.

The Administrator at that time was unequivocal that BPA's ability to meet its statutory obligations is directly connected to whether its rates are competitive. Among those obligations is ensuring cost recovery, meeting Treasury payment obligations, encouraging the widest possible diversified use of Federal power at the lowest cost consistent with sound business principles, protecting and enhancing fish and wildlife, and giving highest priority to cost-effective conservation when acquiring resources to meet the customers' needs. Confronted with the possibility of becoming uncompetitive, the Administrator explicitly recognized that:

> BPA's ability to accomplish each of the objectives that constitute its mission, however, is in jeopardy. . . Meeting these mandates requires BPA to conduct its affairs with a view toward market considerations. Absent the reforms needed to meet its competitive challenge, BPA increasingly will be hard put to recover its costs, contribute its part to the restoration of endangered fish stocks, make its payments to the Federal Treasury on time, and deliver competitive responsive products to its customers.[6]

Today, if BPA's rates continue to increase in an unsustainable manner, the agency's ability to

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[2] *See* Administrator's Final Record of Decision, 1996 Wholesale Power and Transmission Rate Proposal ("1996 ROD"), WP-96-A-02, section 2.2, at 16-22 (June 1996).
[3] *Id.* at 16.
[4] *Id.* at 16-17.
[5] *Id.* at 20.
[6] *Id.* at 20-21 (citing Bonneville Project Act, 16 U.S.C. §§ 832 – 832l (1988); Flood Control Act of 1944, 16 U.S.C. § 825s (1988); Regional Preference Act, 16 U.S.C. §§ 837-837h (1988); Pacific Northwest Federal Transmission System Act, 16 U.S.C. §§ 838-838k (1988); Northwest Power Act, 16 U.S.C. §§ 839 (1988)).

ensure cost recovery as well as to fund fish and wildlife, energy efficiency, and other benefits BPA provides to the Pacific Northwest will be jeopardized.[7]

The agency has previously analyzed the situation where BPA would need to raise rates to recover costs in a competitive wholesale market environment.[8] BPA's analysis showed that "[h]igher rates did not offset the effect of reduced sales, resulting in a net revenue loss to BPA."[9] While the situation today differs slightly because BPA's preference customers are locked into the Regional Dialogue Power Contracts through 2028, these customers are planning for the future, and many feel compelled to examine alternatives because of BPA's unsustainable rate trajectory.

The counsel of the prior Administrator should inform BPA's actions and rate decisions in its current competitiveness crisis. A major first step is adopting a financial reserves policy that will help, not hinder, the agency to incent its power customers to sign long-term sales contracts and invest in the agency's financial vitality. JP07 urges the Administrator to consider a financial reserves policy in this context and not ignore the financial conditions of the present. The Administrator knows all too well of the significant cost increases that power customers have been asked to absorb in recent years. Indeed, the Administrator has recognized that ignoring actual financial conditions at the time when the rates are set is not a sound business practice.[10] The recent trajectory of BPA's rates has caused significant hardship to BPA's power customers, and even this proceeding, which was expected to produce a comparatively modest increase, is now likely to result in another high single-digit power rate increase.

While power customers remain invested in the agency's long-term health and viability,

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[7] *See* Administrator's Final Record of Decision, BP-16 Rate Proceeding, BP-16-A-02 ("BP-16 ROD") at 9-10 (July 2015) (This Administrator has also recognized that "BPA's ability to continue to meet its statutory obligations and public purpose objectives depends on maintaining [its] cost competitiveness and financial strength.").
[8] 1996 ROD at 19.
[9] *Id.* at 20.
[10] BP-16 ROD at 9-10.

the time has come for the agency to objectively demonstrate its commitment to the goal of being the low-cost energy provider of choice when new power sales contracts are offered in the next decade. As described below, the "alternative option" financial reserves proposal[11] that BPA Staff put forth in their rebuttal testimony is far more successful in achieving this goal than their initial proposal. JP07 genuinely appreciates that BPA Staff responded to power customers' concerns with the alternative option and believes that with one further modification, Staff's alternative option could make for a more judicious and more broadly supported financial reserves policy.

B. JP07 Could Support the Adoption of a Sound and Equitable Financial Reserves Policy.

BPA Staff asserted that the Agency needs to adopt a financial reserves policy because its 95% Treasury Payment Probability (TPP) standard does not provide guidance on other crucial aspects of BPA's financial reserves amounts; instead, the TPP only addresses "when BPA should intentionally increase liquidity to ensure a 95 percent probability of making the Treasury payment."[12] JP07 agrees that lack of formal guidance on financial reserves can lead to ad hoc decision-making and inconsistent outcomes, which may not be in the best interest of BPA's long-term financial health. In addition to identifying the need for a coherent policy, BPA Staff identify three primary reasons it is important to carry financial reserves: (1) liquidity, (2) credit rating support, and (3) rate stability.[13] JP07 agrees that these are relevant aspects of BPA's financial health. Although BPA's liquidity is adequately addressed through existing mechanisms, the goals of credit rating support and rate stability are laudable and could be addressed with a sound and equitable financial reserves policy.

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[11] *See* Harris et. al., BP-18-E-BPA-33 at Section 6.
[12] Harris et. al., BP-18-E-BPA-17 at 10.
[13] *Id.* at 13.

First, as noted in JP05's testimony, BPA addresses liquidity through incorporation of the TPP standard into the financial reserves policy.[14] BPA Staff acknowledged this in rebuttal testimony and agreed that a financial reserves policy is not required for BPA's liquidity.[15] They clarify that "an objective of the [financial reserves policy] is to support BPA's liquidity,"[16] but do not believe that "a new policy is needed to solve a liquidity problem."[17] In other words, while liquidity is an important aspect of BPA's financial health, liquidity needs will continue to be addressed through the TPP standard even without adoption of a financial reserves policy.

Second, BPA Staff devoted many pages of testimony to discussing the impact that an insufficient amount of reserves can have on BPA's credit rating, as well as the dangers of not having a comprehensive financial reserves policy.[18] BPA Staff note that under BPA's current policies, "BPA could operate on a negative cash basis before taking rate action to increase financial reserves," and that this can result in "long-term harm to the financial health of BPA, particularly with respect to BPA's credit rating."[19] JP07 agrees that a sound financial reserves policy can mitigate threats to BPA's credit rating, but BPA must recognize that factors other than the existence of a financial reserves policy or a certain level of financial reserves can also impact its credit rating, such as, "service area economic strength and customer base stability; willingness and ability to recover costs with sound financial metrics; and rate competitiveness."[20] As explained above and in the JP05 testimony, "these factors underscore the need for BPA to ultimately adopt a financial reserves policy that supports its initiative to become cost-competitive

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[14] *See* Deen et. al., BP-18-E-JP05-01 at 4-5.
[15] Harris et. al., BP-18-E-BPA-33 at 32.
[16] *Id.*
[17] *Id.*
[18] *See id.* at 13-18, 10-27.
[19] *Id.* at 16.
[20] Deen et. al., BP-18-E-JP05-01 at 9 (citing Moody's Public Power Rate Methodology, 1 March 2016, Appendix A).

and improve its cost trajectory."[21] Any financial reserves policy that BPA adopts must balance short-term and long-term needs. A policy that overreaches in the short-term could contribute to more damaging long-term problems with respect to BPA's competitiveness, and there is no amount of reserves that can, on their own, ensure that BPA will remain cost competitive.

Finally, BPA Staff assert rate stability as the third reason for BPA to adopt a financial reserves policy that requires BPA to hold a certain amount of reserves.[22] BPA Staff state that by accumulating financial reserves when financial performance is better than expected, financial reserves provide liquidity for "when financial results are worse than expected."[23] Staff conclude that, "[f]inancial reserves may therefore allow BPA to forgo a rate increase that would otherwise have been necessary."[24]

However, this would not be the case under Staff's initial proposal because "financial reserves that accumulate when financial performance is better than expected will be used to increase the Cost Recovery Adjustment Clause (CRAC) thresholds until Power reaches the proposed lower threshold."[25] Contrary to Staff's assertions, this means that BPA would not be able to use reserves to help offset a rate increase until both Power and the agency as a whole were above the upper thresholds set by the reserves policy.[26] BPA Staff concede that rate stability would be fully realized only "when the lower threshold has been phased in," and that "Power rate stability is somewhat impaired during the phase-in period."[27] JP07 agrees with BPA Staff that rate stability should be a primary objective of any financial reserves policy. In this regard, the alternative option BPA Staff put forth in their rebuttal testimony is a significant

[21] Deen et.al., BP-18-E-JP05-01 at 9-10.
[22] Harris et. al., BP-18-E-BPA-17 at 19.
[23] *Id.*
[24] *Id.*
[25] Deen, et. al., BP-18-E-JP05-01 at 6.
[26] *Id.*
[27] Harris et. al., BP-18-E-BPA-33 at 40.

improvement, but needs to be further modified to mitigate the potential for rate shock.

In sum, JP07 agrees that a financial reserves policy that is transparent and equitable between business lines, minimizes rate instability, and presents a solid business case for customers may aid the agency's long-term financial health. As stated in the JP05 testimony, JP07 could support the 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 a maximum level of reserves before using them for other purposes; and is equitable between Power and Transmission business lines."[28] As described in more detail below, the financial reserves policy BPA Staff advanced in their initial proposal does not meet these objectives and the Administrator should reject it.

C. BPA Staff's Initial Financial Reserves Policy is Unacceptable.

1. <u>BPA's Initial Financial Reserves Policy Proposal Undermines BPA's Cost-Competitiveness Efforts and Will Lead to Rate Instability.</u>

The financial reserves policy BPA Staff advanced in their initial proposal is counter to the agency's effort to be cost-competitive and to position itself as the power supplier of choice for preference customers post-2028. The credit agencies have noted that "two of BPA's biggest strengths are its cost-competitiveness and long-term contracts with customers," and that "[a]s the contracts get closer and closer to expiration, their weight in BPA's credit assessment diminishes."[29] BPA should not adopt policies that will lead to unnecessary rate increases and make customers question the agency's commitment to cost-competitiveness.

Specifically, BPA's initial proposal for a financial reserves policy includes mechanisms that undermine BPA's cost competitiveness and rate stability. First, the Incremental Rate

[28] Deen et. al., BP-18-E-JP05-01 at 14.
[29] *Id.* at 12.

Pressure Limiter would ensure that "the non-Slice rate increases will be at least three percent until Power's lower threshold is met."[30] Establishing a policy that would guarantee a minimum of a three percent rate increase until the lower threshold is achieved undermines BPA's effort to be cost-competitive, and directly conflicts with competitiveness, one of the key strengths identified by the rating agencies.

Second, the Good Year Ratchet creates excessive and unwarranted rate instability. The Good Year Ratchet would take any amount of financial reserves above the current Power CRAC threshold and use those reserves to increase the CRAC threshold until it reaches the proposed lower threshold.[31] This conflicts with the methodology underlying the agency'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."[32] As JP05 explained in its testimony, "[b]y definition, actual net secondary revenues could be either above or below the expected value, but should average out over time."[33] Assuming the expected value of net secondary revenues and relying on financial reserves in the circumstances where actuals are either above or below the expected value is an integral part of BPA's existing risk management practices. The proposed Good Year Ratchet would undermine this risk mitigation framework and be in direct conflict with how BPA forecasts secondary net revenues in rate cases.

Ironically, the Good Year Ratchet is even less flexible than BPA's existing mechanisms for responding to an unexpected decrease in financial reserves. Under the status quo, BPA is able to "use reserves flexibly to mitigate adverse business results by dictating restoration of

[30] Deen et. al., BP-18-E-JP05-01 at 16.
[31] *Id.*
[32] *Id.* (Emphasis in original).
[33] *Id.*

reserves the next year via a CRAC."[34] In an even more extreme situation where BPA needs to utilize the Treasury note, repayment of the Treasury note is more flexible than BPA Staff's proposed Good Year Ratchet because "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."[35] Thus, the Good Year Ratchet and the Incremental Rate Pressure Limiter would jeopardize BPA's ability to provide competitive rates and rate stability.

2. BPA's Initial Proposal Does Not Align Costs with Benefits and Unduly Burdens Power Customers.

As noted above, the primary objective of BPA Staff's proposed financial reserves policy is to maintain BPA's credit rating. BPA Staff estimated the impact of a credit rating downgrade "could increase revenue requirements costs by as much as $33 million for Transmission Services and $22 million for Power Services per year."[36] However, as JP05 explained in testimony, this overstates the actual impact of a downgrade on an average annual basis, which "would be $22.5 million for Transmission Services and $16.1 million for Power Services per year from FY 2018 through FY 2027."[37] BPA Staff's initial proposal would result in the equivalent of an average rate impact to Power rates of at least $30 million per year, which well exceeds the maximum potential cost savings to Power of $22 million per year.[38]

Further, BPA Staff's initial proposal does not appropriately consider how each business line would benefit from a financial reserves policy that supports BPA's credit rating. BPA Staff have stated that "BPA's credit rating is critical to its capital programs for both its Power and Transmission business lines"[39] because BPA's credit rating is the primary factor in determining

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[34] Deen et. al., BP-18-E-JP05-01 at 16-17.
[35] *Id.*
[36] *Id.* at 13 (citing Harris et. al., BP-18-E-BPA-17 at 17).
[37] *Id.*
[38] *Id.* at 14.
[39] Harris et. al., BP-18-E-BPA-17 at 13.

the interest rate BPA will receive on that debt.[40] As BPA Staff described, "[t]he higher the credit rating, the lower the interest rate," and thus the lower the interest expense in the business line's revenue requirement.[41] Yet, BPA Staff does not offer compelling analysis of how shouldering Power Services with 75 percent or roughly $300 million of responsibility for agency reserves would produce commensurate benefits for Power Services either in terms of lower interest expense or other expense reduction. By contrast, Transmission Services, which is more dependent on third-party borrowing, is allocated only 25 percent or roughly $100 million of responsibility.[42]

3. BPA Staff Failed to Justify the Upper Threshold in the Initial Proposal.

BPA Staff's initial proposal set the upper threshold on financial reserves at 120 days' cash on hand but failed to provide sufficient justification for why 120 days is the appropriate threshold. BPA Staff assert that it "is a 'safe place' because it equates to roughly 'four times the absolute minimum level of days' cash on hand required by Moody's.'"[43] Evidently, BPA Staff analyzed how often the Reserves Distribution Clause (RDC) would have triggered with the 120-day upper threshold since 2004, and "the RDC would have triggered 25 percent of the time over the last 12 years."[44] But again, Staff failed to explain why 25 percent is the appropriate frequency for the RDC to trigger. Staff also failed to address how numerous other factors, such as major contractual changes, BPA's debt-to-asset ratio, and power rate increases totaling 27 percent since FY 2009, could be impacted by an upper threshold of 120 days' cash on hand.[45]

For these reasons, the financial reserves policy BPA Staff advanced in their initial

[40] Harris et. al., BP-18-E-BPA-17 at 13.
[41] *Id.*
[42] *See* Power and Transmission Risk Study, BP-18-E-BPA-05, at Tables 11 and 12; *see also* Harris et. al., BP-18-E-BPA-33 at 141.
[43] Deen et. al., BP-18-E-JP05-01 at 15.
[44] *Id.* (citing Response to Data Request NR-BPA-26-16).
[45] *Id.*

proposal is unacceptable and should be rejected.

D. The Administrator Should Reject Proposals Advanced by JP02, Powerex and MSR.

Joint Party 2 ("JP02"), Powerex, and M-S-R Public Power Agency ("MSR") raise a variety of concerns related to BPA Staff's initial proposal and the JP05 proposal for a financial reserves policy. There are a number of commonalities among those concerns, in particular with respect to equity among business lines and the phase-in for the collection of reserves attributable to Power Services. For the reasons set forth below, these concerns are misguided and not supported by the facts. Further, MSR's proposal to "lend" reserves between business lines is in conflict with how BPA manages its reserves.

1. The Concerns of JP02, Powerex, and MSR Regarding Equity Between Business Lines Are Not Supported by the Facts.

A common theme in the JP02, Powerex, and MSR testimony is that there is inherent inequity in the relative distribution of financial reserves between the Power and Transmission business lines. Their primary argument is premised on a narrow and simplistic analysis pointing out that in recent years and on a projected basis for the BP-18 rate period, Transmission has a higher attribution of reserves than Power. They claim that this is demonstrative of an inequity between the business lines.[46]

By limiting their analysis to whether the financial reserves held by Transmission and Power are proportionate to the revenue requirement of the business line, JP02, Powerex, and MSR fail to consider other important factors relevant to equity. The first fact that these parties overlook is the change in the relative amount of financial reserves attributed to each of Power and Transmission over time.[47] Recently, it is true that more reserves have been attributed to

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[46] *See* Opatrny, BP-18-E-PX-01 at 13; Wrigley et. al., BP-18-E-JP02-01 at 7; and Arthur, BP-18-E-MS-12 at 24.
[47] Deen et. al., BP-18-E-JP05-02 at 6.

Transmission than Power. However, extending the analysis further, it becomes clear that this has not always been the case. In fact, "between 2004 and 2009, more than half of the agency's financial reserves were attributed to Power, with a peak of more than 80% of the agency's financial reserves attributed to Power in 2006 and 2007."[48] BPA Staff also reiterate that the longer-term interaction between business lines is the appropriate metric to examine, not short-term snapshots of which business line is attributed greater reserves. BPA Staff state that "a short-term reliance by one business line on financial reserves attributed to the other is not inequitable as long as there are provisions in place to ensure that such reliance is truly only short-term."[49]

Any evaluation of the equitability of financial reserves policy must also take into account the benefits of such policy in comparison to the costs of carrying the reserves. Simply looking at financial reserves in comparison to a business line's operating expenses does not achieve this and does not tell the whole story. JP02, Powerex, and MSR fail to account for the relative benefits each business line would see and therefore draw faulty conclusions with respect to equitability. One of BPA Staff's stated reasons to adopt a financial reserves policy is to support BPA's credit rating; consequently, the primary benefit to the agency is reduced interest expenses that result from a higher credit rating.[50] BPA Staff calculate that a credit rating downgrade would add approximately 50 basis points to the agency's borrowing costs on newly issued non-Federal debt.[51]

Determining who benefits from a stronger credit rating requires consideration of the capital expenditures of each business line. BPA Staff state that over the course of the next 10

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[48] Deen et. al., BP-18-E-JP05-02 at 6; BPA Financial Reserves Workshop #3 at 18 (June 15, 2016).
[49] Harris et. al., BP-18-E-BPA-33 at 136.
[50] Deen et. al., BP-18-E-JP05-01 at 7.
[51] Harris et. al., BP-18-E-BPA-17 at 17.

years, BPA plans to issue approximately $3.9 billion in non-Federal debt for Power and $5.4 billion for Transmission.[52] Taking into account these planned debt issuances, a 50-basis-point interest rate increase could increase the Transmission revenue requirement by up to $33 million and the Power revenue requirement by up to $22 million.[53] Transmission customers clearly have more to gain from the proposed BPA financial reserves policy, and any sound financial reserves policy should reflect that.

JP02, Powerex, and MSR also mischaracterize the interaction between the TPP standard and the financial reserves policy. The TPP standard and financial reserves policy serve two different purposes. The TPP standard addresses revenue volatility and is BPA's primary method of assessing its need for liquidity.[54] On the other hand, BPA Staff proposed a financial reserves policy with the intent of being responsive to concerns raised by the credit rating agencies and consequently increasing the likelihood of maintaining BPA's credit rating.[55] JP02, Powerex, and MSR do not fully appreciate this distinction. For example, in an attempt to declare the proposed financial reserves policy inequitable, MSR states that it is "not equitable for one business line to be forced to carry greater reserves than necessary to meet its liquidity, while the other is permitted to carry far less than necessary for an extended period of time."[56] Likewise, Powerex incorrectly states that "Transmission is carrying the burden of internal liquidity" because financial reserves attributed to Transmission are greater than the financial reserves attributed to Power based on recent history and projections for the BP-18 rate period.[57]

JP02, Powerex, and MSR rely on these mischaracterizations of the interaction between

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[52] Harris et. al., BP-18-E-BPA-17 at 17.
[53] *Id.*
[54] *See* Harris et. al., BP-18-E-BPA-33 at 32; Deen et. al., BP-18-E-JP05-02 at 11.
[55] Harris et. al., BP-18-E-BPA-33 at 29.
[56] Arthur, BP-18-E-MS-12 at 25.
[57] Opatrny, BP-18-E-PX-01 at 16.

the TPP standard and the financial reserves policy to argue that BPA should not use the Treasury Facility when calculating whether Power Services satisfies the TPP standard.[58] As stated previously, revenue volatility is addressed by the TPP. Each business line is required to meet the TPP standard on a standalone basis and therefore neither business line is forced to take on an undue share of BPA's liquidity needs.[59] JP05 correctly points out that:

> The 95 percent TPP standard should remain in place and be separate and distinct from a financial reserves policy that primarily supports BPA's credit rating. These two policies serve very different purposes; combining the two muddles that distinction and potentially lessens the effectiveness of both policies because of misunderstandings of their applications and purposes.[60]

Additionally, eliminating the use of the Treasury Facility for determining whether Power meets or exceeds the TPP standard would materially harm Power customers. The result would be higher rates or a substantially higher probability that the CRAC would trigger.[61] This outcome would occur not out of necessity, but because BPA chose not to take into account all of the liquidity tools it had available.[62] For these reasons, it is imperative that BPA continue its current approach of using the Treasury Facility when calculating TPP.

2. <u>Arguments to Limit a Phase-In Are Not Grounded in Sound Financial Management.</u>

JP02 and MSR each critique the phase-in of BPA Staff's financial reserves proposal for Power. JP02 argues that a 10-year phase-in for Power is "too long and uncertain."[63] Along the same lines, MSR believes the "proposed Phase-In elements for Power avoid rate shock, but undermine the Policy Goals of maintaining equity, setting lower and upper reserves thresholds,

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[58] Wrigley et. al., BP-18-E-JP02-01 at 9; Arthur, BP-18-E-MS-12 at 21; Opatrny, BP-18-E-PX-01 at 5.
[59] Deen et. al., BP-18-E-JP05-02 at 12.
[60] *Id*.
[61] *Id*. at 13.
[62] *Id*.
[63] Wrigley et. al., BP-18-E-JP02-01 at 2.

and ensuring Treasury repayment."[64] In making these assertions, JP02 and MSR ignore the larger context surrounding the impact of BPA's financial reserves policy on power rates and the need for BPA to achieve cost-competitiveness for its power customers. These considerations, however, are not lost on BPA's power customers. BPA also recognizes the importance of taking cost impacts into account and specifically refutes JP02's position by stating that it "disagree[s] with [the] JP02 interpretation of the phase-in. The phase-in is meant to strike a balance between rate shock and equity between business lines while protecting the Agency's credit rating."[65]

It is critical that BPA take into account cost and rate impacts associated with any financial reserves policy.[66] As pointed out by JP05, "[m]aintaining a particular credit rating level is a business decision based on the costs and benefits of doing so. Failing to consider the costs of implementing a policy for credit rating support would constitute unsound financial management."[67]

Although JP02 and MSR raise general complaints about the phase-in of a financial reserves policy, they do not offer specific proposals or recommendations. BPA Staff sum up the lack of support by stating that "[w]hile JP02 may want this to be done over a 'shorter' period it has not proposed how to do this and fails to explain what compelling policy or factual basis supports its undefined 'shorter' period."[68] BPA Staff's alternative option submitted in rebuttal testimony offers a predictable course of action to collect reserves for credit support, without the uncertainty surrounding the phase-in mechanisms included in the initial proposal.

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[64] Arthur, BP-18-E-MS-12 at 1.
[65] Harris et. al., BP-18-E-BPA-33 at 81.
[66] Deen et. al., BP-18-E-JP05-02 at 14.
[67] *Id*.
[68] Harris et. al., BP-18-E-BPA-33 at 81.

3. MSR's Proposal to Lend Reserves Between Business Lines Should Not be Adopted.

MSR proposed a "measure that would permit the Administrator to 'lend' reserves from one entity to the other at the highest prevailing interest rate of the lending entity."[69] MSR's characterization of each business line as an "entity" illustrates its misunderstanding of BPA's financial management. BPA is "a single entity, with one account responsible to meet all expenses from both Transmission Services and Power Services, and therefore its creditworthiness is based on BPA as one entity."[70]

Further, BPA already attributes interest credits to each business line based on the amount of reserves that are attributed to that business line.[71] This means that each business line is already receiving fair value from any reserves that are attributable to that business line in the form of lower net interest expenses.

BPA Staff provided additional rationale in their rebuttal testimony as to why MSR's proposal is inappropriate:

> [A] temporary imbalance between business line contributions to the Agency's financial reserves is acceptable so long as it is not systemic or long-term, and both business lines continue to contribute reasonable amounts. BPA's proposed FRP puts Power and Transmission's financial reserves on a path to be balanced within the next 10 years. Thus, compensation for the temporary lost opportunity from one business line to the other is not warranted, and should be cautioned against given the many interdependencies between the two business lines that are tied together physically, legally, and financially.[72]

For the reasons above, adopting MSR's proposal to "lend" between business lines at the highest prevailing interest rate runs counter to how BPA manages its reserves and does not serve a useful purpose for BPA, or either of its business lines individually.

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[69] Arthur, BP-18-E-MS-12 at 33.
[70] Deen et. al., BP-18-E-JP05-02 at 15-16.
[71] *Id*. at 16.
[72] Harris et. al., BP-18-E-BPA-33 at 98.

E. BPA Staff's Alternative Option Is an Improvement to the Financial Reserves Policy BPA Staff Advanced in the Initial Proposal.

As discussed above, the financial reserves policy BPA Staff advanced in their initial proposal was so problematic and such a poor business proposition for power customers that they testified that "risking a downgrade would be financially preferable for power customers relative to BPA staff's proposal."[73] Specifically, JP05 testified that the financial reserves policy BPA Staff advanced in their initial proposal was "fundamentally problematic" and contrary to the agency's competitiveness efforts because it would (1) create significant rate volatility; (2) have substantially negative financial impact on Power Services' customers without clear benefits; and (3) not promote equity between business lines.[74] BPA Staff's alternative option alleviates these concerns to some extent in two primary ways.

First, BPA Staff's alternative option allocates responsibility for agency's financial reserves to each business line "based on its fraction of a 10-year projection of BPA capital spending."[75] This allocation results in approximately 45 percent allocation of responsibility to Power Services and 55 percent allocation of responsibility to Transmission Services, or $180 million to Power and $220 million to Transmission for the BP-18 period.[76] By contrast, BPA Staff's Initial Proposal implicitly allocated responsibility for agency reserves by the size of each business line as measured in operating expenses, which shouldered Power Services with 75 percent or roughly $300 million of responsibility for agency reserves, and Transmission Services with 25 percent or roughly $100 million of responsibility.[77] This inequitable allocation of responsibility to Power Services came with no commensurate benefits to its customers, given

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[73] Deen et. al., BP-18-E-JP05-01 at 21.
[74] *Id*. at 17.
[75] Harris et. al., BP-18-E-BPA-33 at 145.
[76] *Id*.
[77] *See* Power and Transmission Risk Study, BP-18-E-BPA-05, at Tables 11 and 12; *see also* Harris et. al., BP-18-E-BPA-33 at 141.

that the benefit to power customers of avoiding a downgrade was $16 million per year on average, roughly half of the power customers' projected cost.[78] Because power customers were expected to bear the majority of responsibility for the agency's financial reserves, the cost of such a financial reserves policy greatly exceeded any benefits power customers would derive from maintaining BPA's current credit rating.

JP07 appreciates that in their alternative option, BPA Staff adopted the power customers' suggested method of allocating responsibility for the agency's reserves based on the percentage of total capital expenditures attributable to each business line over the next 10 years. While this allocation method is less advantageous to power customers over other potential allocation methods such as projections of third-party borrowing, it takes a long-term and balanced view of aligning costs and benefits and acknowledges that both business lines benefit from BPA managing its debt portfolio on an integrated basis.[79] Most importantly, this allocation method addresses perhaps the most problematic feature of BPA Staff's initial proposal – the inequitable treatment of Power Services relative to Transmission Services. By better aligning the costs of maintaining the agency's credit rating with the benefit to each business line of borrowing lower-cost money, the alternative proposal gets closer to actually maintaining equitable treatment between business lines.

Second, BPA Staff's alternative option wisely replaces the initial proposal's Good Year Ratchet and Incremental Rate Pressure Limiter with a proposal to include $20 million of Planned Net Revenues for Risk ("PNRR") per year in Power's revenue requirement in each rate period until forecast Power financial reserves exceed the Power lower threshold.[80] Staff's proposed Good Year Ratchet would result in excessive and unacceptable rate instability for power

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[78] Deen et. al., BP-18-E-JP05-01 at 21-22.
[79] *See id*. at 23-24.
[80] Harris et. al., BP-18-E-BPA-33 at 145.

customers.[81] In essence, in order for Power Services to reach its share of the agency's lower reserves threshold, the Good Year Ratchet would continuously usurp any amount of reserves above the current CRAC threshold and use those reserves to increase the CRAC threshold until it reached the proposed lower threshold.[82] Effectively, the Good Year Ratchet ensured that Power Services would have minimal reserves available for risk until it reached its lower threshold, and resulted in BPA being on the verge of a CRAC – and power customers being on the verge of an unpredictable rate increase – virtually all the time.[83] Further, the initial proposal's Incremental Rate Pressure Limiter meant that the non-Slice rates would increase at least three percent each rate period until Power met its lower reserves threshold.[84] Although power customers participating in the rate case vehemently testified against these aspects of BPA's initial proposal, BPA Staff continues to wonder whether some power customers "might prefer a rate impact that was less certain, and that might depend more on financial performance."[85]

Suffice it to say that members of JP07 have no appetite for excessive and unwarranted rate instability over the next 10 years and much prefer the alternative option's predictable approach of increasing reserves through a steady amount of PNRR. Power customers advocated for this approach all along because it has "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."[86] However, members of JP07 also understand BPA Staff's desire to have a reserves policy that specifies when to increase the Power CRAC threshold from its current level of $0 to the lower

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[81] Deen et. al., BP-18-E-JP05-01 at 16.
[82] *Id*.
[83] *See* Harris et. al., BP-18-E-BPA-33 at 142.
[84] Deen et. al., BP-18-E-JP05-01 at 16.
[85] Harris et. al., BP-18-E-BPA-33 at 143.
[86] Deen et. al., BP-18-E-JP05-01 at 24.

threshold for Power. There is merit to the alternative option's concept of combining the PNRR with a one-time ratchet in the Power CRAC threshold. Unfortunately, the one-time ratchet could still expose power customers to excessive and unwarranted rate shock. However, with one modification discussed below, BPA Staff's alternative option could make for a tolerable financial reserves policy.

F. BPA Staff's Alternative Option Must Be Modified to Mitigate Potential Rate Shock to Power Customers.

In rebuttal testimony, BPA Staff noted that while the financial reserves policy they proposed in the initial proposal is their "preferred option," the alternative option they advanced in rebuttal testimony "is also a strong alternative that the Administrator should consider."[87] As explained above, given the circumstances surrounding the Administrator's rate decisions in this case and the serious flaws of the initial proposal, BPA Staff's alternative financial reserves policy option is the only Staff proposal the Administrator should consider adopting, although with one much-needed modification.

Pursuant to BPA Staff's alternative option, each business line's lower threshold would be based on its share of BPA's capital spending over the next 10 years, multiplied by the agency 60 days' cash on hand level.[88] This would mean that Power Services would have a lower threshold requirement of approximately $180 million for the BP-18 period. For Power Services to reach the lower threshold, $20 million of PNRR per year would be included in Power Service's revenue requirement and collected in power rates until forecast Power Services financial reserves meet or exceed Power Services' lower threshold.[89] At that point, the Power CRAC threshold would immediately increase from the current level of $0 to the Power Services' lower threshold

[87] Harris et. al., BP-18-E-BPA-33 at 140.
[88] *Id*. at 145.
[89] *Id*. at 145-46.

level ($180 million for BP-18 period).[90] From then on, the Power CRAC threshold would remain at Power Services' portion of the agency's lower threshold level for all future years.[91] In other words, when Power Services end-of-year financial reserves are forecasted to reach Power Services' lower threshold level (either through collection of PNRR or natural reserves accumulation) as established by the reserves policy, the Power CRAC threshold would immediately be ratcheted up in a single step to the level of Power Services' lower threshold, or $180 million in the case of BP-18.[92]

This proposed one-time ratchet still raises significant concerns about rate shock in the situation where poor financial results occur following the CRAC ratchet. In this circumstance, power customers would be suddenly exposed to a CRAC that would not otherwise have occurred. Consider, for example, a rate period where Power Services is forecasted to reach exactly $180 million in reserves (assuming that Power Services' lower threshold is $180 million). Under BPA Staff's alternative option, the Power CRAC would increase from its current level of $0 to $180 million at once. Due to adverse hydrological conditions, Power Services loses $100 million in financial reserves during the first year of the rate period, leaving Power Services' reserves at $80 million. Under BPA Staff's alternative option, the Power CRAC would trigger for $100 million – and cause an immediate five-percent average rate increase on top of any proposed baseline rate increase – in the second year of the rate period. Had the CRAC threshold not increased, or increased incrementally, power customers would have seen neither a CRAC nor the additional rate increase. The agency would have simply gone back to adding $20 million of annual PNRR in each rate period until the Power Services' reserves were restored to the lower threshold level.

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[90] Harris et. al., BP-18-E-BPA-33 at 145.
[91] *Id*. at 143.
[92] *Id*.

BPA Staff correctly testified that "[i]n developing any policy, there are often competing interests that inevitably lead to tradeoffs."[93] In an effort to be constructive and demonstrate their commitment to the agency's long-term financial health, the power customers told the agency they could "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."[94] BPA Staff seem to agree that among the competing objectives that need to be balanced in the development of a financial reserves policy are the need to minimize rate shock and the impact of this new policy.[95]

1. JP07's Proposed Two-Step Phase-in of Power CRAC Threshold.

To mitigate the potential rate shock associated with a one-step CRAC ratchet, JP07 urges the Administrator to modify BPA Staff's alterative proposal to phase in the CRAC threshold in two steps with a buffer in reserves, rather than in one step. For example, when Power reserves reach the lower threshold of $180 million, rather than the CRAC threshold increasing all the way to that amount, the threshold would increase to 50 percent of the Power Services' lower threshold as Step 1 (or $90 million, using BP-18 period numbers). Unless Power reserves fall below the lower threshold level for Power Services, the agency would stop collecting yearly PNRR of $20 million but would continue to add to reserves through natural accumulation. When Power reserves reach 150 percent of Power Services' lower threshold (or $270 million, using BP-18 numbers), then as Step 2, the Power CRAC threshold would increase to the amount of Power Services' lower reserves threshold as established by the agency reserves policy (or $180 million, using BP-18 numbers). From then on, the Power CRAC threshold for the subsequent

[93] Harris et. al., BP-18-E-BPA-33 at 78.
[94] Deen et. al., BP-18-E-JP05-01 at 1 (emphasis added).
[95] *See* Harris et. al., BP-18-E-BPA-33 at 78; 81 ("The phase-in is meant to strike a balance between rate shock and equity between business lines while protecting the Agency's credit rating."); 101 ("As described above, we have modeled our proposal and have demonstrated that the Good Year Ratchet and IRPL can be used to limit rate shock without severely reducing the likelihood that replenishment of financial reserves attributable to Power will occur.").

and all future years would be set at the Power Service's share of the agency's lower threshold level of 60 days' cash on hand.

Following this two-step phase-in of the CRAC threshold, any time Power Services' reserves fall below its lower threshold level, a Power CRAC would trigger to replenish them to the appropriate amount in the following year. Under this approach, even as the CRAC threshold is raised substantially and eventually reaches BPA Staff's recommended level, there is always a sizable buffer at the time of the increase to mitigate for bad financial results and protect the power customers from an untimely CRAC.

Consider the difference this modification would make for power customers in the previous example. In a rate period where Power Services is forecasted to reach exactly $180 million in reserves (assuming that Power Services' lower threshold is $180 million), the Power CRAC would increase from its current level of $0 to $90 million. Due to adverse hydrological conditions, suppose Power Services loses $100 million in financial reserves during the first year of the rate period, leaving Power Services' reserves at $80 million. Under JP07's modification to BPA Staff's alternative option, the Power CRAC would trigger for $10 million instead of $100 million – and increase the power rates by less than one percent instead of five percent – in the second year of the rate period. BPA would return in the following rate period to collecting $20 million in PNRR per year until Power reserves have been restored to Power Services' lower threshold level set by the reserves policy.

Notably, power customers would still bear the risk of a substantial CRAC after the phase-in is complete and the Power CRAC threshold is equivalent to the Power Services' lower threshold for financial reserves. However, until then, JP07's modification to BPA Staff's alternative proposal provides power customers with a buffer that would limit rate shock without

substantially reducing the likelihood that reserves attributable to Power Services will be steadily and surely replenished. Thus, this modification meets BPA Staff's objective of having a financial reserves policy that specifies precisely when the Power CRAC threshold will increase from its current level of $0 to the appropriate lower threshold for Power Services.[96]

As part of their rebuttal testimony, BPA Staff performed an analysis that considers the probability of BPA's financial reserves falling below 30 days' cash on hand on a sustained basis under the status quo, BPA Staff's initial proposal and alternative option, and rate case parties' alternative proposals.[97] BPA Staff testified that relative to the status quo, their alternative option "performed quite well" when it reduced the likelihood of agency financial reserves falling below 30 days' cash on hand for two years from 20 percent to 12 percent.[98] Indeed, BPA Staff's alternative option performed better than their initial proposal on this metric, reducing the likelihood of agency financial reserves falling below 30 days' cash on hand for two years from 13 percent in BPA's initial proposal to 12 percent in BPA Staff's alternative option.[99]

Using BPA Staff's modeling tools, JP07 analyzed its modification to BPA Staff's alternative option and found the modification to have minimal impact.[100] Specifically, JP07's modification would increase the probability of agency reserves falling below the 30 days' threshold from 12.4 percent to 12.9 percent.[101] The modification would also reduce the expected cost to power customers by approximately $1 million annually. But more importantly, JP07's modification would substantially mitigate the possibility of rate shock in the event of a bad financial performance following the CRAC threshold increase without increasing the probability

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[96] *See* Harris et. al., BP-18-E-BPA-33 at 143.
[97] *Id*. at 22, 151.
[98] *Id*. at 151.
[99] *Id*.
[100] Data Responses Admitted via BP-18-M-MS-06, BP-18-E-MS-15 at 63 (Response to Data Request PP-BPA-26-60).
[101] Notwithstanding BP-18 discovery deadlines, JP07's work papers supporting this analysis will be made available upon request.

of the agency reserves falling below what BPA Staff perceives to be a dangerous level. It would also better balance the potential rate impacts to Power customers with the potential benefits of providing the agency with credit support.

III. CONCLUSION

For the reasons presented above, JP07 respectfully requests that the Administrator reject the financial reserves proposal BPA Staff advanced in their initial proposal, and consider adopting BPA Staff's alternative option with JP07's proposed modification.

Respectfully submitted this 2nd day of May, 2017.

s/ Irene A. Scruggs	*s/ Betsy Bridge*	*s/ Christopher Hill*
Attorney for PPC	Attorney for NRU	Attorney for PNGC

Post-Hearing Exhibit List of Joint Party 7

Exhibit	Document Title	Date Filed	Status
BP-18-E-JP05-01	Direct Testimony of Joint Party 5	1/31/17	Admitted
BP-18-E-JP05-02	Rebuttal Testimony of Joint Party 5	3/14/17	Admitted
BP-18-Q-PP-03	Qualification Statement of Michael Deen	1/23/17	Admitted
BP-18-Q-NR-01	Qualification Statement of Megan Stratman	1/27/17	Admitted
BP-18-Q-PN-02	Qualification Statement of Scott Russell	1/26/17	Admitted
BP-18-Q-PN-01	Qualification Statement of Greg Mendonca	1/26/17	Admitted
BP-18-Q-PP-01	Qualification Statement of Kevin O'Meara	1/23/17	Admitted
BP-18-Q-PP-04	Qualification Statement of Chris Weber	1/23/17	Admitted
BP-18-M-MS-06	Joint Motion to Admit Evidence	4/5/17	Admitted
BP-18-E-MS-15	Data Responses Admitted via BP-18-M-MS-06	4/21/17	Admitted

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: May 2, 2017.

s/ Irene A. Scruggs

Irene A. Scruggs
Public Power Council
825 NE Multnomah, Suite 1225
Portland, OR 97232
Tel. (503) 595-9779
E-mail: iscruggs@ppcpdx.org