



March 31, 2016

Elliot Mainzer
Administrator
Bonneville Power Administration
911 NE 11th Ave
Portland, OR 97232

Re: PPC Follow-up on Focus 2028 Process

Dear Elliot:

As you know, the Public Power Council (PPC) is appreciative of the commitment and leadership of the Bonneville Power Administration officers and staff to engage in a review of the long-term competitiveness of the agency's power and transmission products. This letter is intended to outline some of the potential short and long-term steps we see ahead in order ensure that BPA is a competitive power supplier when the current requirements power contracts expire.

The February meetings hosted by BPA were well-attended by PPC members, and proved useful and informative in many ways. While the level of detail varied, the presentations by senior BPA management and the various business units provided background on the current state of BPA's budgetary practices, and displayed some of the reasoning behind current spending levels.

It was clear at the meetings that the preference customers understand that there are many factors behind the rise in costs. And, even as we work together to address these factors, customers have expressed a strong interest in making sure that the Federal Columbia River Power System is well maintained, that the value and the assets are adequately preserved, and that the system meets its statutory obligations into the future.

In addition, it was helpful to learn that BPA is currently in good financial condition. A notable comment during the presentations was by a representative of Fitch Ratings, who observed that a key factor in BPA's high credit rating was the fact that BPA had long-term power contracts with its customers. The most critical step that BPA can take to assure its long-term financial health is to be a competitive power supplier so that customers will re-sign power sales contracts.

The Need to Focus on Agency-Wide Competitiveness

In the opening remarks in the Focus 2028 meetings, it was correctly noted by you, other BPA officers, and various public power leaders that the recent pattern of power and transmission rate increases is unsustainable. It was also noted that the important next phase of this Focus 2028 effort should identify what BPA and its customers can do specifically to help break that pattern of rate increases. There was a clear recognition that changes must start in the near term in order to affect the cost trajectory in the long term.

While the future path of market rates for power is inherently uncertain, it was noted in the Focus 2028 meetings that the market price of power now is the same as it was twenty years ago (nominal terms, not adjusted for inflation). Meanwhile, the power rate that BPA charges its preference customers has gone up significantly over that time. BPA's power rate to preference customers has gone from \$21 in 1997, to \$34 now; and, the forecast for 2030 in the Focus 2028 reference case is \$43.50.

Clearly one step that we look forward to working with you on is better targeting what constitutes competitiveness in an uncertain world. Regardless, with all of the other cost and regulatory pressures on retail utilities, there is great concern among customers that the range of 2030 BPA reference case results present **significant risk to the competitive position** of their primary wholesale power and transmission supplier.

Addressing the Cost Issues

The presentations made during the Focus 2028 meetings provided a good introduction to the cost pressures experienced in several areas of BPA's budget. Clearly, there will need to be a continuing emphasis on addressing specific areas that have seen unusual growth over time, such as fish & wildlife, generation and transmission operations, maintenance, capital, regulatory, security, and energy efficiency costs.

But focusing on individual cost areas will not be sufficient for an effective and comprehensive long-term approach that can change the trajectory. BPA will need to implement more **fundamental change in how it creates and implements budgets and cost controls** in order to succeed. Presentations by BPA budget staff showed some of the positive steps made in recent years for which BPA should be commended. For example, the creation of cost pools to manage growth within the major constituent parts of BPA and centralization of some of the management of spending within a fiscal year are useful practices. Building on that success with added agency-wide, top-down, centralized enforcement of strategic prioritization will be critical to establishing long-term cost control.

Budget Process Reforms for Consideration

One budget process suggestion for consideration would be for BPA to **set longer-term rate targets** to meet or beat; this could assist in getting beyond the short-term focus that can dominate discussions in the processes around a two-year rate cycle. We heard this idea discussed repeatedly both at the BPA public meetings and in member meetings at PPC; the heart of Focus 2028 is to establish a longer-term view. Seattle City Light's long-term budget process was used as an example, where SCL sets a six-year rate target (updated every two years), and requires permission of the Seattle city council to deviate from that rate target. Other public utilities use similar control methods.

Since 2028 is twelve years off, a modification of this approach for BPA could establish an interim long-term rate target for 2022, and a final long-term rate target for 2028. Establishing rate targets like this would necessitate a hard look at BPA's cost trajectory, at what level of long-term rates are viable, and what changes will be needed to hit those rate targets. Establishing a target would serve as a benchmark against which BPA's progress in controlling costs and rates could be strictly measured.

A second idea that has been discussed in many meetings is that BPA strengthen an internal office (likely within the BPA finance department) with the explicit charge of providing **greatly enhanced centralized direction to BPA's budget activities**. This would be a provision of greater authority than contained in the office currently providing budget support. The concept is that the office would have functions similar to the federal Office of Management and Budget, including strong budgetary control functions over the agency.

Another part of centralized budgeting would be the integration of that budget process and enforcement with implementation of a long-range plan for BPA that lays out well defined strategies and objectives that support the core business. This coordination between the strategic plan and short and longer-term centralized budgeting could assist in **identifying the necessary programmatic tradeoffs required** to allow BPA to be a cost-competitive agency.

A third proposal that public power has discussed is to convene a **panel of outside experts**, including the General Managers of consumer-owned utilities, who have experience in addressing budgeting and prioritization questions. They could advise the agency informally on budget process matters, and on how they implement centralized budgeting structures at their utilities. We understand that BPA used such a group of outside experts to help implement its successful budget control efforts in the mid-1990s. BPA was losing load due to its lack of competitiveness and implemented centralized cost-control (with the "two cents in 2000" campaign), bringing BPA's power rate to preference customers down to \$21/MWh in 1997.

If there is one theme to the above suggestions, it is that the goals of leadership in preserving competitiveness may be more effectively implemented with more

centralized, strategic, long-term budgeting focused on agency-wide affordability.

Next Steps

In addition to creating a specific proposal on how to better centralize and enforce budget authority, and the formation of an outside budget process advisory group, there are steps that will be needed within each area of the BPA budget in order to retain competitiveness long term.

One key next step is to take the financial information created in Focus 2028 and add any needed additional analysis to carefully consider the historical and expected rate of escalation in key cost areas. Building on that information should lead to **specifically laying out what steps** BPA and its partners in other agencies need to take to control these costs, while continuing to make needed investments in the system.

Such cost-control efforts have a long-term component to them, as well as a short-term component. While it is important that BPA find short-term cost savings, realistically it would take from 18 months to two years to make significant agency changes. In pursuing this, BPA should consider bringing in outside expertise to look at how and where some restructuring can be most effective.

For example, BPA's IPR-related power costs went from about \$1 billion in 2009 to a planned level of \$1.26 billion in 2015 – far exceeding the increase in the consumer price index (CPI), which went up by 11% during this period. About \$110 million of that increase was an escalation of hydro-related costs, much of that attributable to increased staffing at Grand Coulee Dam to oversee the ongoing refurbishment efforts there. Given that the staffing at Coulee has already been increased, continued upward pressures on those particular costs should be considerably less. With respect to the whole array of federal hydropower projects, it will be critical to **continue close work with the Bureau of Reclamation and Army Corps of Engineers to identify additional efficiencies** while maintaining the system. These partnerships and joint efforts are crucial to success of the Focus 2028 effort.

We appreciate that BPA staff noted that the fish and wildlife program is “mature” given its alarming budget trajectory in recent years. Since 2009, direct fish and wildlife budgets increased by \$68 million, or 29%, again substantially exceeding CPI (for programs not necessarily impacted by economic inflationary pressures in any case). Many customers were concerned to see some predictions that these programs would continue to increase at 2% annually. This should be revisited with a finer focus applied to the drivers for these proposed increases. As part of its prioritization of fish and wildlife costs, BPA should clearly identify **mandatory versus discretionary** spending and use that as a guideline for prioritizing funding and long-term decision making, including the consideration of any proposed long-term funding agreements.

The Columbia Generating Station operations and maintenance costs have increased about at the rate of inflation since 2009. While \$55 million of that cost increase came in a variety of areas, it is noticeable that “non-generation operations” went up by 20%, and “power internal support” went up 25%, both about double the rate of inflation. Working with Energy Northwest in this area will be important.

In addition, overall energy efficiency expenditures went from \$86 million to \$150 million over that time period. A large portion of that expense had previously been capitalized, but it will now all be expensed. So, any further increases in energy efficiency costs will have an immediate and direct impact on rates. In the area of energy efficiency, we also look forward to working with you on areas of program improvement under discussion in recent months. We are submitting separate comments on that topic that will include several proposals regarding helpful changes to the BPA Energy Efficiency program.

Finally, we wanted to note again that we appreciate, and it is to your great credit, that you and your staff are proactively addressing the agency competitiveness issue, rather than waiting until we are on the brink of negotiations for the 2028 contracts. Customers are already starting to consider their options for 2028. As you know well, the risks are too great to wait.

PPC looks forward to working diligently with BPA on an ongoing basis to ensure a healthy and competitive agency in 2028.

Sincerely,

A handwritten signature in black ink that reads "Scott Corwin". The signature is written in a cursive style with a large initial 'S'.

R. Scott Corwin
Executive Director