UNITED STATES OF AMERICA

U.S. DEPARTMENT OF ENERGY
BEFORE THE
BONNEVILLE POWER ADMINISTRATION

Fiscal Years (FY) 2018-2019 Proposed Power and Transmission Rate Adjustments	BPA Docket No. BP-18

REBUTTAL TESTIMONY OF
POWEREX CORP.

WITNESS: Carol C. Opatrny

SUBJECT OF TESTIMONY:
Response to Proposed Alternatives to the Financial Reserves Policy

March 14, 2017

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TESTIMONY OF CAROL C. OPATRNY

Witness for Powerex Corp.

SUBJECT: RESPONSE TO PROPOSED ALTERNATIVES TO THE FINANCIAL RESERVES POLICY

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TESTIMONY OF
MS. CAROL C. OPATRNY
Witness for Powerex Corp.

SUBJECT: RESPONSE TO PROPOSED ALTERNATIVES TO THE FINANCIAL RESERVES POLICY

I. <u>Introduction and Purpose of Testimony</u>

Q: Please state your name and qualifications.

A: My name is Carol C. Opatrny. I am President of Opatrny Consulting, Inc. My business address is 18509 NE Cedar Drive, Battle Ground, Washington 98604. A summary of my qualifications is contained in BP-18-Q-PX-01.

Q: What company is sponsoring this testimony?

A: I am submitting this testimony on behalf of Powerex Corp. ("Powerex").

Q: Please summarize the first point of your rebuttal testimony.

A: Several parties have proposed allocating the financial reserves contributions from each business line based on the forecasted, 10-year, capital debt financing needs of each business line on the theory that each business line should make a proportionate contribution based on the benefits it receives from BPA's strong credit rating, i.e., the benefit of borrowing lower-cost money.

In this testimony, I demonstrate that basing financial reserves contributions based on a forward-looking forecast improperly ignores the historical context of Transmission's disproportionate contributions, the relative magnitude of the revenue requirements of each business line, and the respective revenue volatility of each business line. To begin, I explain that BPA's debt obligations currently exceed $15 billion, of which Power's debt obligation is 64 percent, nearly twice that of Transmission's obligation (36 percent). I explain that BPA's business is capital intensive and that its current and projected capital needs exceed BPA's $7.7 billion Treasury borrowing authority. To close this gap, I recount how BPA and its customers identified financing alternatives that could help ensure access to capital and extend BPA's Treasury borrowing authority. The alternatives that BPA has implemented have included Debt Optimization, Debt Service Reassignment, rate and reserves capital financing, and Lease Purchases. I demonstrate that the implementation of these efforts has placed an inequitable financial burden on Transmission, and to date, except for $15 million for conservation, Transmission customers have been the major source of funds for financing capital with rate and reserves revenues ($180 million). Similarly, only Transmission customers are subject to the higher interest and financing costs of Lease Purchases, as that funding alternative cannot be used for non-Transmission assets. I explain that only Transmission customers have contributed adequate rate revenue to accumulate financial reserves to satisfy BPA staff's proposed Financial Reserves Policy. I conclude that it is not equitable to ignore these realities and adopt a financial reserves allocation method based upon BPA's 10-year forecast of debt-financed capital. Such a policy would perpetuate the inequitable burden on BPA's Transmission customers while ignoring Transmission's disproportionate contribution to freeing up less expensive, Federal borrowing authority.

Q: Please summarize the other points of rebuttal testimony.

A: Several parties proposed to establish both upper and lower reserves thresholds linking the business lines with the Agency as a whole, thus achieving "symmetry".

However, in this rebuttal testimony I demonstrate that the "symmetry" proposals in fact further integrate the two business lines and would perpetuate the inequitable status quo.

Finally, MSR made an observation that there may be a disconnect between the depreciation schedule of Transmission assets and the calculation of debt expenses. I believe BPA Staff needs to fully explore this issue because, if MSR is correct, then BPA has a structural mechanism that may be overstating transmission revenue requirements and/or systematically over-accumulating Transmission reserves.

II. <u>BPA SHOULD NOT ADOPT A METHODOLOGY TO DETERMINE FINANCIAL RESERVES CONTRIBUTIONS BASED ON THE PERCEIVED CREDIT RATING BENEFITS TO EACH BUSINESS LINE</u>

A. Allocating financial reserves between the Transmission and Power business lines based on alleged benefits is inequitable

Q: Starting with your disagreement with various methodologies for allocating financial reserves responsibilities, what did these parties propose?

A: Joint Party 5 ("JP05") proposes Agency lower and upper thresholds of 35 and 95 days' cash on hand, with no action taken if BPA projects financial reserves within this zone. If the Agency projects reserves outside of this zone, then each business line's reserves are checked, and the under-contributing business line is then subjected to the addition of planned net revenues. If the Agency's financial reserves are above the zone, the over-accumulation may be considered for other business line-specific purposes. Decisions to increase or decrease reserve levels would occur every other year, when BPA is setting rates.[1] In the event of under-accumulation, JP05 proposes to allocate the responsibility of financial reserves based upon BPA's forecast of capital

[1] BP-18-E-JP05-01 at 19:17-20:15.

expenditures that would be debt financed for the next 10 years,[2] which JP05 asserts is presently approximately 45% for Power and 55% for Transmission.[3] JP05 explains that BPA's objective to "Maintain equitable treatment between business lines"…"is one of the most important aspects of our proposal."[4] JP05 believes that in order to be consistent with cost causation principles it is necessary to associate "the cost of maintaining the credit rating with the benefit of borrowing lower-cost money realized by the business line borrowing the money."[5]

Similarly, Western Public Agencies Group ("WPAG") proposes that the Agency CRS (credit rating support) Lower and Upper thresholds be calculated based upon 45 and 105 days' cash on hand for the Agency, and that if the Agency is in this zone, there is no need to trigger the CRS-CRAC for either business line. WPAG proposes that the resulting financial reserves contribution requirements be allocated between Power and Transmission based upon "forecasted pro rata share of BPA's capital program over the next 10 years as determined in BPA's biennial Capital Investment Review process…"[6]

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[2] JP05's proposal is unclear on the exact financial reserves allocation methodology. On one hand, it proposes allocating financial reserves contributions based on "each business line's forecasted contribution to BPA's overall planned capital expenditures on a rolling 10-year basis". BP-18-E-JP05-01 at 18:22-23. Yet, in Section 3.3 of Attachment A to BP-18-E-JP05-01, JP05 states that the allocation factor for "each business line shall be its proportion of BPA's total projected capital spending over the following ten years . . . <u>that is intended to be debt financed</u> . . . ." (emphasis added). Table 3.6.2 of Attachment A also defines the capital requirements for Power and Transmission as derived from debt-financed capital. For the purposes of this testimony, I am assuming that JP05 intended to allocate financial reserves contributions based on the debt financed capital expenditures, not all expenditures, regardless of the source of such funds. Moreover, JP05 does not specify whether it intends debt financed capital expenditures to mean both federal and non-federal debt. For purposes of this testimony, I assume JP05 is referring to non-federal debt as BPA's credit rating is relevant only for non-federal borrowing.

[3] BP-18-E-JP05-01 at 19:1-11.

[4] BP-18-E-JP05-01 at 23:12.

[5] BP-18-E-JP05-01 at 23:16-19.

[6] BP-18-E-WG-01 at 10:1-11:10. WPAG appears to intend that the financial reserves contributions from each business line be based on capital expenditures, whether financed from federal debt, non-federal debt, or Transmission reserves.

WPAG explains that this allocation method between business lines is "based on their respective capital needs."[7] WPAG goes on to explain that cost causation principles typically result in costs following benefits, and "because Transmission stands to receive the most benefit from a financial reserves policy, it should be responsible for the cost of that policy in proportion to the additional benefit it will receive."[8] As both of the foregoing proposals suggest an allocation of financial reserves from each business line based on the "benefits" of BPA's strong credit rating, I refer to them as the "benefits" allocation methodology.

Q: Before going further, what is the breakdown between the Power and Transmission business lines for Federal and non-Federal debt obligations?

A: As of September 2016, BPA had $15.2 billion in outstanding debt, of which $7.2 billion is associated with Federal liabilities, and $8 billion is associated with non-Federal liabilities. Power accounts for 59 percent of the Federal liabilities, and Transmission accounts for the remaining, 41 percent. Further, Power has consumed 68 percent of the non-Federal liabilities, whereas Transmission has consumed the remaining 32 percent (of which Lease Purchases make up 25 percent). So, in total, Power's debt obligation is 64 percent of BPA's total outstanding debt, nearly twice that of Transmission's obligation (36 percent).[9] BPA's federal and non-federal liabilities are summarized in the table below.

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[7] BP-18-E-WG-01 at 19:8-10.

[8] BP-18-E-WG-01 at 25:12-16.

[9] Federal Columbia River Power System (FCRPS) Total Liabilities to Federal and Non Federal Parties as of 9/30/2016 (publicly available Nov. 2016), *available at* https://www.bpa.gov/Finance/FinancialInformation/Debt/OutstandingLongTermLiabilities/2016-Liabilities.pdf.

Table 1

Total Liabilities to Federal and Non-Federal Parties as of 9/30/2016			
($ million)	**Generation**	**Transmission**	**Total**
Total Appropriations	2,310.80	119.40	2,430.20
Total Bonds Issued to Treasury	1,940.30	2,818.40	4,758.70
Total Federal Liabilities	4,251.10	2,937.80	7,188.90
BPA Liabilities to Energy Northwest	5,073.00	495.9	5,568.90
BPA Liabilities to Other Non-Federal Parties	93.10		93.10
BPA Liabilities for Lease Purchases		2,027.30	2,027.30
BPA Liabilities for Other Capital Leases		41.30	41.30
BPA Liabilities for Prepay	285.20		285.20
Total Non-Federal Liabilities	5,451.30	2,564.50	8,015.80
Total FCRPS Liabilities	9,702.40	5,502.30	15,204.70

Q: What are your concerns regarding the "benefits" allocation method as it relates to the principle of cost causation?

A: My main concern is that the "benefits" allocation method is not entirely consistent with cost causation. The "benefits" allocation method focuses exclusively on projected, debt-financed capital investments and ignores the historical circumstances that led to BPA needing to finance capital expenditures with *non-federal debt*. Moreover, BPA's Transmission customers should not be saddled with a greater responsibility to accumulate financial reserves because the Power business line has utilized the majority of BPA's less expensive Treasury borrowing authority, the effect of which has been to require the Transmission business line to utilize more expensive funding alternatives, such as lease financing or Lease Purchases.

Q: Please describe the financial circumstances to which you are referring.

A: In simplistic terms, BPA's capital needs exceed its Treasury borrowing authority. To address this concern, BPA has implemented a number of financial decisions since the early 2000s focused on preserving BPA's Treasury borrowing authority. In recent years BPA has embarked on a series of stakeholder-engagement efforts to find additional sources of capital funding, the cumulative effect of which has disadvantaged the Transmission business line.

Q: Please describe the recent historical context of BPA's efforts to find alternative sources of capital funding.

A: BPA recognized this capital funding problem in its 10-year financial plan in 2008 and initiated a customer and stakeholder process for the purpose of discussing the importance of (1) having access to capital to ensure financing needs; (2) extending BPA's Treasury borrowing authority; and (3) ensuring that BPA could meet its capital requirements at the least cost.[10]

Before these more recent efforts, BPA initiated a Debt Optimization program in 2001, and this program was used as a "debt swap" in order to replace Federal *Power* debt with non-Federal debt. In 2003, "to further maximize the benefits" of Debt Optimization, BPA initiated Debt Service Reassignment, which was used to prepay Federal *Transmission* debt by issuing Energy Northwest debt and assigning the resulting Energy Northwest payment obligations ($1.8 billion) to Transmission.[11]

BPA secured additional federal borrowing authority in 2009 as a result of the American Recovery and Reinvestment Act, which increased BPA's federal borrowing authority by $3.25 billion, up to a total of $7.7 billion. Nonetheless, projected capital requirements in 2010, prompted BPA to again engage regional ratepayers and

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[10] Strategic Capital Discussion Overview (Sept. 19, 2011) ("Strategic Capital Discussion Overview"), *available at* https://www.bpa.gov/Finance/FinancialPublicProcesses/2011StrategicCapitalDiscussions/Documents/September-19/Overview.pdf.

[11] Management of Energy, Northwest Debt Presentation to the Energy Northwest Audit, Legal and Finance Committee (May 27, 2010), *available at* https://www.bpa.gov/Finance/FinancialPublicProcesses/DebtOptimization/debtoptimizationdocuments/Management%20of%20Energy%20Northwest%20Debt%20presentation.pdf; BP-18-E-BPA-09A at 86.

stakeholders in an effort to identify additional, alternative funding tools. Specifically, BPA sought "support and assistance" in order to aid the agency "in finding the proper balance between future capital investments and funding alternatives that ensure access to Treasury Borrowing Authority on a rolling ten year basis."[12]

This effort continued and by 2011, the agency was again raising concerns about the anticipated gap between its capital requirements and its access to Treasury borrowing.[13] BPA explained that new sources of capital would need to be developed; otherwise, BPA would run out of its Treasury Borrowing Authority by 2016. BPA forecasted that without new funding sources, its access to capital would be compromised; this was a significant concern of the Agency.[14] Today, BPA's federal borrowing authority remains at $7.7 billion, which includes $750 million associated with the Treasury Facility.[15]

Q: What did the region settle on as the appropriate balance between future capital investments and funding alternatives?

A: In November 2011, in an effort intended to address BPA's Borrowing authority "problem", BPA represented its situation as "facing a $3.3 billion shortfall to reach the

[12] Management of Energy, Northwest Debt Presentation to the Energy Northwest Audit, Legal and Finance Committee (May 27, 2010), *available at* https://www.bpa.gov/Finance/FinancialPublicProcesses/DebtOptimization/debtoptimizationdocuments/Management%20of%20Energy%20Northwest%20Debt%20presentation.pdf; BP-18-E-BPA-09A at 86.

[13] Strategic Capital Discussion Overview at slide 9.

[14] Fact Sheet, Strategic Capital Discussion at slide 9 (Sept. 2011) ("Sept. 2011 Fact Sheet"), *available at* https://www.bpa.gov/Finance/FinancialPublicProcesses/2011StrategicCapitalDiscussions/Documents/September-19-and-20/factsheetStrategicCapitalDiscussionSept2011.pdf.

[15] *Id*. at slide 10.

rolling 10 year [capital financing] target." At that time, in addition to what it called "reshaping capital investments", it identified three options:[16]

- Revenue and reserves financing
- Lease financing
- Prepayment of Power bills

Q: To what extent has BPA relied upon these options?

A: First, since 1984 BPA has attempted to fund capital with rate revenue and reserves financing; specifically BPA proposed approximately $290 million in rate revenue and reserves funding for capital needs as follows: Transmission reserves - $120 million; Power rate revenue for conservation - $35 million; and Transmission rate revenue - $135 million.[17] This sort of financing has proven a challenge as BPA has found that its intentions to fund capital with revenue have actually resulted in borrowing for investments once the operating year was underway.[18] Nonetheless by 2016, BPA has successfully used $195 million from both rate revenue and reserves for funding capital needs, of which $180 million was used for Transmission capital and $15 million was used for conservation capital needs.[19]

Second, although, BPA identified "prepayment" as a funding alternative, I am not aware of BPA generating any significant cash with this financing source.

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[16] Strategic Capital Discussions, Update on Capital Spending Scenario Analysis & Rate Impacts/Funding Tools at slide 41 (Nov. 18, 2011), *available at* https://www.bpa.gov/Finance/FinancialPublicProcesses/2011StrategicCapitalDiscussions/Documents/November-18/2011-11-17_MeetingMaterial_final.pdf.

[17] *Id*. at slide 54.

[18] *Id*.

[19] *Id*.; BPA Financial Reserves Presentation at slide 7 (Mar. 29, 2016), *available at* https://www.bpa.gov/Finance/FinancialPublicProcesses/AccesstoCapital/2016_Reserves_Workshop_1.pdf; BP-18-BPA-14 at 16:2-9.

Finally, BPA identifies lease financing or "Lease Purchase" arrangements as its "primary existing alternative source of financing to help preserve BPA's limited Treasury borrowing authority."[20] By far, BPA is relying most heavily upon lease financing to finance Transmission capital projects because asset ownership is required by this funding mechanism.[21] While BPA has responsibility to market the output of the generating assets owned by the Corps of Engineers and Bureau of Reclamation assets, and collects revenues to cover the costs to operate and maintain these assets in its rates, it does not have title to the assets, and so lease financing is not an option for assets that support Power services. Also, BPA explains that conservation and fish and wildlife capital are intangible assets and so it does not hold title on those assets. As a result, BPA has relied upon the lease financing option for securing capital for those assets it owns, i.e., Transmission, to free-up Treasury borrowing for other assets for which it has financial responsibility.

The Power business line also has helped relieve pressure on the Treasury borrowing authority through non-federal (Energy Northwest) debt, which was a Debt Optimization program, and BPA now expects an additional $3.9 billion of Energy Northwest debt in the coming 10-year period. The Transmission business line helped enhance the Debt Optimization effort with the Debt Service Reassignment, which resulted in pre-paying federal debt (that financed transmission assets) and in turn taking on non-federal (Energy Northwest's) principal and interest obligations. While helpful in

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[20] Strategic Capital Discussion Overview at slide 19.

[21] Access to Capital Background Presentation (publicly available July 16, 2012) ("Access to Capital Background"), https://www.bpa.gov/Finance/FinancialPublicProcesses/AccesstoCapital/Access_to_Capital_Tools_Info_Package.pdf.

terms of freeing up Treasury borrowing, these cumulative efforts still do not meet BPA's needs for capital spending, and as a result, BPA has now increased its reliance on Lease Purchases ($5.4 billion in new borrowing expected in the next 10 years), as a major source of non-federal funding.

Q: What is the magnitude of BPA's lease financing program?

A: In BP-18, BPA proposes to fund about half of Transmission capital expenditures with lease financing through what the agency calls "Lease Purchase" (i.e., $227 million in 2017; $231 million in 2018; and $244 million in 2019).[22] Importantly, it is the Lease Purchases that free up Federal borrowing in the BP-18 rate period: $891 million for Power and $755 million for Transmission.[23]

BPA started using the lease financing funding source in 2004, and by 2012, BPA had about $738 million in leases for projects.[24] In early 2013, BPA announced as part of its Access to Capital Strategy that it raised the level of lease financing to 50 percent of the Transmission capital program.[25] As shown in Table 1, as of the end of FY 2016, BPA's lease financing obligations have nearly tripled, to over $2 billion in four years. And, with the addition of $1.6 billion of Treasury borrowing for Power and Transmission during BP-18, BPA is within $500 million of reaching the borrowing limit (assuming

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[22] BP-18-E-BPA-09A at 79.

[23] BP-18-E-BPA-09A at 78-79; BP-18-E-BPA-02A at 65-66.

[24] Access to Capital Background at slide 7.

[25] BPA's Lease Financing Program Presentation at slide 10 (2013), *available at* https://www.bpa.gov/Finance/FinancialInformation/Debt/LeasePurchaseProgramDocuments/Lease%20Financing%20Program%20Overview%20FINAL.pdf; *Bonneville Power Admin*., Letter to Customers re Access to Capital Strategy (Jan. 10, 2013), *available at* https://www.bpa.gov/Finance/FinancialPublicProcesses/AccesstoCapital/Access%20to%20Capital%20Strategy%20-%20CFO%20Letter.pdf.

continued reliance upon the Treasury Facility for rate making). BPA projects that the Lease Purchase payment stream will cost BPA's Transmission customers $2.8 billion in principal and $4.6 billion in total payments over the coming thirty year period.[26] This, of course, ignores the impact of the rest of the anticipated incremental Lease Purchase 10-year forecast of $5.4 billion.[27]

Q: Is the cost of lease financing comparable to Treasury borrowing?

A: No. According to BPA, lease financing is more expensive than Treasury borrowing authority both in terms of interest rates and other costs that apply.[28] In 2012, BPA prepared a rate comparison contrasting weighted average "all in" rates for lease financing with "comparable" Treasury financing rates. This analysis indicated that the interest rates for lease financing were 29 to 161 basis points higher.[29] These results are corroborated by an earlier analysis that BPA performed as part of the Strategic Capital Discussions in 2011. At that time, BPA estimated the "all-in costs" that applied to the various non-Treasury borrowing financing options under consideration, and it concluded that lease financing borrowing rates exceeded Treasury borrowing by as little as 95 basis points (for non-Oregon, 30 year term) and 150-220 basis points (for Oregon, 30 year term), and as much as 110-165 basis points (for non-Oregon, 7 year term), and

[26] BP-18-E-BPA-09A at 81-86.

[27] BPA stated that it expects $9.3 billion in non-federal borrowing over the coming 10-year period ($3.9 billion in Energy Northwest debt and $5.4 billion in Lease Purchase debt). BP-18-E-BPA-17 at 13:21 – 14:2. Yet, BPA expects total capital expenditures in the coming 10-year period to be approximately $9.48 billion. *See* Integrated Program Review and Capital Investment Review Presentation at slide 5 (Jun. 15, 2016), *available at* https://www.bpa.gov/Finance/FinancialPublicProcesses/IPR/2016IPRMeetingMaterials/2016-IPR-CIR-Capital-Portfolio-Management-Workshop.pdf. Thus, it appears that nearly all of BPA's capital needs will have to come from non-federal borrowing.

[28] Sept. 2011 Fact Sheet.

[29] Access to Capital Background at slide 7.

165 – 290 basis points (for Oregon arrangements, 7-year term).[30] While I have not conducted an independent analysis to compare the Federal borrowing costs with the lease purchase borrowing costs, based on BPA's relatively recent statements, as I summarized previously, it seems reasonable to conclude that the incremental transactional expense associated with Lease Purchases, and the relatively higher cost of debt for Lease Purchase arrangements, results in a clear and distinct inequity in terms of the financial burden imposed on Transmission.[31]

Q: Do you think that the proposed allocation of reserves between business lines, based upon the 10-year forecast of non-federal capital investments for the agency is consistent with cost causation principles?

A: No. Transmission investment is being financed with non-federal funds because BPA does not have access to adequate Treasury borrowing for all of its capital requirements and because the non-federal lease financing arrangement is only available for assets that BPA owns, i.e., transmission assets. Moreover, this financing option is relatively more expensive than Treasury borrowing, as I explained previously, which creates an embedded incremental cost to the Transmission business line in the form of higher interest and transactional costs.

Given this set of circumstances, I do not agree that the financial reserves contributions should be allocated based upon forecasted debt over the coming 10

[30] Access to Capital Tools Presentation at slide 56 (Sept. 20, 2011), *available at* https://www.bpa.gov/Finance/FinancialPublicProcesses/2011StrategicCapitalDiscussions/Documents/September-20/FundingTools.pdf.

[31] BP-18-E-BPA-09A at 84. I highlight this inequity only to illustrate that it would be further injury to then require Transmission customers to disproportionately fund financial reserves for BPA's credit rating, as various parties have proposed in direct testimony through the "benefits" allocation methodology.

years. First, as displayed in Table 1, Power has utilized more than twice the volume of non-federal debt as Transmission, and focusing only on projected non-federal debt needs—while ignoring the credit risk presented by a specific business line—omits how BPA arrived at the present situation. And second, Transmission *may* have greater non-federal borrowing needs going forward, but this result is largely because Transmission is bearing the burden of alleviating pressure on BPA's Treasury borrowing authority. In other words, Transmission is using more expensive debt financing options, Lease Purchases, to make room for other Power and Transmission borrowing needs under BPA's Treasury borrowing authority. To then require Transmission customers to bear a higher burden of financial reserves contributions based on the benefits allocation methodology fails to recognize the inequity of the historical circumstances, perpetuates the inequitable status quo, and runs counter to equity and cost causation principles.

Instead, I support BPA's proposal to use the Days' Cash financial reserves allocation methodology because it assigns independently determined Days' Cash on Hand responsibilities, reflective of the magnitude of operating expenses associated with each business line.

B. The proposal to link business line thresholds with Agency thresholds is inequitable

Q: What do JP05 and WPAG propose in terms of triggering the upper and lower reserves thresholds?

A: JP05 proposes that "no action would be taken to increase reserves for credit support as long as BPA as a whole is between the 35 and 95 days' cash on hand threshold." If, the Agency projects financial reserves to be below this zone, then each business line's reserves are checked, and the business line that is under-contributing is then subjected to the addition of planned net revenues. If financial reserves are forecasted to be above the zone, then the over-contributing business line may have financial reserves redeployed for other business line specific purposes. Decisions to increase or decrease reserve levels would occur every other year, when BPA is setting rates.[32]

WPAG proposes that as long as the Agency reserves are between 105 and 45 days' cash on hand, there is no need for triggering the CRS-CRACs for either business line.[33] WPAG explains that "Credit rating agencies evaluate BPA's financial reserves on an Agency rather than business line basis."[34] WPAG goes on to express its belief that "raising rates to support BPA's credit rating when current Agency reserve levels are already sufficient to meet that objective is inconsistent with BPA's obligation to set its rates at the lowest possible level consistent with sound business principles."[35] WPAG also ties business line and Agency reserves levels together, so that a business line's Reserves Distribution Clause ("RDC") will only trigger if both the reserves for the business line and the financial reserves for the Agency exceed the CRS Upper Thresholds starting in BP-18.[36]

Q: What do you find problematic in these proposals?

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[32] BP-18-E-JP05-01 at 19:17-20:15; PX-JP05-26-1 (reproduced in Attachment A).

[33] BP-18-E-WG-01 at 10:1-23.

[34] BP-18-E-WG-01 at 7:18-19; BP-18-E-WG-01 at 10:1-3.

[35] PX-WG-26-10 (reproduced in Attachment A).

[36] BP-18-WG-01 at 11:5-10.

A: These proposals appear to further integrate the two business lines, without taking into account the volatility of each business line's revenues, and by extension the credit risk associated with each business line. Moreover, the proposals undermine BPA's obligation to separate the costs and revenues for each business line. These proposals highlight the problem with having a Financial Reserves policy that mixes independent business line requirements with Agency requirements. The foregoing proposals both seek to rely upon the financial reserves that Transmission customers accumulate to reduce the chance that the Lower Thresholds trigger. In addition, the proposals reduce the chance that the Upper Thresholds trigger, an arrangement that maximizes the probability that the Agency reserves will be in the zone of financial reserves adequacy where BPA will take no action, while ignoring potential, perpetual over-contributions by one business line.[37]

Unlike WPAG's claim that "there will likely be years where Transmission reserves are short and Power reserves are sufficiently robust...", history has demonstrated that Transmission revenues are relatively predictable and reliable in comparison with Power, i.e., since 2004, Transmission has accumulated a minimum of $131 million in 2005 (82 days' cash on hand, assuming BP-18 Transmission operating expenses), and as much as $606 million (379 days' cash on hand, assuming BP-18 Transmission operating expenses).[38]

Q: WPAG also argues that its proposal "is consistent with cost causation principles because when Agency reserve levels are below the Agency CRS

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[37] PX-JP05-26-1.

[38] PX-WG-26-6 (reproduced in Attachment A).

Lower Level Threshold, only that business line that is below its individual CRS Lower Threshold, would be subject to a CRS-CRAC."[39] Do you agree?

A: No. The problem with this logic is that it ignores the historical context, as I explained previously, about how BPA has arrived at the present situation. WPAG's proposal attempts to continue the interdependency between the business lines, perpetuating the inequitable over-contribution by Transmission customers.

While I recognize the realities of BPA's singular Agency credit rating and singular Agency borrowing authority, BPA separately accounts for costs, revenues, and derives rates for two separate business lines. Implementation of a Financial Reserves Policy, which is effectively a "cost" in the form of required financial reserves, has to satisfy the needs of the Agency while respecting the independence of two, separate business lines. This is important because there are two different groups of customers for these two businesses, and because formalizing this policy is taking place after many years of excessive contributions by Transmission customers. Reducing the probability of triggering Individual (business line) CRS Lower Thresholds because reserves are between the Agency Upper and Lower thresholds actually undermines cost-causation principles; it does not correct for the over-contributions by one business line or the under-contributions by the other.

Q: Do you think that either the business line and Agency Lower Thresholds or CRACs and the Upper Thresholds or the RDCs should be linked?

A: No. While I understand why BPA has linked the business lines with the Agency financial health for triggering the RDC in its Initial Proposal, such proposals ignore

[39] PX-WG-26-10.

principles of inter-business line equity and appropriate risk allocation. During BPA's proposed 10-year Power CRAC lower threshold phase in period, I proposed an alternative approach that attempts to treat Transmission and Power customers similarly by imposing a cap on the level of Transmission financial reserves during the phase-in period.[40] Conversely, assertions that this linkage is necessary starting in BP-18 to ensure lowest possible rates, in practice, disadvantage Transmission customers by perpetuating the current inequitable level of over-contribution.[41]

Q: Any other areas of concern?

A: WPAG proposes that BPA adopt a $15 million/year cap for its CRS-CRAC for Power based upon a "…maximum downgrade to Power… with an average cost from FY 2018 through 2027 of $16 million/year."[42] WPAG also suggests a $22.5 million/year CRS-CRAC cap for Transmission, and again, justifies this as being consistent with cost causation principles, whereby costs generally follow benefits.[43] Through discovery, WPAG presents a different cap, i.e., both Power and Transmission CRS-CRAC caps of up to $15 million.[44] Because the allocation of financial reserves based upon forecast non-federal capital investments is inequitable to Transmission customers and deviates from cost causation principles, the adoption of the suggested CRS-CRAC caps also is inequitable.

C. BPA should investigate the possible disconnect between depreciation of Transmission assets and the calculation of

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[40] *See* BP-18-E-PX-01.

[41] BP-18-E-WG-01 at 23:8-16.

[42] BP-18-E-WG-01 at 21:1-7.

[43] BP-18-E-WG-01 at 25:1-16.

[44] BPA-WG-26-8 (reproduced in Attachment A).

Transmission debt expenses

Q: Please explain your concern with MSR's position on BPA's depreciation methods.

A: I believe that MSR offers an interesting observation in its direct testimony. Specifically, MSR points out that since 2009, there appears to be a relatively consistent condition whereby Transmission net revenues exceed the change in reserves. MSR suggests that this average annual excess net revenue (e.g., $116 million) may be the result of "a disconnect between the time over which Transmission assets are depreciated, and the term of the debt expenses associated with those assets."[45]

Q: Why is this of particular importance at this time?

A: I have demonstrated that there is increasing pressure to find additional financing mechanisms and to protect access to Treasury borrowing. Since 1984, BPA's Transmission customers have directly financed nearly $200 million of Transmission capital investments with rate revenue and accumulated reserves. In addition, BPA is clearly relying upon Transmission customers to absorb the relatively higher cost of Lease Purchase arrangements so to protect continued use of Treasury borrowing. As earlier explained, this financing tool is projected to cost Transmission ratepayers $4.6 billion over the coming thirty years, and BPA is forecasting $5.4 billion in transmission capital funded with Lease Purchases over the coming ten years. Given that BPA is on the brink of adopting a formal Financial Reserves Policy, resulting in more clearly delineated responsibilities between the business lines to accumulate financial reserves, fine-tuning the tools used to calculate operating expenses is a necessary step.

[45] BP-18-MS-12 at 42:1-10.

Q: What is your suggestion regarding this issue?

A: I encourage BPA to further examine MSR's hypothesis, and if correct, make efforts to rectify the mismatch between depreciation schedules and debt expenses.

III. Conclusion

Q: Please summarize your rebuttal testimony.

A: My rebuttal testimony can be summarized as follows:

(1) BPA should adopt a days' cash on hand methodology to determine each business line's financial reserves contribution because the "benefits" methodology proposed by several parties neglects Transmission's historical, disproportionate contributions and the relative magnitude and revenue volatility of each business line.

(2) BPA should not link the Agency and Business Line Upper and Lower Thresholds starting in BP-18 because such linkage would perpetuate the inequitable status quo;

(3) BPA should further examine MSR's hypothesis regarding a potential mismatch between depreciation schedules and debt expenses assumed in the calculation of Transmission rates.

Q: Does this complete your testimony?

A: Yes.

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing on the Bonneville Power Administration's Office of General Counsel, the Hearing Clerks, 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.

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