

Bonneville Power Administration Power Function Review Regional Meeting April 19, 2005

**Red Lion, Idaho Falls, Idaho
Approximate Attendance: 3**

[The handouts for this meeting are available at: www.bpa.gov/power/review.]

Introduction

Paul Norman (BPA) explained that BPA is on the verge of setting rates and is having the Power Function Review (PFR) meetings to help establish the costs that will go into new rates. When we set rates, we also look at loads; credits, which are primarily revenues from surplus sales; and how to manage risks – all of these decisions are made in the formal rate case, he said.

Costs, however, are not decided in the rate case and are historically determined outside that process, Norman said. The question for us in the PFR is, “how low can costs be and still allow us to meet our various responsibilities,” he stated. We are asking our customers and ourselves this question in the PFR, Norman said. We want customers and others to understand our costs and to tell us what they think, he said.

Norman went over a 10-year rate history, noting that “rates jumped way up in 2002.” They have come down a little, and we don’t know yet what they will be for 2006, he said. The focus of the PFR is costs that will go into rates for the 2007-2009 period, Norman explained. We’ve been having discussions about costs for four months, and on May 2, we will put out a draft closeout letter proposing cost levels for the rate case, he said. We will take comments on the proposal until May 20, and final decisions on costs will be released in mid-June, Norman said. We’re discussing costs now, and we will look at credits, risks, and loads later in the year in preparation for the rate case, he said.

In simple terms, we come up with our power rate by taking our costs, minus credits, plus risk, and divide by our loads, Michelle Manary (BPA) said, explaining the formula displayed in the meeting packet. The bar chart (p. 5) is a stack of our costs, she said. In the PFR, we are going through each of these areas of cost, Manary said. On May 2, we will put out our proposal on costs for the rate case; the numbers you see here will change in the proposal – some will decrease and some may increase, she explained. Manary pointed out that the second bar on the chart represents BPA’s fixed debt, which is 39 percent of the total expenses.

Assuming we could forecast perfectly, we have calculated that our costs would result in a rate of about \$28 per megawatt-hour (MWh), she continued. But we have risk to deal with in setting rates, Manary stated. Our hydro generation can vary by the equivalent of

two nuclear plants, she said. We can't ignore this risk, and we are asking in the PFR how we can mitigate it, Manary said.

If we went with a fixed flat rate that incorporated risk, we'd have to be at the top of the range on our graph, about \$36 per MWh, she went on. But we know that is unacceptable, and we are looking at ways to get that figure down, Manary stated.

You have done a lot in the past few years to cut your costs, and I wonder "how much wiggle room" you have left, Don Bowden (City of Albion) commented. And on top of that you are having a low water year, he said.

Our projected costs have been coming down in the PFR process – I don't know how much they will come down in our May 2 proposal, but they will come down, Norman said. If customers want to take on some of the risk of the swings in our revenue, the rate could come down a lot, he stated. We are aiming "to cut costs and manage risk smarter," Norman said. We will update hydro conditions and forecasts before we go into the rate case, Manary added.

People have asked us since we will no longer have the system augmentation costs we have in the current rate period, why rates can't come back down closer to where they were in 2001, Manary said. The answer is that we are doing a lot more than we were doing in 2001, she explained. She listed significant increases that have occurred since then, including IOU benefit increases, F&W program costs, larger public utility load, O&M and debt service increases, and the conservation and renewables discount. The latter is small, but it makes a difference, Manary said. These cost increases are partly offset by other things – reduction in aluminum loads and higher market prices for our surplus power – but the increases far outweigh the offsets, she explained.

Manary also said BPA's risk has increased. She noted that the IOU residential exchange settlement has changed and that a long-term surplus sale, which brought in a rate higher than the agency's preference power rate, will be expiring. Even with augmentation going away, costs are going up, Manary stated. A table in the appendix of the meeting packet (p. A-11) shows the difference between our costs now and those projected for the next rate period, she said. Bowden pointed out that BPA pushed some costs forward when it refinanced its debt.

In the PFR, we have been going through out costs "line item by line item" and have compiled a list of changes that have been suggested, Manary said. A number of the items on the list are reductions, and we plan to make many of these, Norman said. The reductions we make won't be trivial compared with the costs we came into this process with, he added.

The question we are asking is, "are we spending the right amount – getting the biggest bang for the buck – and still meeting our mission," Manary said. On May 2, we will put out our proposal, there will be three weeks of comment followed by a closeout in mid-June on the budgets that will go into the rate case, she reiterated.

Linda Milan (City of Idaho Falls) asked about the reduction listed in the renewables program area. Manary explained that it relates to a geothermal project. We are in arbitration with the developer of the project, and we could assume that at the earliest it will come online in 2008 or we could push the expense out of the rate period entirely, she said. Our position in the arbitration is that our purchase contract should be terminated because the developer did not prove out the geothermal source by the date specified in the agreement, Norman clarified.

My worry with cutbacks in extraordinary maintenance is that you reduce the budget number, but that doesn't change the reality about what needs to be done, Milan said. Manary explained that there are some very expensive extraordinary maintenance items at the hydro projects that cannot be capitalized because they are not items that extend the life of the plant. They are expensive repairs, but they are not depreciable like other capital items, Larry King (BPA) pointed out.

My concern is that we have a constrained transmission system all over the region, and if we don't have sufficient generation, we have to go outside for purchases, Bowden said. If you have to buy power outside the region because something on a generator gives out, you have created unpredictability due to transmission and market rates, he indicated. If you push these projects to the point that things start going out of commission, you could set up a bad situation, Bowden cautioned. "It increases the unknowns," he added.

Norman explained that the O&M figures for the Corps of Engineers and Columbia Generating Station (CGS) show big increases. "We are looking hard at these categories," he said. The expenses have gone up a lot, and people are saying there has to be a way to bring them down, Norman stated. Energy Northwest was proposing a \$69 million annual increase for CGS O&M in the next rate period, but they are now saying they can bring that number down by \$23 million, he said. We are also hoping to gain 300 to 400 MW by increasing generating efficiency in the hydro system, Norman stated. He noted that security costs at the generating plants are going up.

Bowden asked about the increase in IOU benefits. In 2001, BPA bought back the power benefits that were going to IOU customers and used the power to serve other load, Manary explained. In the new rate period, the benefits will go to the IOUs as dollars, she said. From 1997 to 2001, we paid about \$84 million annually for IOU residential exchange benefits, Norman said. But in the next rate period, the benefits are geared to the market price of power and could be as low as \$123 million or as high as \$323 million, he said. When we set the rates, we will know the IOU benefit amount for 2007, but not for 2008 or 2009, Manary added.

When you have a constrained transmission system, where is there room for competition? Bowden asked. And I don't see how an independent system operator is going to benefit the Northwest – it seems like it will increase costs, he said. The Northwest economy was built on low power rates, Bowden pointed out. We don't know where the priorities will be if we get a new centralized entity operating the system, he said. I'm not sure we will

find a good balance, Bowden said. No one is building new transmission, and if a new entity takes over, it will take a while to get that moving, he said. I hope there is a transition plan to make sure this works – we are a small player compared to California, and “we could get stomped,” Bowden stated.

There is still activity going on to set up a regional transmission organization called GridWest, Norman responded. But your worry about the transition is noted, he said.

The meeting adjourned at 6:30 p.m.