NRU

Northwest Requirements Utilities

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Submitted via BPAFinance@bpa.gov

Re: NRU's Comments on BPA's Proposed Leverage Policy and Financial Reserves Policy Phase-in

Northwest Requirements Utilities (NRU) represents 53 Load Following, NT customers of BPA, who rely on BPA for most, if not all, of their power supply. As such, BPA's provision of affordable and reliable power supply and transmission is of the utmost importance to NRU members. BPA's recently released Strategic and Financial Plans provide an outline for the agency to improve its financial health. NRU supports the approach of looking comprehensively at all factors affecting BPA's financial health and developing solutions tailored to the underlying causes. BPA must consider all issues holistically and be mindful of the impacts of the agency's actions on its affordability and reliability.

BPA Should Adopt a Power Rate Target Policy.

It goes without saying that BPA's finances are complex and multi-faceted. While it can be appealing to isolate issues into their own processes, we must consider all issues collectively and holistically. This is challenging to do when topics are discussed in a staggered manner (e.g., Leverage Policy and Financial Reserves Policy (FRP) Phase-in now, Access to Capital next, IPR after that, concluding with the rate case which brings everything together). Therefore, NRU proposes that BPA adopt a Power Rate Target Policy to provide an avenue through which the agency can comprehensively consider the ultimate rate impact to customers (the combination of the Tier 1 rate, Spill Surcharge FRP Surcharge, CRAC, etc), and take actions necessary to keep Power cost competitive.

BPA's Proposed Leverage Policy Appropriately Identifies and Addresses a Key Factor of BPA's Financial Health.

NRU supports the general approach described in the proposed Leverage Policy because it targets one of the key factors of BPA's financial health and establishes a plan to directly respond to it. BPA has demonstrated that Transmission is currently in a very capital-intensive business cycle and is projected to be for at least the next decade. A reliable transmission system with sufficient capacity to serve load is critical for NRU members and the region. NRU expects BPA staff to thoroughly scrub its capital plans, both for project need and efficiencies in completing the same work at less cost, and will closely evaluate the proposed capital plans in the forthcoming IPR. However, given that the majority of Transmission's projects are sustain/replace, the solution to Transmission's capital needs is not simply slashing its capital budget.

BPA has demonstrated that Transmission is a significant net borrower, both historically and projected for the future, having net borrowed over $1.8B since 2012 and projected to net borrow even more in the next six years. In contrast, Power is a net re-payer, both historically and projected for the future, having repaid $100M since 2012 and projected to net repay three times that in the next six years.

Transmission's intense capital needs are significantly straining BPA's debt capacity. In fact, the agency projects to run out of Borrowing Authority by 2023, including use of the $1.5B it has earmarked for short-term and capital liquidity. To the extent BPA needs to access non-federal debt to increase debt capacity for Transmission, its credit rating becomes more important and its leverage ratio is a factor in those credit ratings.

In addition, BPA notes that continued 100% debt-financing of Transmission's capital program will more than double the amount of interest expense allocated to Transmission rates within 10 years. Already, 40% of Transmission's revenue requirement is attributed to debt-service (repaying principal and interest). Debt-service is a fixed cost that needs to be paid in the future. Carrying such a large fixed cost with uncertain future revenues creates significant risk for the Transmission business line.

Consequently, the proposed Leverage Policy appropriately identifies the underlying causes of BPA's leverage ratio and adopts a policy to address those causes. Achieving a leverage ratio of 75-85% within ten years is an appropriate approach because it aligns the corrective actions with the underlying drivers of the issues. To smooth projected Transmission rate increases, BPA could allow Transmission's leverage ratio to increase slightly while staying at or below 85%.

<u>BPA's $40M Surcharge Proposal to Achieve the FRP Goal of $300M of Reserves Within 10 Years is Unjustified.</u>

NRU supports BPA staff's proposal to keep the Cost Recovery Adjustment Clause (CRAC) threshold at $0, as this provides the opportunity to use financial reserves to mitigate future rate impacts. Additionally, NRU believes the current CRAC mechanisms should stay in place (i.e., $1 for $1 for the first $100M, then $0.50 on the $1 up to $300M).

NRU supports BPA staff's concept of using a surcharge instead of including an amount of money in the rates (i.e., PNRR). A surcharge will allow the additional cash flow to terminate at the end of the fiscal year once the lower threshold is reached, instead of waiting until the next rate period.

Where NRU disagrees with BPA's proposal is the level of the surcharge and the justification for choosing that level. BPA has proposed a surcharge of $40M per year, with the goal of achieving Power's lower threshold of 60 days cash on hand (DCOH), approximately $300M, within 10 years.

BPA has offered several reasons why it believes 60 DCOH is the appropriate lower threshold, thus attempting to justify a phase-in period of 10 years. NRU disagrees that these justifications outweigh the importance of moderating Power's rate trajectory and positioning the agency to be the power supplier of choice post-2028. Put more bluntly, the primary factor used to decide the amount of the surcharge should be Power's cost competitiveness and demonstration of the agency's willingness to limit rate increases.

Power rates have increased over 30% since the start of the Regional Dialogue contracts and continue to face upward rate pressure from things like increasing fish and wildlife costs, depressed wholesale market prices, and other drivers, some of which may or may not be within BPA's control. The amount of the surcharge, however, *is* within BPA's control, and BPA should avoid unwarranted Power rate increases at this critical moment in time. Realistically, there are but two rate cases before post-2028 contracts are negotiated and executed. It is paramount that BPA demonstrates to Power customers its intent to follow the Strategic Plan to provide competitive rates and be the power supplier of choice. Selecting a FRP phase-in that does not cause unjustified upward rate pressure should be the minimum action taken by BPA at this critical juncture.

NRU proposes that the surcharge amount should not exceed $20M per year. BPA should provide a business case justifying any surcharge amount. BPA has previously pointed to the credit rating agencies' reports expressing concern about declining financial reserves and the risk of a credit downgrade. In response, BPA has adopted the FRP and is proposing a Leverage Policy to address another concern cited by the rating agencies. BPA has also published Strategic and Financial Plans that are positioning the agency to address its financial health and long-term sustainability. These actions have been positively recognized by the rating agencies.

While BPA has already taken steps to address some of the rating agencies' concerns, it must not lose sight of another key rating driver cited by the rating agencies, which is its long-term power sales agreements and Power's cost competitiveness. As 2028 approaches, the existing power sales agreements are no longer considered "long term" and BPA's cost competitiveness is in serious question. In its most recent report, Fitch summarized its concerns on this issue: "If new [Power] contracts are not signed beyond 2028, revenues available to service Bonneville's debt obligation would be reduced. Bonneville's ability to offer a competitively priced power supply will be a key factor during the extension of power sales contracts."

Consequently, BPA must consider the impact on cost competitiveness and its ability to be the power supplier of choice as it decides the appropriate amount of the surcharge. Power's financial health is impacted by numerous factors, not just the amount of financial reserves; all of these factors must be taken into account when determining the appropriate level of the surcharge. BPA's analysis shows there is a 67% probability that Power will reach its lower threshold by 2028 with a $20M per year surcharge and $0 CRAC threshold, which represents a reasonable balance between achieving the lower threshold and addressing Power's cost competitiveness.

Finally, BPA should limit the amount collected in a fiscal year to the higher of the CRAC or the surcharge, not both. This would further demonstrate BPA's commitment to making Power cost competitive. For example, if the CRAC triggers for $30M, BPA would only collect $30M from Power customers, instead of $50M (CRAC + $20M surcharge).

BPA Should Adopt a More Conservative Estimate of Secondary Revenues and Find Cost Reductions to Offset Any Increase to the Revenue Requirement.

NRU appreciates BPA responding to our request for analysis on what a different rate treatment of secondary revenues might look like.

While we do not support a fundamental change to the rate design at this time, we do ask that BPA adopt a more conservative estimate of secondary revenues to help address volatility. Importantly, the rate impact from a more conservative estimate *must be* offset by cost reductions taken elsewhere in Power Services. In other words, if a more conservative estimate of secondary revenues increases the revenue requirement by, say, $25M, Power must find cost reductions of $25M elsewhere so there is no rate impact to Power customers. Power customers have already absorbed the impact of inaccurate secondary revenues forecasts through increased rates and reduction in financial reserves, which they are now repaying via the FRP. Reduced volatility will benefit the customers and the agency, and we ask the agency to identify commensurate cost reductions to prevent a rate impact from this change.

Conclusion

NRU appreciates BPA staff's engagement with us in this process to explore different ideas and look forward to continuing to work with BPA to refine these proposals. To the extent this requires additional time or comment periods, we ask the agency to provide this. It is important for us to develop well-vetted and thoughtful policies that address the agency's and customers' needs both in the short and long term.

Should you have any questions about these comments, please don't hesitate to contact me.

Respectfully,

Megan Stratman
Rates and Policy Director