Public Power Council
1500 NE Irving, Suite 200
Portland, Oregon 97232
503.232.2427
Fax 503.239.5959

15 September 2004

VIA E-MAIL
Madonna Radcliff
Senior Financial Analyst
Programs in Review – T-Ditt2
Bonneville Power Administration
PO Box 491
Vancouver, Washington 98666
tblfeedback@bpa.gov

Re: Joint Customer Comments on TBL's 2004 Programs In Review

Dear Ms. Radcliff:

BPA's Transmission Business Line (TBL) is preparing for the largest rate increase in many years. This occurs at a time when BPA's power rates are still very high when compared to historical levels. The most recent estimate of a TBL rate is an increase of about 14% for FY 2006 and FY 2007 compared to current rates.

Representatives of the Joint Customer Group have participated in the workshops held by TBL over the last two months, and we appreciate the detailed information that has been provided in response to our questions. Based on this information, we recommend that BPA review all areas of its transmission costs, and draw down TBL's more than adequate cash reserves to offset its revenue financing proposal, with the goal of significantly reducing, or eliminating altogether, the proposed increase. This letter contains the Joint Customers' recommendations on the areas BPA should scrutinize as it considers cost reductions. In this regard, we recommend that an important tool for identifying and implementing cost reductions is provided by the recently released KEMA report.

In FY2003, TBL's actual total operating expenses were $325 million. The 2003 rate case forecast for FY 2004 was $367 million. Total operating expenses contain both operation and maintenance expense and inter-business line expenses. In the face of declining revenues, BPA has been able to reduce its expenses to a forecasted level of $329 million for

FY2004, which is very close to FY2003 actuals. TBL is to be commended for recognizing the need to reduce its spending. We applaud these efforts, which should continue in the future while maintaining a reliable transmission system for Northwest consumers and meeting TBL's transmission commitments.

Recommendations on Capital Costs

A major driver for the proposed increase for FY2006 and FY 2007 is the increase in depreciation expense, which is in turn driven by new transmission projects going on-line in the upcoming rate period. Depreciation expense is up 23% when compared to 2003 actual data. A key driver for transmission investment is the maintenance of reliability of the system while meeting TBL's existing transmission commitments, which is an appropriate use of BPA's limited capital resources. On the other hand, integration of new resources should continue to face the "or" pricing test and, if network upgrades are needed, the generators should provide advance funding for them.

BPA needs to work with its utility and industrial customers to ensure that the investments that we pay for are consistent with these principles, and that the timing of TBL's new investments is properly reflected in TBL's cost of service and repayment analyses, so that only those investments in service during the upcoming rate period are included in the costs that are being recovered from current rate payers. A closer look at this issue could save additional costs.

Customers would like more opportunity to provide meaningful input to BPA's overall capital planning process. At the August 25 PIR workshop, it became clear that the decisions regarding capital investments in FY2006 began last April, and that TBL had already submitted its capital and expense budget request for FY2006.

In other words, these decisions were made before the current PIR process. This seriously undermines the ability of the customers to have meaningful input to TBL's capital program for FY2006-07. We recognize that BPA has obligations as a federal agency to make submissions to the Department of Energy (DOE) and the Office of Management and Budget (OMB) by September of this year to enable investments to be made in FY2006. A new process is needed to enable the customers to participate in TBL's capital project analysis/selection process before BPA's budget submissions are made to DOE and OMB.

Further, the customers have been waiting since early 2003 for BPA to share its thoughts on its overall Sustainable Capital Program, as BPA promised it would do. Inasmuch as this Program will have effects on both transmission and power rates, and is a critical part of the agency's long-term capital planning, it is essential that the customers be provided an opportunity to work with BPA in its development. We urge TBL to work with other parts of the agency to ensure that the proposed Sustainable Capital Program is released as soon as possible so that decisions that will affect future power and transmission rates are made with the maximum possible input from those paying the bills.

Recommendations on Expenses

In addition to capital program issues, continued attention to cost reduction in the expense program area is also important in order to eliminate or keep to a minimum any potential transmission rate increase. We urge BPA to review all its program costs again to find more cost savings. As a starting point, the following program items are areas the Joint Customers recommend that BPA scrutinize to reduce or eliminate any cost increases. These program areas show significant increases in the FY 2006-07 rate period, well above the expected rate of inflation, when compared to 2003 actual expenses:

- Information Technology (66% above 2003 actuals);
- Awards (592% above 2003 actuals);
- Regulatory and association fees (194% above 2004/5); and
- Corporate G&A (31% above 2003 actuals).

Taken together, these programs are 64% higher than 2003 actuals.

Other programs' FY2006-07 costs are increasing at rates above the rate of inflation. These programs include redispatch, stability reserves, and technical support for scheduling. Although these types of programs have an element of reliability associated with them, we recommend that reliability-sensitive issues such as these should be looked at using a reasonable, sustainable-funding approach. In other words, what long-term reasonable expense level will fund these programs so that the integrity and adequacy of the transmission system are not jeopardized, but huge cost and rate increases are avoided? Moreover, the funding levels for these programs need to be based on objective studies, standards, assessments or analyses that identify the deficiencies of the transmission system and their impacts on reliability. We believe that savings are possible in the range of $20 million per year in a variety of areas, including the four program areas listed above.

It has become clear that although the BPA power and transmission business lines have made genuine efforts to control their own costs, the same does not appear to be true for the Corporate division of the agency. When faced with the shock to the Northwest economy of PBL power rate surcharges in FY2002, the Power Business Line successfully undertook an effort to get its controllable, internal costs down to the actual levels of FY2001. When transmission revenues fell dramatically in FY2004, the Transmission Business Line cut its costs accordingly and has basically managed to live within its means.

The same is not true for Corporate. For example, according to information from the PIR workshops, Corporate FTE levels are projected to exceed 2001 actual levels through 2007. Although this is not necessarily a good proxy for total Corporate annual costs, it is an indicator that Corporate has not yet adopted objectives similar to those practiced by the two business lines. We recommend that TBL work with Corporate to reduce projected Corporate costs, the objective of which being the return to actual 2001 expense levels.

Finally, the recently released KEMA report identifies a number of areas where further cost reductions can be obtained. These should be implemented where appropriate and the savings should be reflected in the FY 2006 and FY 2007 cost estimates.

Sincerely,

/s/

C. Clark Leone
Manager

For the Joint Customers:
Alcoa
Avista Corporation

Benton County Public Utility District
Clark Public Utilities
Columbia Falls Aluminum, LLC
Grays Harbor Public Utility District
Idaho Energy Authority
Idaho Power Company
Industrial Customers of Northwest Utilities
Northwest Requirements Utilities
PacifiCorp
PNGC Power
Portland General Electric Co.
Power Resource Managers, LLP
Public Generating Pool
Puget Sound Energy
Snohomish County Public Utility District
Tacoma Power
Western Montana G&T
Western Public Agencies Group

cc: Joint Customers
PPC Executive Committee