Comments of the M-S-R Public Power Agency
BPA BP-26 Workshop Presentation and Proposals

September 11, 2024

The M-S-R Public Power Agency ("M-S-R") is a joint powers agency formed by the Modesto Irrigation District, and the Cities of Santa Clara and Redding, California, each of which is a consumer owned utility. Beginning with a 2005 contract, M-S-R obtained contractual rights to the output from some of the first large scale wind resources developed in Washington State. M-S-R and its members currently have rights to 350 MW of wind generation in Washington and Oregon, which its members use to serve their customers and meet California's Renewable Portfolio Standards. Those customers ultimately bear the cost of the Bonneville Power Administration ("BPA") Transmission and ancillary services rates and charges.

SUMMARY

M-S-R appreciates the opportunity to comment on BPA's August 27-28, 2024, Workshops for BP-26 and TC-26. The BP-26 workshops highlighted both the magnitude of the proposed spending levels and the intentions and priorities of BPA. The discussion of forecasted spending and revenue mechanisms confirmed M-S-R's concerns expressed in its comments regarding the BP-26 Integrated Program Review (IPR) process. In fact, the magnitude of the increase to the revenue requirement resulting from the forecasts and potential revenue financing is worse than M-S-R estimated in its prior comments. M-S-R anticipated potential rate shock – what is proposed is severe rate shock.

M-S-R fully supports BPA's intention to maintain a reliable transmission system that will meet both current and future regional needs. M-S-R has concerns with the level of expenditures forecasted, as well as the mechanisms proposed to fund those expenditures.

M-S-R also has reservations with BPA's inconsistent treatment of the Power Business Line (PBL) and the Transmission Business Line (TBL). M-S-R's

comments are not intended to change BPA's policy toward PBL but rather to refocus BPA policy towards TBL so it better aligns with the policy approach to PBL. Specific areas of concern are: Approach to risk, Approach to capital structure, Approach to RDC allocations, and Approach to Revenue requirements. From M-S-R's perspective BPA consistently makes decisions which accelerate revenue requirements for transmission customers and shift costs from future rate periods to the current rate period. This intentional policy represents a severe tax on the region, amounting to $375 million for BP-26, and is inconsistent with BPA's strategic objective of "Be an engine of growth."

M-S-R remains concerned with the lack of transparency associated with the extreme upswing in capital forecasts. M-S-R encourages BPA to consider the history of underspending, the sharp level of increase, and the impacts of rate shock when it considers how to apply its policies and establish revenue requirements.

COMMENTS

M-S-R's comments are organized as follows. First, M-S-R will address its concerns with the Approach to risk, Approach to capital structure, Approach to RDC allocations, and Approach to Revenue requirements. Second, M-S-R will address concerns regarding the lack of transparency surrounding BPA's forecasted expenditures, and concerns with the slope of the spending curve. Third, M-S-R will comment on the proposed level of revenue financing. Fourth, M-S-R will address rate mechanisms to mitigate rate shock. Last, M-S-R raises some questions on which it seeks clarification at the September 25, 2026 BP-26 workshop.

I. Approach to Risk

At the August BP-26 workshops BPA indicated that its financial policies regarding capital structure implicitly assume that the associated risks for TBL and PBL are similar. BPA also chose not to include the risk bands associate with the Monte Carlo analysis. In the past these risk bands expressed in dollars of standard deviation have been presented and starkly indicated that the revenue risks associated with PBL were significantly greater than the revenue risks associated with TBL. The primary reason for this difference is: PBL relies heavily on the revenues associated with water year and market prices. TBL relies heavily on

revenues from long-term contracts and to a lesser extent short term transmission purchases.

The financial results from the last few years dramatically demonstrate this reality. PBL results have swung from positive net revenues of $700 million to a loss of over$ 600 million, a delta of over $1 billion. Given a budget of $2 billion this is quite significant.

At this same time TBL net revenues have deviated by less than $30 million, on a budget of approximately $1 billion. BPA's primary policy action is to remove the $75 million of Treasury borrowing authority from the TPP calculation for PBL.

M-S-R clearly recognizes that the significant difference in revenue risk between PBL and TBL is not the result of BPA forecasting error or BPA marketing. Rather it is the direct result of the inability to accurately predict weather and difficulties of accurately forecasting future energy prices.

There was discussion regarding revisiting the approach to risk. Any discussions regarding the approach to risk need to recognize the differing risk profiles of the business lines, and provide an opportunity for all customers to participate.

II. Approach to Capital Structure

At the August BP-26 workshops BPA indicated that it applied the same capital structure to both PBL and TBL. (Both are expected to meet an 80/20 structure currently and reach a 60/40 structure by 2040.) Applying the same capital structure to two different businesses implies that their respective financial risks are similar.

As the above discussion on risk demonstrates the relative financial risks of TBL and PBL are fundamentally different, not as the result of any failure in performance, but as the direct result of their respective businesses and the inherent associated risks. Specifically, PBL has financial risks nearly 10 -15 times those of TBL. Yet, BPA asserts that each business line should have the same capital structure.

An historical lookback results in a similar disconnect. Historically, PBL has had a capital structure either above 100% debt or near 100%. TBL has consistently been below 100% often near 80%-85%. In context this means that BPA has accepted a 100% debt business with significant revenue risks.

Currently, both PBL and TBL have debt to asset ratios in the 80% range. Yet PBL has approximately 10-15 times the revenue risk.

Based on BPA's current and proposed policy for capital structure it does not appear that BPA considers risk as a material component in capital structure.

III. **Approach to Revenue Requirements**

The above analysis clearly documents that BPA does not include relative risk assessment in its determination of revenue requirements. If BPA did, it would target a much higher debt structure for TBL than it does for PBL. (Historically TBL carried a much lower debt-to-asset ratio than the PBL, but that is not necessary for risk.)

M-S-R is not suggesting that BPA lower the target for PBL rather M-S-R is suggesting that BPA recognize the very low revenue risk associated with TBL and adjust the target ratio accordingly. A target of 90%/10% is likely quite appropriate for TBL given its very low revenue risk profile.

M-S-R recognizes that BPA's Financial Policy is not the focus of BP-26. However, revenue requirements are at issue, and a proposed $375 million of revenue financing to meet a capital structure that is inconsistent with the associated risks is a valid subject for comment. As M-S-R has indicated TBL is not a risky business. A 60%/40% target for a very low risk business is unnecessary and if enforced will result in a significant and unnecessary tax on the region.

BPA has consistently highlighted the reality that it provides 75%-80% of the region's high voltage transmission. It also has indicated that the region is approaching full utilization of the available capacity. There is very little risk that BPA will be unable to collect the required revenues to meet its financial obligations.

$375 million of revenue financing is not necessary for financial risk purposes. It is not necessary for appropriate capital structure purposes. It does not support economic growth.

When in the past BPA faced the prospect of limited access to capital, revenue financing was a last resort option. Today BPA has access to over $10 billion of borrowing authority. It is not capital constrained.

BPA does not need to tax the region $375 million. BPA should not tax the region $375 million.

IV. Approach to Reserves Distribution Clause Implementation

M-S-R recognizes that RDC distributions are not directly a subject of BP-26.   But revenue requirements and the associated rates are at issue and given the magnitude of the proposed revenue increase the potential for net revenues seems quite high. Historically, BPA has distributed much of the RDC for PBL in the form of rate reductions and distributed most of the RDC for TBL in the form of debt repayment acceleration.

If it is BPA's intent to continue this policy tendency toward TBL then M-S-R respectfully requests that BPA reconsider its revenue requirements and give further consideration to reductions which may limit the likelihood of a large RDC in the near term. Alternatively BPA should commit to return either business lines excess reserves as rate relief.

V. Capital Forecasts and Insufficient Information

In its IPR comments, M-S-R raised concerns about the extreme magnitude of forecasted increases in capital spending, as well as with the forecasted 20% increase to IPR expenses. The concerns are based on historical underspending, and also based on the shear magnitude of the forecasted increase. The forecast calls for over one billion dollars in capital spending for Transmission each year of the three year rate period. The total of $3.7 billion in direct capital expenditures over three years ($4.3 billion with indirects) is more than the $3.6 billion the TBL has actually spent on capital over the past 8 years combined. While increased spending plans are rational given the regions needs, an increase of the magnitude proposed is very likely to be missed. As M-S-R and others commented, there are many barriers that are likely to prevent BPA from ramping up its spending as quicky as forecasted.

When customers questioned the level of spending and the lack of information regarding the projects on which the spending would occur, the BPA workshop panel suggested the information should have been provided in the IPR process. It was not provided. It has been a few years since BPA's IPR included project by project projections that created true transparency for customers. In contrast, all that was included in the 2024 IPR was a single line item in the Appendix to the

Initial Publication for Expand/Sustain, with nearly $3 billion forecasted over the three years. That level of information is far from transparent. In its IPR comments M-S-R requested a table that summarizes the major expenditures. For example, how much will be spent on new transmission lines? Which lines? How much will be spent on upgrades to existing transmission lines? How much additional capacity will be created? Which specific projects will provide additional capacity, how much, and what revenues are expected to result from the additional capacity? Without additional information there is no way for customers to determine how much is proposed to be spent on new build projects, how much is upgrades and replacements, or how much is associated with the new Vancouver Control Center.

The lack of transparency, coupled with the extremely steep slope of the projected increases in spending contributes to customer uncertainty and a lack of confidence in the forecasted spending levels.

VI. Proposed Revenue Financing

The August BP-26 workshops included presentations on potential levels of revenue financing. In particular, slides 52-53 present four potential BP-26 alternatives considered by BPA Staff. M-S-R understands the first alternative "BP-26 w/1% limiter" reflects revenue financing at a level that applies the 1% limiter from the Sustainable Capital Financing Policy. As explained during the August workshops, that alternative would add $15 million per year in revenue financing to the existing $55 million in revenue financing in BP-24, for an annual revenue financing of $70 million, and a total during the BP-26 rate period of $210 million. The other three alternatives would ignore the Policy's limiter and impose even greater revenue financing without regard to rate shock. BPA Staff's alternatives are summarized, below, with a focus on the level of revenue financing each would impose, over and above the other rate pressures for actual costs.

BPA Staff Alternatives (Slide 53)	Annual Revenue Financing (Millions)	Rate Period Revenue Financing (Millions)	Annual Revenue Financing as Percentage of $1.4 Billion Average Total Expenses (Slide 75)
BP-24	$55	$165	4%
BP-26 w/1% Limiter	$70	$210	5%
BP-26 w/new $55 RF	$125	$375	9%
BP-26 w/new $148 RF	$218	$654	16%
BP-26 w/new $195 RF	$265	$795	19%

Given the uncertainties surrounding BPA's ability to increase spending to the degree forecasted, and given other IPR rate pressures, M-S-R submits that, at most, BPA should adopt the "BP-26 w/1% Limiter" approach, increasing the annual revenue financing to $70 million per year. Doing so would still tax the region by $210 million over three years, and would cause a 5% increase to rates on top of the likely increase resulting from increased IPR expense forecasts. However, it is the least harmful of the BP-26 alternative presented by BPA Staff.

M-S-R reiterates its opposition to revenue financing of forecasted capital expenditures because revenue financing imposes charges on current customers for assets that may not be useful for several years, and which, once they become used and useful, will remain useful for decades to come but will have been paid for in year one. The more rational and prudent approach given BPA's access to debt that does not vary with leverage levels continues to be use of debt with a tenor that resembles the useful life of the assets. M-S-R also agrees with the customer led presentation that explains revenue financing coupled with depreciation results in a duplicative charge to customers. With that said, if the revenue financing under the Sustainable Capital Financing Policy is going to applied, the Policy's 1% limiter needs to be applied as well, particularly given the concerns with the level of forecasted capital spending and resulting rate shock.

VII. Phased-In Rates

Several customers have suggested mechanisms for phasing in rates, or applying limiters to the rate increases. These approaches were raised during the August BP-26 workshops, as well as in comments to the IPR process. For example, the Public Power Council comments to the IPR suggested a 20% "lapse" factor should continue to be applied to forecasted capital spending, similar to how BPA addressed capital forecasts in BP-22 and BP-24. While PPC's comments focused on the PBL capital forecast, the same should be applied for the TBL. Doing so will help mitigate some of the rate shock that will result from the IPR and capital forecasts presented by BPA Staff.

In addition, M-S-R reiterates the approaches it suggested in its IPR comments, a form of contingent IPR budgeting. Similar to the construct of "firm" energy vs. "secondary energy", the construct of "firm" spending" and "secondary spending" could be considered.

The IPR could include both "firm expenditures" where the likelihood of execution during the rate period is very high, similar to firm energy where the likelihood of its availability is very high. The IPR also would include "secondary expenditures" where the need is established but the likelihood of execution during the rate period is less certain.

In the context of the Initial IPR Proposal for BP-26 this construct might be as follows: (These percentages are for illustrative purposes only. Actual percentages would be developed in the appropriate forum(s)).

Firm Expenses. 90%
Secondary Expenses 10%

Firm Capital 80%
Secondary Capital 20%

Firm VCC expenditures 95 %
Secondary VCC Expenditures 05%

Given the historical actual spending of approximately 93% and the magnitude of the proposed escalation in expenditures M-S-R would suggest as an initial allocation the following: Expenses would be partitioned 90% firm. 10% secondary. Capital would be partitioned 80% firm 20% secondary (this recognizes the

significant increase and considerable uncertainty). The VCC would be partitioned 95% firm and 5% secondary (this recognizes that this project is in-progress and there should be better information regarding expenditures and availability of labor and materials).

In the subsequent 7(i) process rates would be set as firm to recover all "firm" expenditures and as contingent pending the level of actual expenditures during the rate period. If the expenditures reach a defined threshold the secondary rates would be implemented to provide the necessary additional revenues required for completion of the secondary expenditures (programs and work). This approach ensures that BPA has the necessary revenues to perform IPR work but reduces the likelihood that various constraints and uncertainties will result in the collection of excess revenues.

Alternatively, BPA should consider moving to a formula rate transmission tariff, which provides transparency on spending levels and creates annual true ups of actual expenses and actual revenues. The result would be certainty on debt repayment probability, and decreased risk to the Agency.

VIII. Requested Clarifications

M-S-R's IPR comments requested clarification of a number of issues raised by the IPR materials. Similarly, M-S-R seeks clarification of the following issues from the BP-26 workshops and materials.

A. Capacity Definition

M-S-R would like to clarify a comment made by BPA at the August BP-26 workshop. It is M-S-R's understanding that BPA assigns capacity value to mid-C purchases. If this is correct can BPA provide more detail.

B. Revenue Financing

M-S-R's understanding of Revenue Financing is as follows:

Approximately 10% of the Transmission rate period's proposed capital budget is financed with revenue from current rates. This means that during the current rate period current rate customers will be paying 10% of the capital cost of investments that may not be energized for several rate periods in the future. Until energized these investments will not earn any offsetting revenues since they will not provide

any additional transfer capacity. For the BP-26 rate period BPA Staff suggested that $375 million would be included in rates with no certainty that any additional transfer capacity will be created by the capital expenditures during the BP-26 rate period. M-S-R respectfully requests BPA's response as to whether or not this is a correct understanding.

C. EIM and Day Ahead Markets (DAM)

M-S-R understands that BPA has concluded that it may not have sufficient capacity to meet the reserve capacity requirements associated with the projected increases in renewable energy resources. M-S-R understands also that for BP-26 BPA does not assume participation in a day ahead market.

If BPA did participate in a DAM would that change BPA's capacity requirements for the additional renewable energy? If not why not? If yes why?

During the August BP-26 workshops BPA discussed the reduced DEC Reserves as a result of EIM. How does BPA determine the benefits of EIM of reserves? How is it quantified?

IX. Conclusion

M-S-R appreciates the opportunity to comment on the BP-26 rate workshop materials and discussions. M-S-R understands the general need for increased capital spending, but reiterates its concerns that the chance of material underspending is quite real and the associated adverse impact to existing transmission customers is substantial. M-S-R encourages BPA to take into account the impacts on all of BPA's customers when it considers the application of its policies, and pursue all means to mitigate rate shock, including the use of a lapse factor or other means to phase in rates.

M-S-R hopes BPA will find these comments constructive and consider the offered suggestions.