Comments of the M-S-R Public Power Agency Regarding Bonneville Power Administration's April 24, 2018 Gen Inputs Workshops

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Introduction.

The M-S-R Public Power Agency 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 (RPS). Those customers ultimately bear the cost of the Bonneville Power Administration (BPA) transmission rates.

M-S-R appreciates the opportunity to comment on the Gen Inputs issues and concepts presented during BPA's initial Gen Inputs workshop, held on April 24, 2018.

Summary of Proposal.

M-S-R understands that BPA is proposing to rework the manner in which it allocates its costs to the Gen Inputs rates. Rather than starting from the costs of the "big 10 hydro" facilities that actually provide the Reserves products, BPA proposes to allocate costs to Gen Inputs using a Variable-Fixed methodology. BPA would allocate all of its fixed costs to capacity, and its variable costs to energy. M-S-R understands that BPA categorizes the following costs as fixed: (1) debt, amortization and depreciation; (2) Firm annual energy purchases; and (3) statutory obligations, which are primarily fish and wildlife programs. BPA would then divide those total fixed, or embedded costs by BPA's one hour critical capacity plus firm purchases, rather than using an average of 120 hour denominator. Using the BP-18 data, the results of the new

methodology would be similar to the existing methodology, with total embedded/fixed costs being $1.145 Billion, divided by 13,503 MW, resulting in a capacity cost of $7.07/kW/month. (The BP-18 calculations resulted in $7.03 for Balancing Capacity and $7.39 for Operating Capacity)

M-S-R Concerns.

M-S-R has a number of concerns with the proposed methodology regarding the following:

- Assets to be included in the cost of service calculation
- Allocation of costs to energy vs. capacity
- Priority of Service
- Conformance to BPA's Strategic Plan
- Implications for future revenue enhancement
- Inconsistencies with other BPA approaches

Assets for Inclusion in the Cost of Service

BPA's use of fixed costs from all of the Federal Columbia River Power System does not follow cost causation.

First assets are included, such as Columbia Generating Station ("CGS"), that were not developed by BPA, are not owned by BPA, and are dedicated to a select group of customers who have exclusive rights to that resource. M-S-R cannot understand how a resource owned by a select group of customers, managed by that group of customers, and dedicated to their exclusive use can possibly assign the associated costs to customers who have no rights to the output, no input to the decisions regarding the facility past present or future. Further, M-S-R understands the CGS is not capable of varying its output in a manner that can produce a Reserves product.

Second, costs of regulatory assets are included that were "guaranteed" by BPA for the sole benefit of a somewhat different group of customers

for facilities that were never completed some 40 years ago. These facilities provide no benefits to Gen Inputs customers.

Third, it is M-S-R's understanding that only a modest subset of BPA's hydro resources are capable of providing the required ancillary services. Yet all BPA hydro resources are included in the cost of service calculation, which does not follow cost causation or benefits.

Allocation of Costs to Capacity and Energy

BPA's hydro system represents a unique mix of very high fixed costs and relatively modest variable costs, since water, the fuel of a hydro plant, is almost zero cost. However, M-S-R understands that BPA's rates for its Power customers collects most of its revenue from volumetric charges ("variable rates") and a modest portion from demand charges ("fixed costs"). M-S-R does not understand why that same weighting towards energy does not take place when BPA calculates its Gen Inputs rates, where BPA is proposing to assign nearly 50% of the costs to capacity (demand charges) and 50% to energy charges ("variable charges").

Further M-S-R understands that BPA intends to reflect market rates for the energy component in its ancillary service, thus creating the very likely result that the demand charge plus the energy charge (schedules 9 & 10) in the Pro Forma Tariff will be materially higher than the fully allocated cost of the assets designated to provide ancillary services, meaning the rates are above cost-based rates.

Priority of Service

During the workshop, BPA clarified that it intends to continue the practice of assigning the first 400 MWs of capacity to native load service, and reserves will only be available to support services such as VERBS if there is more than 400 MWs of capacity available. However, the lower priority is not reflected in pricing of the reserves products.

Implications for the Strategic Plan

BPA's Strategic Plan indicates that it will emphasize cost based rates, equity between customer groups, market competitiveness, and strong cost management. The Gen Inputs Proposal is in conflict with critical elements of the Strategic Plan.

First, there is not equity between the customer groups. Ancillary service customers likely will be charged more than the cost based rates would justify, ignoring the inclusion of assets that are not available for ancillary services, and ignoring the secondary priority afforded reserves for ancillary services.

Second by any reasonable evaluation BPA's ancillary service Gen Inputs rate is not competitive. BPA has indicated that it VERBS customers will reduce their subscription to BPA's VERBS service from approximately 4800 MW to 1900 MW- a loss of 2900 MW of customer volume over a period of approximately four years. Public filings indicate the high VERBS rates play a part in the departures. Those remaining VERBS customers likely do so not by choice but due to a lack of any realistic alternative. The methodology being proposed does nothing to address this issue, as it results in approximately the same rates as the old methodology.

Implications for Future Revenue Enhancement

In various workshops over the past several months BPA has indicated that material revenue losses from secondary sales and loss of VERBS customers have created some urgency to find new sources of revenue to replace these lost revenues. The most likely source for new revenues is in the provision of ancillary services to utilities managing relatively high levels of variable resources. Unfortunately, rather than expanding its customer base for ancillary service for variable resources, BPA has adopted pricing policies that have incentivized nearly 60% of its variable resource customers to terminate service. Although BPA indicated it intends to price services to the market at negotiated rates, rather than use the method proposed for tariff service, it appears that a more effective approach is to develop a reasonable cost of service methodology that will allow BPA to responsibly price its ancillary service(s) at a level that will be competitive with other market alternatives.

Inconsistent with other BPA Approaches

Traditionally, BPA has priced its customer services to Tariff customers on a cost of service basis. Gen Inputs seems to represent a material departure from traditional practice. The proposed cost of service

methodology includes resources whose output is restricted to certain customer groups but whose costs are to be paid for by all customer groups. The proposed cost of service methodology likely will result in Gen Inputs customers paying more than the revenue requirement associated with the resources included in BPA's proposed methodology. They will be the only Tariff customer group required to pay rates above cost.

In summary, M-S-R is sympathetic to the competing interests underlying BPA's decisions for development of a framework for Gen Inputs, but it appears the new methodology has features that are outwardly worse than the old methodology, and achieve the same general price range that has been rejected by the majority of BPA's wind customers.