Testimony of
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Subcommittee on Water and Power
" Opportunities and Challenges on Enhancing
Federal Power Generation and Transmission"

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Introduction

Mr. Chairman, Ranking Member and members of the Committee, my name is C. Clark Leone and I am the manager of the Public Power Council. PPC is a regional trade association representing Bonneville Power Administration's (BPA) consumer-owned utility customers. PPC's 114 members consist of municipal and cooperative utilities and public utility districts (PUDs) located in Oregon, Washington, Montana and Idaho. These consumer-owned utilities purchase power and/or transmission from BPA and provide the largest share of BPA's income, which is used to meet BPA's repayment obligations to the U.S. Treasury and all other BPA operating and program costs, such as BPA's obligations to provide benefits to the small farm and residential customers of the region's investor-owned utilities (IOUs), to implement the fish and wildlife mitigation programs, and to fund the development of conservation and renewable resources.

As the entities that pay the bulk of BPA's bills, we appreciate the opportunity to testify today on the important issues on enhancing BPA's generation and transmission resources. In my testimony today, I will highlight the need for

1. retaining the historical cost-basis for BPA power rates;
2. access to capital for transmission investments to ensure the reliability of BPA's transmission system;
3. coordinated regional planning to improve the operation of the regional transmission system;
4. significant reductions in BPA's power costs in the near and long-term; and
5. a move towards cost-effective fish and wildlife mitigation measures.

Administration's Market Rate Proposal

Mr. Chairman, nothing presents more of a challenge to enhancing BPA's role in the Pacific Northwest's power and transmission markets than the Administration's recent Budget proposal to require a 20 percent increase in BPA's power rates per year until those rates are equal to market. While the Budget claims this change is needed to redress so-called "subsidies," the fact is that BPA's customers repay - in full and with interest - the federal investment in the power component of these multipurpose water projects and recover all costs of BPA's operations. This radical proposal would overturn nearly a century of statutory requirements that federal power be sold at cost-based rates and would devastate the financial well-being of PPC members and their communities.

In 1996, BPA's customers, tired of claims that they were subsidized by taxpayers, agreed to pay the U.S. Treasury of $100 million to reconstitute BPA's debt. The legislation set the interest rate on BPA's debt at then-current interest rates of approximately 7 percent and raised BPA's rates to recover the $100 million payment.

Now the Administration wants more money from Northwest consumers. If the Administration's proposal were implemented today, a 20% rate increase would cost NW consumers $480 million dollars in the first year, $960 million in the second year and $1.1 billion in the third year of implementation. This amounts to over $2.5 billion dollars in 3 years. By the fifth year of implementation, BPA's power rates would double.

The Administration's proposal is not only arbitrary but is unworkable. The 1996 Debt Buy-Out legislation required BPA to offer its customers a contract right to sue for damages under the U.S. Judgment Fund if BPA's rates were set to recover more than the cost of reconstituting BPA's old debt. A 20 percent increase in BPA's rates would trigger this contract right and may result in damages paid by U.S. taxpayers.

PPC opposes this legislation and would urge the Committee to oppose it as well.

Challenges and Opportunities on Enhancing BPA's Transmission Resources

Overview of BPA's Transmission System

BPA owns and operates approximately 75% of the Pacific Northwest's high voltage transmission system. BPA's system includes 15,000 miles of transmission line and 285 substations. The lines network across 300,000 square miles in the states of Oregon, Washington, Montana, Idaho and small sections of Wyoming, Utah and California. Within its system, BPA operates the Pacific Northwest portion of interties with California. Not only does BPA's transmission system provide facilities for the delivery of power to PPC member utilities, industrial customers and investor-owned utilities in the region, but BPA's system also allows the delivery of power between Canada, the Pacific Northwest and California. Thus BPA's transmission system is the backbone of the entire Pacific Northwest's power system and is an integral component of North America's western power system.

Collectively, consumer-owned utilities are the largest users of BPA's transmission system. Not only do they receive power over BPA's lines, but in some cases, BPA entered into contracts with other transmission owners to use non-federal transmission lines to deliver federal power to public preference customers. These contracts, called General Transfer Agreements (GTAs), were viewed as a more efficient way to deliver power to statutory customers. Rather than duplicating an existing transmission line, BPA entered into long-term contracts to deliver power to customers. A little over half of PPC's members receive federal power deliveries through GTAs.

Ensuring Reliability and Efficiency of BPA Transmission System

Access to Capital Financing

A significant challenge for enhancing BPA's transmission system is the need for infrastructure investment to shore up the aging system and keep pace with load growth in the region and reliable access to capital to accomplish this goal. Since 2000, PPC has worked with and supported BPA's efforts to upgrade and expand its transmission system. At that time, BPA realized that it could no longer ensure the reliable delivery of power to customers over its aging system. The system was quickly reaching capacity usage and new transmission lines and upgrades to existing lines were necessary. Identified repairs and investment in the transmission system were estimated to exceed the limit on BPA's authority to borrow funds from the U.S. Treasury.

Over the next three years, BPA worked with its customers, the NW congressional delegation and the Administration to secure additional borrowing authority – identifying priority projects and the funds necessary to complete those projects. PPC supported BPA's request for $1.3 billion in additional borrowing authority. A key issue for the Administration was the need for BPA to seek third-party financing of transmission system investments. BPA agreed to do so, and in the Fiscal Year 2004 Energy & Water Development Appropriation bill, received congressional approval for $700 million in additional borrowing authority. The general understanding at the time was that BPA would seek third-party financing to make up the $600 million difference between the agency's original request and the actual amount authorized.

The following year, the Administration's Fiscal Year 2005 Budget contained a proposal to reclassify certain third-party financing arrangements entered into by BPA as federal obligations, and indicated its intent to transmit legislation to Congress along these lines. The Administration has included this proposal in its recent FY 2006 Budget as well.

While we have yet to see specific legislative language, the intent of the Administration's proposal is clear: any third-party financing of BPA's transmission system would count against BPA's ability to borrow funds from the U.S. Treasury. In essence, the $700 million in additional authority that BPA received would be reduced by third-party financing arrangements and could effectively amount to zero additional funds to build priority projects. Third-party financing would no longer a viable tool for BPA to make priority improvements to ensure the reliability of its transmission system.

PPC opposes any legislative proposal that would hamper BPA's ability to make reliability and efficiency investments on its transmission system. As noted earlier, BPA's transmission network is the backbone of the Pacific Northwest's transmission system. BPA is currently the only utility in the region making significant investments in its transmission system. These investments are sorely needed to meet the region's growing energy needs and to ensure cost-effective and reliable operation. While the Administration may have legitimate policy reasons to reclassify BPA's debt, those policy objectives must be reconciled and balanced against BPA's statutory obligation to ensure a reliable and cost-effective transmission system.

PPC urges the Committee to ensure BPA's ability to maintain a reliable and cost-effective transmission system and to facilitate needed investments in the system. To do this, BPA must have access to capital whether it is through increased borrowing authority or through other mechanisms.

Ensuring Near-Term Improvements to the Regional Transmission System

In addition to ensuring the reliability of BPA's transmission system, improvements must be made in the near-term to the operation and planning of the regional transmission system. PPC has joined with several regional private and consumer-owned utilities and agencies to form the Transmission Issues Group (TIG). The goal of the group is to identify problems in the operation and planning of the regional transmission system and to develop solutions that can be achieved in the near-term, or two to three years.

TIG has developed a package of practical, cost-effective, and incremental changes to improve the operation and planning of the system. Those improvements include reducing or eliminating excess transaction costs for use of multiple transmission systems; coordinated regional transmission planning and expansion; enhanced reliability and security of the system; market monitoring; and simplifying transmission access when multiple systems are involved.

More work is needed to develop further and implement the identified near-term improvements. Given BPA's significant ownership of the regional system, BPA's involvement in TIG is crucial to ensuring the implementation and success of these improvements. Last fall, BPA committed staff to working with TIG on developing near-term improvements to the regional transmission system. In addition to staff time, BPA should commit funding to aid implementation and the realization of the system improvements. PPC urges the Committee to seek BPA's commitment to contribute funding to TIG's efforts to implement near-term improvements to the transmission system.

Opportunities and Challenges on Enhancing BPA's Generation Resources

Overview of BPA's Power System

Since 1937, BPA has been charged with selling, at cost, the electric power generated at federal dams along the Columbia River and its tributaries to statutory customers. Today, BPA supplies about half the power needs of the Pacific Northwest.

PPC's members are statutorily entitled to priority and preference to the power marketed by BPA, which today consists of power generated at 31 federal dams, Washington Nuclear Plant No. 2, and several renewable projects. Consumer-owned utilities in the region are BPA's largest customer base. As mentioned earlier, PPC's members are responsible for the largest share of BPA's costs.

In the 1980 Northwest Power Act, BPA was given the responsibility of meeting the load growth to the region. Under that law, BPA is statutorily responsible for purchasing sufficient electric power to meet the needs of its customers. BPA's authority is limited in that it cannot own generating facilities, but may contractually acquire the output of new facilities.

In the mid-1990s, electric utility restructuring changed the manner in which the west coast utility industry planned to meet customer peak demand and short-term load growth. BPA, as did other utilities, began to rely on the market for acquisitions of electric power; when faced with an unexpected increased demand from consumer-owned utilities, turned to the market for supply. Coupled with a historical drought and the collapse of the California market, BPA's power rates increased by almost 50 percent. BPA's power rate increase has hit PPC member communities very hard. For a number of years, Oregon and Washington have had the highest unemployment rates in the country. BPA's power rates had serious consequences for the regional economy. BPA has taken a number of steps to reduce this rate increase, yet a significant reduction in BPA's power rates is not expected anytime soon.

Lowering BPA Power Marketing Costs

A significant challenge for BPA in the near- and long-term will be to lower its costs and reduce its power rates to pre-2001 levels. BPA must do this by lowering its internal operating costs and by reducing its reliance on the volatile wholesale electricity market to meet its contractual obligations to sell power.

In response to BPA's high costs, PPC and its members have supported several initiatives geared toward lowering BPA's overall operating costs. Those initiatives include working with customers to identify cost cuts, involving customers in review of BPA's power costs, and a broad review of BPA's ability to provide value to the region at the lowest possible cost.

A significant step to lowering BPA's costs in the long-term would be to remove BPA's obligation to acquire resources to meeting load growth, as required under law. PPC's Executive Committee took an historic vote in June 2004 approving a proposal that would require consumer-owned utilities, not BPA, to acquire resources to meet load growth. The proposal advocated for allocating the existing Columbia River Power System resources among customers. Any customer or group of customers could seek BPA's help in acquiring resources, but the cost of that acquisition would be passed on by contract to that customer or group rather than melded into the overall power rate charged to consumer-owned utilities. This proposal would reduce BPA's overall costs by removing its responsibility to purchase power to meet load growth and reducing its reliance on the volatile wholesale market.

BPA must also carefully consider the cost impacts of the benefits it provides to the region's investor-owned utility residential and small farm customers (IOU customers) and the remaining Direct Service Industrial (DSI) customers. Both of these costs have a direct impact on the level of the power rates paid for by BPA's consumer-owned utility customers. While PPC does not challenge BPA's obligation to provide benefits to IOU customers, BPA is no longer obligated to provide benefits to the DSIs.

The existing level of benefits provided to the IOU customers and the contractual terms of that arrangement have had a direct effect on the high level of BPA's rates. In 2002, BPA decided to no longer follow traditional residential exchange procedures under the Northwest Power Act, which help to reduce the costs of electric service to the IOU customers. Instead, BPA provided power to the IOUs for service to their residential and small farm customers. This decision exacerbated BPA's reliance on the market for power and contributed to BPA's almost 50 percent power rate increase. Currently, the residential customers of BPA's consumer-owned utilities are paying higher costs to subsidize the cost of service to IOU customers. IOU customer rates are now lower than consumer-owned utility rates due to BPA's new approach to providing benefits to IOU customers. PPC supports a return to the traditional residential exchange program as provided for by Congress under the Northwest Power Act.

As mentioned above, BPA is no longer statutorily obligated to sell power to the DSIs. The DSIs are industrial customers identified in the Northwest Power Act as historical customers of BPA. These customers are mainly made up of aluminum companies that located in the Pacific Northwest during the early days of construction of the federal dams on the Columbia River. BPA was required by Congress to enter into 20-year power sale contracts with the DSIs, and was prohibited from selling power directly to any new large industrial customer. Once those contracts expired in 2000, BPA's obligation to sell power to the DSIs expired. Due to the highly competitive Russian and Asian aluminum industries, few DSIs continue to operate today. Any sale of power by BPA to the DSIs must be purchased by BPA from the market or other sources. The costs of those purchases are rolled into the power rate paid by PPC's consumer-owned utilities. Sales to the DSIs, therefore, raise consumer-owned utilities rates and the cost of electric service to the communities PPC's members serve. PPC is in the process of determining the level of DSI benefits its members will support.

Cost-Effective Fish and Wildlife Mitigation
Finally, a key factor in the high cost of BPA power is BPA's fish and wildlife program. BPA's fish and wildlife program is defined by its obligations as a federal agency under the Endangered Species Act and its obligations to mitigate for harm caused to fish and wildlife under the Northwest Power Act.

To date, BPA's has contributed $6 billion to comply with requirements to recover salmon species listed as threatened or endangered under the ESA and to mitigate for harm caused to fish and wildlife by the hydroelectric system. This funding has paid for various mitigation measures and programs that include $3 billion in lost power revenues and purchase power costs.

The current revised 2004 Biological Opinion for the Columbia River Power System would have BPA paying $600 million annually to recover listed salmon species. Additionally, fish and wildlife mitigation program spending under the Northwest Power Act is estimated at $139 million a year and is expected to increase significantly in the future. State and Tribal fish and wildlife managers have requested an increase in this funding to $460 million annually.

All costs for both ESA measures and the regional fish and wildlife plan under the Northwest Power Act are paid through BPA rates. As the customers picking up the largest portion of BPA's costs, PPC members pay the bulk of BPA's fish and wildlife funding.

PPC members support efforts to recover listed salmon species and to mitigate for harm caused by the hydroelectric system on regional fish and wildlife. We do not, however, support measures that are not beneficial to fish and wildlife. Early in BPA's fish and wildlife mitigation program, many measures were funded that, over time, have been proven to provide little benefit to listed species in relation to the measures high costs. For instance, the summer spill program costs $88 million per year and was identified as not cost-effective – alternative measures were identified that would provide the same benefits to salmon and cost almost $80 million less than the summer spill program.

In light of BPA's high power rates and the depressed economy in the Northwest, PPC members and the communities they serve should not be required to pay for measures that independent scientific analysis proves ineffective in recovering listed species or not helpful in mitigating the damage caused to fish and wildlife. As the entities that are legally required to pay for BPA's costs, we are motivated to speed recovery of ESA listed species. Continuing to pay for costly measures that are proven to provide little or no benefit to listed salmon species will not increase the likelihood of recovering these species. Such measures will instead continue to inflate the cost of BPA power and depress the economies of the Pacific Northwest.

PPC urges the Committee to support actions to lower BPA's overall power costs through reducing BPA's internal operating costs, the agency's dependence on the volatile wholesale market, and supporting cost-effective fish and wildlife mitigation measures.

Conclusion

Mr. Chairman, as I hope my testimony has demonstrated, BPA plays a unique and integral role in the economy of the Pacific Northwest. By owning and operating 75 percent of the region's high-voltage transmission and supplying roughly 50 percent of the region's power needs, BPA is the backbone of the region's electric power system. Given current challenges, BPA's ability to continue providing benefits to the region could diminish. We urge the Committee to ensure that

- BPA continues to charge cost-based, as opposed to market-based, rates;
- BPA has access to capital for critical infrastructure improvements to its transmission system;
- BPA makes a significant contribution towards regional transmission system planning and operational efficiencies;
- BPA takes concerted steps to lower power costs through allocating power among customers and reducing its dependence on the volatile wholesale energy markets; and
- federal and regional fish and wildlife mitigation measures are cost-effective.

On behalf of PPC's members, I appreciate the opportunity to appear before you today.