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January 4, 2012

MEMORANDUM

TO: Power Committee

FROM: Terry Morlan

SUBJECT: Background on Bonneville's Capital Budget and Proposed Cuts in Conservation Funding

Bonneville is scheduled to discuss its federal borrowing cap and capital budgets with the full Council. A related issue is the overspending of Bonneville's conservation capital budgets in 2011 and its implications for available future conservation acquisition compared to the Council's Sixth Power Plan targets. A Bonneville document entitled "Draft Decision Document: Energy Efficiency Capital Fundings, November 2011" is attached as further background.

Council comments on Bonneville's post-2011 efficiency program encouraged Bonneville to provide more year to year budget flexibility to capture uneven conservation opportunities. In staff's view, at least, the overspending in 2011 allowed Bonneville to capture important savings that were available at relatively low cost. It is important to recognize that such savings may be more difficult in future years and may cost more. Savings not captured because of budget reductions could jeopardize Bonneville's ability to meet the Council's targets, and could leave additional cost-effective savings unachieved. As the Council has consistently pointed out, the targets are a minimum goal, not a maximum. The targets are a result of fairly arbitrary constraints on the rate of acquisition the Council thought could be achieved. If we could do more, faster, it would result in a lower-cost and less risky power system and delay investment in higher cost generating resources.

It is fundamental that Bonneville is committed to meeting the Council's conservation targets; and Bonneville has been very successful in doing so. Bonneville believes that it will meet its share of the 5-year targets from the Sixth Power Plan. Nevertheless, the Council may wish to seek some clarification about Bonneville's proposed longer-term conservation budget cuts and how it hopes to achieve the Council's conservation targets in spite of the cuts.

Staff will provide a background presentation at the Power Committee meeting.

Attachment

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DRAFT Decision Document:

Energy Efficiency capital funding

November 2011

Background

Since July, BPA has been monitoring an expected overrun in its capital budgeted for energy efficiency incentives, primarily those provided under Energy Conservation Agreements. Sept. 30 marked the end of the 2011 fiscal year, allowing BPA to begin a final accounting of the size of the overrun. We have also been in ongoing discussions with our public utility customers and other stakeholders over possible strategies for addressing the overrun, including adjustments in future years.

In our Sept. 12 decision document, we confirmed that the 2011 fiscal year capital costs for energy efficiency were expected to exceed the \$115 million in the mid-year forecast. Capital costs are used to fund regional programs (such as the Energy Smart Grocer and Energy Smart Industrial program), infrastructure projects (such as EE Central) and incentive and associated performance payments to utilities for qualifying energy efficiency efforts under Energy Conservation Agreements. The ECAs were established in late fiscal year 2009 as five-year agreements (fiscal years 2010 through 2014) to provide utilities with funding certainty and utility budget management across years. The ECAs established the amount available from BPA to each utility for qualifying conservation and associated performance payments.

When the ECAs were established, the implementation budget did not allocate funds to specific fiscal years. A utility could access its ECA funds at any time during the contract period. In April 2011, after much dialogue with external stakeholders, BPA announced that, beginning on Oct. 1, 2011, each utility's ECA implementation budget would be re-set to equal its allocation of BPA's Energy Efficiency Incentive for the rate period. The allocation is based on the utility's share of the Tier One Cost Allocator. This change is consistent with the new Regional Dialogue contracts and tiered rates.

The Overrun. As BPA authorized additional ECA funding during the 2011 fiscal year, our projected utilization rate increased significantly. Toward the close of the third quarter, the energy efficiency representatives worked with utilities to estimate each utility's forecast for ECA invoicing over the remainder of the fiscal year and discovered that, even if utilities completed only a fraction of projects underway by the end of the 2011 fiscal year, BPA would greatly exceed its budget.

In anticipation of the budget overrun, BPA met with customers and other stakeholders in August and outlined several approaches for managing capital spending in future years. Each of these



approaches reflected our decision to keep total capital spending on energy efficiency during the five-year period (fiscal years 2010 through 2014) at or under the Integrated Program Review level of \$459 million. Based on utility feedback, BPA agreed to maintain fiscal year 2012 EEI budgets at levels previously established while addressing the fiscal year 2011 budget overrun by making adjustments to fiscal year 2013 and 2014 EEI budgets. The approaches discussed are presented below.

1. **Level impact approach** – This approach spreads the impact of the 2011 fiscal year capital overspend proportionally across all customers with 50 percent of the overspend coming from fiscal year 2013 EEI funds and 50 percent from fiscal year 2014 EEI funds. Essentially, each customer would receive the same percentage of EEI funds they would have before the overspend but from a smaller base because the EEI budgets would be reduced to offset the overspend.
2. **Equity impact approach** – This approach targets the impact of the 2011 fiscal year capital overspend on the utility customers who, in the 2011 fiscal year, spent beyond the share they would have been allocated if BPA had used the Tier One Cost Allocator mechanism for establishing EEI budgets.
3. **Hybrid impact approach** – This approach melds the impact of the 2011 fiscal year overspend by reducing fiscal year 2013 and 2014 budgets through applying 50 percent of the overspend using the level impact approach and 50 percent of the overspend using the equity impact approach.

Of these three alternatives for rebalancing future utility Energy Efficiency Incentives, we had previously indicated we were leaning toward an approach between the published hybrid and equity approaches but that we would not make a decision until after a complete accounting of fiscal year 2011 spending.

Future approach

Our fiscal year 2011 accounting books are now closed and the final tally for the fiscal year 2011 efficiency capital spending is \$161.7 million. While we had expected a significant overrun, we are disappointed that the number is as high as it is. Although it was not until late in the year that we realized spending could be excessive, we were hopeful our collective focus on the budget would slow down the level of spending once our utility customers understood that we expected to exceed our budget and that an overrun would affect future funding levels.

BPA has considered the three alternatives and the feedback it has received from its customers and stakeholders. Some parties urged BPA to find a way to increase the fiscal year 2013 and 2014 budgets to avoid reductions that would be required if the agency adheres to the overall five-year budget amount of \$459 million. Others commented that a large reduction would threaten the positive momentum achieved this year.

BPA considered the input but has decided it is important to stay with the overall five-year budget set in 2009 that aligned with the Integrated Program Review and the Northwest Power and Conservation Council's Sixth Power Plan. BPA believes that staying on budget is important for



rate stability and prudent and predictable budget management. We had also previously decided against suggestions to reduce our energy efficiency expenditures due to the recession. Future Integrated Program Review processes will determine new budgets for fiscal year 2014 and beyond and provide an opportunity for all parties to advocate for changes in those budgets.

In our discussions with customers and stakeholders, we heard support for both the level impact solution and the equity impact solution. The size of the overrun, however, has swamped all expectations from the start of the year when we anticipated that conservation costs would follow the pattern of past years. We believe that some amount of the equity impact approach must be included in the solution. BPA is also sympathetic to the logic that, since we started the year with the expectation of using a level impact approach, it would not be fair to completely change the rules now and go fully to the equity based approach. Because these two arguments are equally valid, BPA believes it is appropriate to establish fiscal year 2013-2014 EEI amounts according to the hybrid approach. Further, fiscal year 2013 and 2014 budgets can be supplemented by customer self-funding conservation dollars that were not spent in the 2011 fiscal year. Budgets beyond fiscal year 2014 will be determined later. The individual utility impact numbers are included as an attachment.

Energy Efficiency 5-Year Budget				
\$459 Million				
2010 Actual	2011 Actual	2012 Budgeted	2013 Forecast	2014 Forecast
\$58	\$162	\$89	\$72	\$78

While fiscal year 2013 and 2014 budgets will be reduced, the impact will be softened somewhat by the fact that fiscal year 2012 budgets remain unchanged. We will also provide EEI funds on a rate period basis during the fiscal year 2012-2013 rate period, which allows EEI spending to be shifted between the two fiscal years within the two-year EEI budgets. The question of whether EEI funds are provided on an annual or rate period basis in fiscal years 2014 and 2015 will be decided at the same time fiscal year 2015 budgets are set.

Final feedback period

We will not finalize the decisions reflected in this paper – in particular the hybrid approach and the within-rate-period EEI budget flexibility – until Nov. 17, 2011, to give regional parties a final chance to consider their specific impacts and whether they would like to provide BPA additional input prior to our concluding decision.



The documents BPA shared during the summer as these budget issues and approaches for addressing them were discussed have been posted to BPA's website at <http://www.bpa.gov/Energy/N/EECBI.cfm>.

The Aug. 4 presentation contains detailed explanations of the energy efficiency capital funding history. The BPA proposal and supporting data documents outline the three alternatives for balancing future incentive funding.

The conservation achievement

While fiscal year 2011 conservation spending greatly exceeded the established capital budget with resulting consequences for the fiscal year 2013 and 2014 budgets, it is also important to keep in mind that the region achieved what is likely a record high level of energy efficiency savings. We far exceeded the 2011 fiscal year conservation target, accomplishing a currently estimated 117 average megawatts as compared to a target of 99 aMW and at a per average megawatt cost well below the target (\$1.7 million compared to a target of \$2.2 million). The increased energy savings associated with the overspend means that the region is enjoying the economic and environmental benefits of the energy savings sooner than originally planned and likely at a lower unit cost than had these same savings been achieved in future years. With the continued challenges facing the economy and the elimination of the compact fluorescent light bulb program, it is also not certain that these savings will continue to be available to the same extent or at the same cost. BPA will work with the Northwest Power and Conservation Council to confirm achievement of the Council's five-year conservation target at the Council's interim review.

Conclusion

We recognize the difficulty that the fiscal year 2011 capital spending situation has created for everyone involved and are attempting to chart the fairest and most balanced course to address the situation. We also recognize that, no matter which solution we choose, there will be some parties applauding our decision and others frustrated with it. Our intent is simply to make the best of a difficult situation. To that end, please send your feedback to comment@bpa.gov, or, if you wish to talk directly with us about the situation and our proposed set of remedies, please call Mark Gendron, vice-president for Requirements Marketing, through Nov. 15 at 503-230-7640 or Greg Delwiche, senior vice-president for Power Services, after Nov. 15 at 503-230-4452.



Topics to be Covered

- Bonneville's share of the Council target
- Historical costs of conservation savings
- Expected savings from proposed capital funding levels



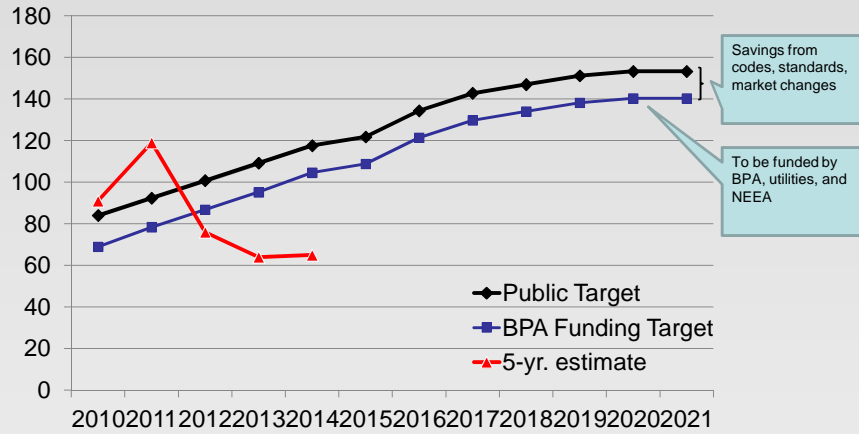
Bonneville's Initial 5-Year Target

- 1200 aMW = Council 5-year target
- 504 MWa = Bonneville share of 5-yr Target
- How does Bonneville plan to reach the target?
 - - 76 MWa = Non-programmatic, codes, etc.
 - - 76 MWa = Through NEEA
 - 353 MWa = Bonneville programs
 - - 88 MWa = Utility funded share 25%
 - 265 MWa = Bonneville capital funding target

- **BPA revised estimate is 282 MWa**



Long-Term Target for Conservation in Publics and 5-Year Estimate of Savings



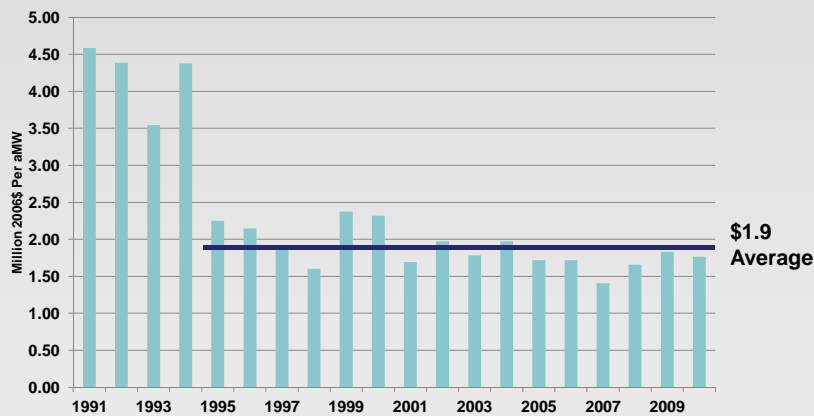
IPR Conservation Budget, Actual 2010-11, and Proposed 2012-14 (Millions)

	2010	2011	2012	2013	2014	Total
IPR Budget	\$47	\$80	\$104	\$111	\$117	\$459
2010-11 Capital Spending	\$58	\$162				\$459
CRC Funding	\$41	\$12				
Revised 2012-14			\$83	\$79	\$78	



Historical Utility Cost of Conservation Acquired through BPA, NEEA and Utilities

Average Cost of Utility Savings



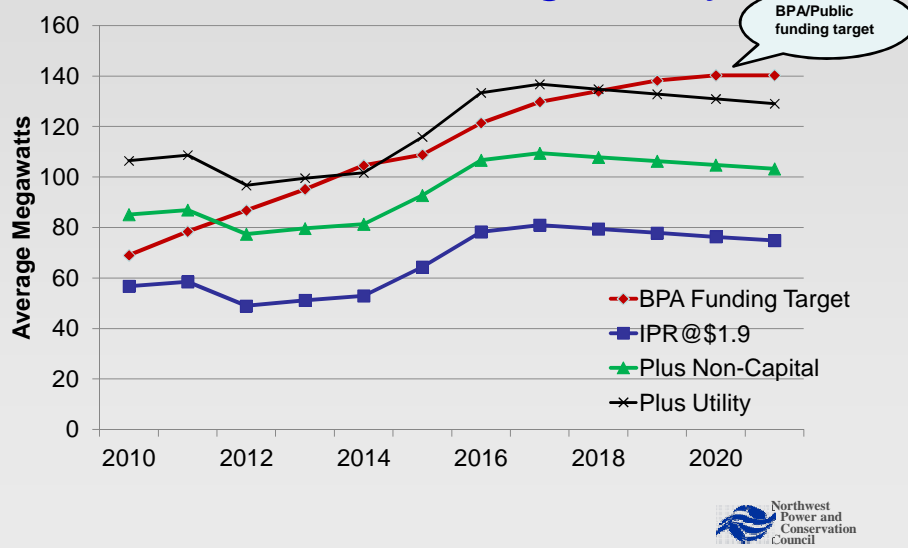
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Aligning The Cost Estimate and the Savings Targets

- The historical \$1.9 million per MWa includes utility and NEEA savings, but not codes and includes all spending not just capital \$
 - Appropriate target is 429 Mwa (353 MWa + 76 NEEA) for utility funded, out of 504 MWa total
 - To estimate savings, BPA capital and expensed, NEEA, and utility self-funded spending should be divided by \$1.9 million per MWa

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At Historical Costs What Would BPA's IPR Budget Buy?



Why Is There Concern?

- Discussion of significant funding reductions in borrowing cap discussions
- Targets are not a cap on conservation, Act says acquire all cost-effective, plan demonstrated faster better
- 2010-11 were successful years
 - CFLs, industrial low-hanging fruit, ARRA funds, tax credits
- Achieving savings in 2013-14 may be harder and cost more
- Continuity of programs and business relationships behind successful programs is important
- Success depends on public utilities funding 25%, non-programmatic savings, and continued non-capital funding

Mitigating the Concerns

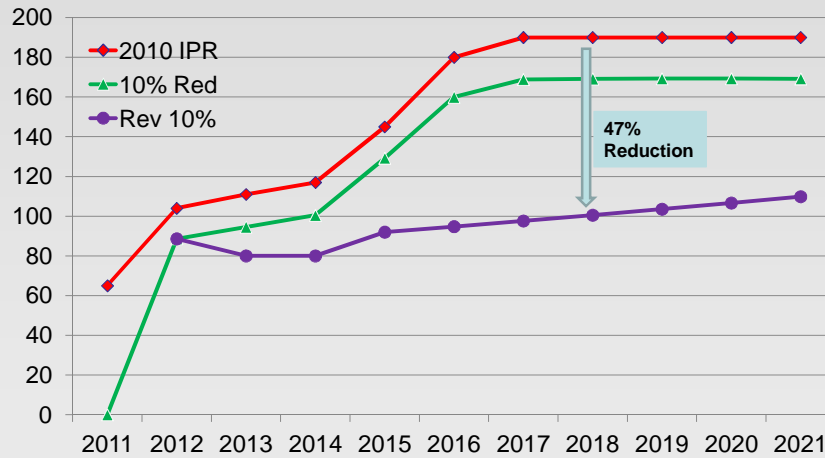
- Bonneville has committed to meeting the targets
- Region has exceeded conservation targets for last several years
- Budgets and programs are adjustable, especially after 2014
- Codes, standards and market changes may contribute to increased savings, lowering future plan targets (?)
- Potential for increased savings at lower cost from utilities, NEEA, ETO, and improved programs
 - Or not



Backup Slides



Bonneville Proposal to Reduce Capital Budgets for Conservation



What Would the 5-year Budget Need To Be Based on \$2.2 Million Per Average Megawatt?

- 265 Mwa = Bonneville capital funding target
- At the assumed cost of \$2.2 million per Mwa, required capital budget would be \$583 million
- IPR 5-yr. conservation capital budget = \$ 459 million
 - This 5-year budget is maintained in the proposed capital spending cuts
 - Overspending in 2010-11 made up by cuts in 2012-14



Spending for Conservation During 6th Action Plan (Millions)

	2010	2011	2012	2013	2014	Total
IPR Budget	\$47	\$80	\$104	\$111	\$117	\$459
Actual & Proposed	\$58	\$162	\$89	\$72	\$77	\$459
Difference	+11	+82	-15	-39	-40	0



What Savings Can Be Expected From These Budgets?

- Bonneville's IPR assumed that savings cost \$2.2 million per MWa
- This assumption is consistent with the last 15 years. [\$2.2 million in 2015 converted to 2006\$ equals \$1.9 million]
- Bonneville costs per MWa were lower in 2010-11 (\$1.6 and \$1.5 excluding some expenses); expect to get 2012-14 @ \$1.7 million per MWa in 2006\$
- At these costs, Bonneville could meet the 5-year target, if....



Bonneville Capital Budgets for Conservation (2006\$)

