

MEMORANDUM

May 12, 2020

TO: Kevin Nordt, General Manager

VIA: David Churchman, Chief Customer Officer

FROM: Bob Brill, Economist

SUBJECT: Grant PUD Response to the March 23, 2020 USBR and BPA ROE Comments

Introduction

At the January 27, 2020 Commission Workshop, the Transmission Cost of Service Study (COSS) was presented to the Commissioners. The COSS reflected a transmission cost to serve of \$26.3 million, with a Return on Equity (ROE) of 9.80%. At the March 10, 2020 Commission Meeting, staff presented its ROE memorandum explaining why the ROE was necessary. As a result of that March 10, 2020 discussion both the United States Bureau of Reclamation (USBR) and Bonneville Power Administration (BPA) (jointly the parties) submitted comments and questions on March 23, 2020 concerning the use of an ROE in Grant's Transmission COSS. The purpose of this report is to address these comments and questions.

Grant PUD Response

Grant PUD's Transmission COSS development is consistent with the Federal Energy Regulatory Commission (FERC) transmission ratemaking concepts used for regulating electric wholesale transmission "wheeling" investor owned utilities (IOU).¹ Part of FERC regulation authority is approving IOU rate cases, when the IOU requests rate and tariff modifications. If an IOU is seeking a rate adjustment through a rate case, a component of its cost to serve is its ROE calculation. Grant's Transmission COSS was developed to mirror FERC transmission "wheeling" ratemaking concepts, including its proposed ROE calculation.

The parties argue that Grant should not be allowed to recover an ROE from its transmission customers and that the use of an ROE is inappropriate for a variety of reasons, such as:

- The ROE does not accurately reflect the actual capital costs that Grant Public Utility District (Grant) needs to recover (O&M expenses, A&G expenses, and annual debt service);
- Grant is not subject to the same obligations as an investor-owned utility;
- ROE should be based on the needs of Grant and its customers, not just general comparisons to other differently situated utilities that must attract equity investors seeking a ROE;
- The ROE formula is for solving shareholder profit, not estimating future asset growth; and
- There is nothing about future projects or costs in the record that could justify adding \$33 million per year to the COSS.
- FERC rate cases where it allowed an ROE for a cooperative utility in an RTO as part of an unopposed settlement of that RTO's tariff is not comparable to Grant PUD. The use of a FERC approved rate for a cooperative utility in an RTO is not applicable to Grant and that an ROE is inappropriate for a PUD.

¹ FERC regulates all investor owned utilities that provide transmission "wheeling" services.

In this document, staff provides its response to the parties' arguments reflected in their comments and questions.

FERC Jurisdictional Authority

USBR argued that Grant has refused to subject its ratemaking to FERC jurisdiction. Grant is not FERC regulated, but under Section 211A of the Federal Power Act, at 60,² FERC has the authority to investigate non-jurisdictional utilities where a complaint is filed claiming discriminatory or preferential treatment.

Even though Grant is not FERC regulated, Grant's goal is to provide non-discriminatory, non-preferential transmission services to all customers, including Grant's own retail customers. The use of the network transmission system by all transmission customers is referenced in the white paper from August 17, 2017 prepared by Brent Bischoff (Sr. Manager Power Delivery Engineering). Within the document Mr. Bischoff discusses how Grant PUD's electric system is designed and operated.

This paper states in Part:

The Grant County PUD electric distribution system is designed as a networked system. This design practice is common in the electric utilities industry in order to provide the most reliable possible electric service to customers...This ensures that outage frequency and duration to utility customers are kept to a minimum...The distribution system is a networked system designed to provide the highest level of reliability and service to each customer regardless of their location in the service territory.

...Since electric distributions systems are networked and provide equal quality of service to all customers, it is common utility practice to spread the cost to build, operate and maintain the system equally among customers... [Emphasis added]

Transmission COSS ROE Calculation

The Transmission COSS model uses a cost of capital calculation to reflect the financing costs associated with Grant's capital costs. *Rather than adjusting target revenue to meet financial metrics and obtaining cash necessary for capital investments, the Grant's Transmission COSS method estimates the cost of capital, which includes the cost of equity (ROE) in the market and treats this as an operating cost.*

² Section 211A., Open Access by Unregulated Transmission Utilities.

(a) Definition of Unregulated Transmitting Utility-In this section, the term "unregulated transmitting utility" means an entity that –

- (1) Owns or operates facilities used for the transmission of electric energy in interstate commerce; and
- (2) is an entity described in section 201(f).

(b) Transmission Operation Services. - Subject to section 212(h), the Commission may, by rule or order, require an unregulated transmitting utility to provide transmission services –

- (1) at rates that are comparable to those that the unregulated transmitting utility charges itself; and on terms and conditions (not relating to rates) that are comparable to those under which the unregulated transmitting utility provides transmissions services to itself and ***that are not unduly discriminatory or preferential.*** [Emphasis Added]

The Transmission COSS reflects a Return on Equity (ROE) or Cost of Net Position of 9.80%, which is based on an average of the FERC approved ROE's of PacifiCorp and Puget Sound Energy, both of which have service territories and do business in the State of Washington.³ See Table 1 for the proposed Transmission COSS's weighted average cost of capital or Rate of Return (ROR):

Table 1: Proposed Grant PUD ROR/Capitalization

| | Capitalization Ratio (Note A) | Cost of Capital | Weighted Average Cost of Capital |
|---|----------------------------------|-----------------|-------------------------------------|
| Debt (Note B) | 60% | 3.50% | 2.10% |
| Net Position (Equity) | 40% | 9.80% | 3.92% |
| | | | |
| Total | 100% | | 6.02% |
| (Note A) Represents Grant PUD's target capitalization ratio. ⁴ | | | |
| (Note B) Represents the average cost of Grant PUD's outstanding long-term debt. | | | |

While there are often differences in opinion on the correct level of ROE in developing transmission rates, the cost of service methodology used in the PUD's Transmission COSS is consistent with FERC guidelines.

Under this proposal, the combination of PUD *low-cost debt* and reasonable ROE results in a competitive weighted average cost of capital of approximately 6%. The competitiveness of the PUD's weighted average cost of capital (ROR) of approximately 6% is illustrated in Table 6, below, where state regulated IOU utilities' average weighted average cost of capital (ROR) is 7.32%. This demonstrates that the PUD's ROR is providing its transmission customers with benefits of lower rates than many state IOUs would, while providing adequate capital to the PUD for its normal business operations.

The ROR is applied to Grant PUD's rate base to determine the appropriate return amounts included in both the Transmission and Distribution costs to serve calculations, see Table 2:

Table 2: Calculation Return Amounts (\$ in millions)

| Description | Rate Base ⁵ | Rate of Return | Return ⁶ |
|--------------|------------------------|----------------|---------------------|
| Transmission | \$151.3 | 6.02% | \$9.1 |
| Distribution | \$394.0 | 6.02% | \$23.7 |
| Total | \$545.3 | | \$32.8 |

The Transmission and Distribution combined ROR (return allowance) is \$32.8 million as indicated by BPA's comments, but if a customer uses only transmission services, they will only be charged the transmission rate. If customer requires both transmission and distribution services, they will be assessed the combined transmission and distribution rates, see Table 3:

³ ROE represents an average of 9.54% and 10.02% which equals 9.78%. For COSS purposes, the number was rounded to 9.8%.

⁴ The actual debt capitalization ratio is currently lower than 60%. The 60% debt/40% equity capital structure rather than the actual results in a lower transmission rate.

⁵ See the January 27, 2020 Commission Workshop material, Transmission COSS Attachment A, Exhibit VII, Ln. 56.

⁶ See the January 27, 2020 Commission Workshop material, Transmission COSS Attachment A, Exhibit VII, Ln. 58.

Table 3: Proposed Transmission and Distribution Rates

| Services Used | Transmission Rate | Distribution Rate | Total Rate Paid |
|------------------------------------|-------------------|-------------------|-----------------|
| Transmission Only | \$3.07 | \$0.00 | \$3.07 |
| Both Transmission and Distribution | \$3.07 | \$5.01 | \$8.08 |

The Transmission COSS is designed to jointly share the transmission costs equally (fairly) between its retail and transmission customers. Because the bulk of transmission and distribution is used to serve Grant's retail customers, most of these costs are assigned to the retail customer rate classes. In other words, the PUD will recover a small portion of the transmission and distribution cost to serve through the transmission and distribution rates charged to BPA and USBR.

ROE Reasonableness Test

The parties question the reasonableness of the proposed ROE of 9.8%. To determine the reasonableness of the Transmission COSS ROE calculation, staff applied three tests to determine the reasonableness. First, is the Transmission COSS's return allowance and depreciation amounts compared to 2017 COSA debt and cash requirement amount, see Table 4:

Table 4: Comparison of Transmission COSS to the 2017 COSA (in millions)

| | 2017 COSA | Transmission COSS | Difference |
|---------------------------|---------------|-------------------|----------------|
| Debt and Cash Requirement | \$19.0 | | (\$19.0) |
| Depreciation | | \$6.8 | \$6.8 |
| Return Allowance | | \$9.1 | \$9.1 |
| Total | \$19.0 | \$15.9 | (\$3.1) |

Second, if the 2017 COSA \$19.0 million debt and cash requirement is converted to an ROR percentage, the corresponding 2017 COSA ROR would have been approximately 9.27% or 53.99% higher than the PUD's proposed ROR of 6.02%.

Third, Grant uses cash accounting for its budgeting purposes and to develop its target revenue for its internal financial metrics and to obtain cash necessary for capital investments. The target financial metrics goal is approximately 4% of gross plant investment, see Table 5 for Grant's transmission metrics calculation:

Table 5: Financial Metrics Calculation

| Description | Amount |
|--|---------------|
| Gross Transmission Plant | \$263,993,166 |
| Metrics Percentage | 4% |
| Financial Metrics Cash | \$10,559,736 |
| | |
| Convert Metrics to a ROE Percentage | |
| | |
| Financial Metrics Percentage | 4% |
| Divide by: Equity Capitalization Ratio | 40% |
| Calculated ROE | 10.00% |

As illustrated in Table 5, if the target financial metrics data were used, the ROE would be higher at 10% instead of the proposed 9.8% and the Financial Metrics Cash of \$10.6 million is higher than proposed ROR of \$9.1 million. From these applied tests, staff believes that the Transmission COSS ROE of 9.8% is reasonable.

Staff further supports its use of an ROE in its Transmission COSS with, [Pub. Util. Dist. No. 2 v. Comcast of Wash. IV, Inc., 8 Wn. App. 2d 418, 438 P.3d 1212 \(2019\)](#) where Pacific County Public Utility District No. 2 (District) permitted Comcast of Washington IV, Inc., CenturyTel of Washington, Inc., and Falcon Community Ventures I, LP, d/b/a Charter Communications (collectively Companies) to attach their communications equipment to the District's utility poles pursuant to written agreements. In 2007, the District instituted significant increases to the rates it charged the Companies to attach their equipment to the utility poles. The Companies refused to pay the increased rates and refused to remove their equipment from the District's utility poles, leading the District to bring this lawsuit.

Within Pacific PUD's proposed pole rate, the District's rate calculation included of a **return on equity, rate of return** for depreciated debt expenses, taxes, and attorney fees as actual expenses.

On November 2016, the Superior Court for Pacific County, No. 07-2-00484-1, entered a judgment in favor of Pacific PUD's rate calculation including the use of an ROE in its rate design. The Court of Appeals confirmed the ruling, holding that the public utility district did not abuse *its discretion* in determining the data and inputs for calculating the maximum permissible rate allowed by RCW 54.04.045, and the court affirmed the judgment.

ROE Comparable Test

Grant PUD acknowledges BPA's comment that the FERC traditional DCF and CAPM models were not used by it to calculate its proposed ROE of 9.8%. Grant does not have the necessary market data to calculate DCF and CAPM formulas, but FERC does rely on these models to review the proposed ROE of the companies in the same operating area such as Avista and PacifiCorp when validating their ROE. FERC and many state commissions frequently use a set of comparable IOUs to determine if an ROE reasonable. This is supported by FERC setting ROE of non-jurisdictional transmission in Regional Transmission Organizations (RTOs) at the same overall rate of return as the dominant zonal transmission owner and further, has permitted the use of ROEs that fall within the range of reasonable returns approved by the FERC (for example see ER15-1775-000).

Recent ROEs approved for State of Washington regulated utilities suggest that the PUD’s proposed 9.80% is reasonable, while the ROR data suggest that the PUD’s proposed ROR of 6.02% is below the average for the IOUs. This suggest that the PUD was prudent in its transmission rate design by developing a lower transmission rate when comparing the industry average of RORs to the proposed ROE of 6.02%. See Table 6:

Table 6: Comparable FERC and State Regulated ROEs Between 2017 and 2019:

| Company | Comparable FERC ROEs | Comparable State Regulated ROEs | Comparable State Regulated ROR |
|--------------------------|----------------------|---------------------------------|--------------------------------|
| Avista – 2018 | 9.90% | 9.40% | 7.21% |
| Avista - 2019 | 9.90% | 9.50% | 7.50% |
| Puget Sound | 9.50% | | |
| PacifiCorp | 10.02% | | |
| Cascade Natural Gas-2018 | | 9.40% | 7.24% |
| Cascade Natural Gas-2020 | | 9.40% | 7.31% |
| NW Natural Gas | | 9.40% | 7.16% |
| Pacific Power - 2015 | | 9.50% | 7.30% |
| Pacific Power - 2016 | | 9.50% | 7.30% |
| PSE - 2017 | | 9.50% | 7.60% |
| | | | |
| Average ROE | 9.83% | 9.45% | 7.33% |

Note: Per S&P Global (4/1) – the national average for electric utilities is 9.64%.

In further support, FERC recently enhanced its ROE methodologies in Docket Nos. EL14-12-003 and EL15-45-000.⁷ FERC concluded that using the *DCF* and *CAPM* models will make its ROE determinations more accurately reflect how investors make their investment decisions, while also avoiding deficiencies in other models. The DCF and CAPM models will be used to establish a *composite zone of reasonableness*.⁸ In these dockets, FERC determined that 9.88% was a reasonable ROE. Using these FERC dockets as a supporting reasonableness test, Grant’s proposed ROE of 9.8% is reasonable. By using the ROE comparable test, it appears that the use of the proposed ROE of 9.8% is reasonable.

Grant’s Business Risks

BPA further argues that Grant PUD does not have a risk profile like a regulated IOU. Grant faces similar risks as investor owned utilities and therefore using the approved ROE for these utilities as a proxy is reasonable for Grant. With respect to transmission, Grant encounters risk from; regional market design risk; State and Federal regulatory risk; transmission customers credit default; potential damage to infrastructure from natural disasters such as wind or fire; unanticipated transmission costs including permitting, cultural or environmental mitigation; unanticipated complications in route selection; unplanned construction expenses; increased financing costs; inflationary risk; and equipment failure e.g. the ongoing pole fires the PUD is currently addressing. These risks are similar to the risks faced by regional

⁷ FERC believed that the new approach was technically sound, legally durable, and would provide needed certainty.

⁸ The zone of reasonableness produced by each model will be given equal weight and averaged to determine the composite zone of reasonableness.

Investor Owned Utilities. The operating model and inherent risks faced by Grant and regional IOU's are substantially similar in virtually all respects.

Future unknown costs are not captured in Grant's 2018 base year used in the transmission COSS. These costs may vary significantly from year to year and adjusting rates in response to these costs when they occur create the potential for rate volatility. Given the Commission's goal of stable and predictable rates it is prudent to include a Return on Equity component to create a more stable cash flow that can be used for these events as they occur without creating year to year rate volatility.

Use of ROE Funds

The parties question how Grant will use the ROE amounts collected through the transmission rates and state that Grant should only recover its actual costs through rates, such as recovery of O&M, A&G, and annual debt service. BPA continues its argument by stating the proposed Rate of Return ensures Grant will generate significantly more revenue than the PUD's actual costs. That is speculative on BPA's part. If Grant were to include future projected transmission capital and O&M expenses, these planned future costs could exceed the costs that are estimated to be recovered using of an ROE. Grant's staff recently provided a presentation to the Commission outlining the need for future investment to replace aging equipment and to meet the transmission planning guidelines to ensure a robust, reliable transmission system.

Transmission cost recovery is partially accomplished by collecting an ROE amount from transmission customers. Grant's intent is not to issue refunds to its retail customers but will use these amounts to fund future projects and to fund unanticipated costs. It may also allow Grant to reduce its use of debt to finance projects which results in savings to Grant's retail customers. This methodology provides retail customers rate relief by lessening debt issuances for future projects - effectively giving retail customers a refund over time.

Another possible cost savings benefit is provided by maintaining or possibly reducing the current debt amount owed by Grant PUD which supports higher debt coverage ratios and a strong credit rating. This allows the PUD to acquire lower cost debt on future debt issuances. These lower debt costs benefit both transmission and retail customers.

While Grant does not distribute dividends such as an IOU does, it does reinvest in its system and pays down debt which produces a benefit to customers. These strategies benefit the customers that provide the necessary capital to construct and maintain the electric system.

BPA suggested that Grant should recover only O&M, A&G, and annual debt service through its rates. By excluding certain costs components, Grant would be in a constant state of under-recovery and would not be able to maintain its current state of system operations. For example, Grant is required to pay Taxes – Other Than Income Taxes. By not including these taxes in both Transmission and Retail rates how would these taxes be paid? Also, virtually all business entities, including BPA, build cash reserves that are necessary for unexpected expenses.⁹ In addition, by using debt financing for all capital costs, Grant's

⁹ For example, assume that a transmission line needed to be immediately replaced at a cost of \$5 million. Without having cash reserves on-hand to least start the repair how would electric service continue. Grant would have to borrow the cash to fund the repair.

percentage of debt to assets would increase causing its credit rating to fall and debt costs to increase. This type of financing could cause rates to become unstable with increased volatility.

Staff believes that it would be inappropriate to design rates on BPA's concept of recovering Grant's "actual cost to serve." Using an ROE approach enables Grant PUD to maintain enough cash reserves for capital maintenance projects or to cover system emergencies, such as wildfire or wind damage to transmission infrastructure and to replace old substation equipment such as breakers and transformers. Further, the cash reserves can be used for the maintenance of existing facilities or even used to retire existing debt.

Grant's Retail Customers

Retail customers should be compensated for the use of transmission and distribution facilities which they funded in part through rates. This is supported by the underlying USBR and BPA history where Grant PUD purchased certain transmission facilities from BPA in 1976 for a price of \$4 million, plus the service provision for specified periods. At that time, Grant assumed the obligation to provide USBR up to 44 MW of wheeling **free of charge** for a 40-year period that ended on June 30, 2017. Grant provided this service as specified.

Under the "wheeling" obligation, Grant was obligated to provide wheeling without additional charges for BPA's use of the facilities, during which time Grant PUD was not able to recover costs that were related to the facilities capital cost and Operation and Maintenance Expenses. These unrecovered costs from the wheeling customers were borne by Grant's retail customers.

The capital cost of substation and transmission line replacements represent only a portion of the costs to provide transmission "wheeling" services. Grant's updated Transmission COSS captures the costs of providing transmission "wheeling" service.

At this time, Grant has not proposed to update the ancillary service charges required to support transmission service. These costs are included in FERC's Pro-Form Open Access Tariff and are associated with providing transmission service. These services include such services as Scheduling, System Control and Dispatch, Reactive Supply and Voltage Control, Regulation and Frequency response, Energy Imbalance Service, and Operating Reserve. Grant will address its proposed changes to its ancillary services at a later time.

It is reasonable for the Grant's retail customers that provide the equity (cash) needed to construct and maintain transmission assets to receive a fair return on their investment in Grant's transmission facilities. If retail customers are not allowed to receive this ROE, then third party transmission customers become *free riders* at the expense of the Grant's retail customers who provide capital to construct and maintain the transmission system.

As an example, when retail customers including farmers, small businesses, or industrial customers make decisions on how to invest their equity, they estimate a reasonable rate of return prior to taking on the risk of a new investment. If a farmer were to use cash to purchase new property they would only do so if they anticipated a reasonable rate of return on their investment, otherwise they would hold onto their cash or invest it in alternative investments. Since Grant's retail customer's available capital is reduced by paying electric expenses, it is reasonable for these customers to expect a return on the cash provided to the utility to invest in transmission infrastructure, particularly when a portion of these costs are used to

finance transmission projects for third party transmission customers whose only contribution to its customers for the cash investment is the return on equity, an “opportunity cost.”¹⁰

Grant’s Ratemaking Authority

BPA commented that the proposed Return of \$9.1 million is not tied to any costs that the PUD may recover through a rate under RCW 54.24.080. BPA fundamentally misunderstands the rate making authority of Washington public utility districts. Grant PUD has “full and exclusive authority to sell and regulate and control the use, distribution, rates, service, charges, and price thereof . . . RCW 54.16.040. The Washington Supreme Court confirmed this authority in *Snohomish County Public Utility Dist. No. 1 v. Broadview Television Company, et al*, 91 Wash.2d 3, 586 P.2d 851 (1978) where the Supreme Court, sitting en banc, stated:

“[T]o construe the provision as creating in the licensee or user a right to challenge the reasonableness of rates charged would be to read into it a provision inconsistent with the legislative intent as expressed in [RCW 54.16.040](#).” *Id.* at 854.

The Supreme Court went on to state:

“Furthermore, a right to obtain review, whether judicial or administrative, would defeat the grant of ‘full and exclusive’ authority to control rates, charges, and prices.” *Id.*

The suggestion by BPA that Grant PUD can only recover “costs” is not supported by Washington law. The elected Commissioners of Grant PUD, exercising their legislative authority, are clearly operating within the authority granted by the Washington State Legislature in setting rates. In its effort to challenge Grant PUD’s proposed transmission rate, BPA also cites RCW 54.24.080 to support its suggestion that the proposed rate “may be illegal”. RCW 54.24.080, which appears in the finance section of RCW Title 54, *does not give customers a right to object to utility rates set by Grant PUD’s duly elected Commission*. In relevant part, RCW 54.24.080 provides:

“The commission of each district which shall have revenue obligations outstanding shall have the power and shall be required to establish, maintain, and collect rates or charges for electric energy and water and other services, facilities, and commodities sold, furnished, or supplied by the district. The rates and charges shall be fair and, except as authorized by RCW [74.38.070](#) and by subsections (2) and (3) of this section, nondiscriminatory, and shall be adequate to provide revenues sufficient for the payment of the principal of and interest on such revenue obligations for which the payment has not otherwise been provided and all payments which the district is obligated to set aside in any special fund or funds created for such purpose, and for the proper operation and maintenance of the public utility and all necessary repairs, replacements, and renewals thereof.” RCW 54.24.080(1).

¹⁰ There is an opportunity cost for customer provided capital which is recognized by the ROE such as a business customer’s loan to finance operations if cash is not available. The ROE represents a threshold for making Grant PUD investment decisions and recognizes that there are alternative customer uses of this cash. For example, if a zero ROE is used, the signal Grant PUD sees is to raise rates to fund a capital project with a 5% return to its customers. However, if that customer’s alternative use of that cash is to pay down debt that exceeds 5%, then the customer is better off if Grant PUD does not make that investment. ROE explicitly recognizes and values the customer’s alternative uses of cash.

In *Broadview Television Company, infra*, the customers challenged the public utility district's rates for pole contacts. It relied on RCW 54.24.080 to claim the rates were illegal because they were not "fair and nondiscriminatory". The Washington Supreme Court rejected the customer's claim. The Court explained as follows:

"The appellants [customers] maintain that the superior court erred in holding that the respondent [public utility] had complete discretion, under the contract and under the law, to set the rates at which it would license the use of its utility poles and that its decision in this regard was not subject to judicial review. It is first suggested that the rates are reviewable under [RCW 54.24.080](#), . . . (citation omitted, emphasis added).

"It is the theory of the appellants that the legislative purpose expressed in this section was to restrain a public utility district from setting rates which are unfairly high from the user's or licensee's viewpoint, as well as those which are unfairly low from the bondholder's viewpoint. We cannot agree with this interpretation. The section is found in the chapter dealing with the financing of the acquisition or construction of utility district facilities, particularly with regard to the sale of bonds.

"The security of the obligation to bondholders was the subject of special legislative attention. In [RCW 54.24.050](#), it is provided that, in creating a special fund pledged as security for the repayment of bondholders, a resolution of the district may contain various covenants, among which is a covenant to establish and maintain adequate rates and charges. [RCW 54.24.080](#) is obviously designed to further this same purpose, that of protecting the bondholder's security. By its terms, the provision has viability only so long as there are revenue obligations outstanding. If the legislature had intended to protect users and licensees against unreasonably high rates, it would surely not have confined that protection to periods when a district is laboring under the financial burden of bond obligations, but would have afforded it also when there is no such obligation outstanding and when the district would be in a better position to lower its rates." *Broadview Television Company, Id. at 853-4.*

In other words, BPA is making the same argument Broadview Television Company made over forty years ago. That argument was soundly rejected by the Washington Supreme Court. Notwithstanding statements from BPA like ". . . under Washington law, costs must be sufficiently justified by the utility" (made without citation to legal authority) BPA's claim that it can challenge Grant PUD's proposed rates using RCW 54.24.080 is misplaced. The statute relied upon by BPA provides no legal basis for a customer to challenge rates set by Grant PUD.

After building its straw argument that Grant PUD's rate making "may be" illegal under RCW 54.24.080, BPA turns to RCW 34.05.570(4)(c) (a provision in Washington's Administrative Procedures Act) to suggest it has standing to bring legal action against Grant PUD. This suggestion is also in error. The cited authority provides for judicial review of certain agency action which may include providing:

"Relief for persons aggrieved by the performance of an **agency action**, including the exercise of discretion, or an action under (b) of this subsection can be granted only if the court determines that the action is:

- (i) Unconstitutional;

- (ii) Outside the statutory authority of the agency or the authority conferred by a provision of law;
- (iii) Arbitrary or capricious; or
- (iv) Taken by persons who were not properly constituted as agency officials lawfully entitled to take such action.” RCW 34.05.570(4)(c). (Emphasis added)

To determine if Grant PUD is subject to this provision allowing judicial review of agency action, one must first determine if Grant PUD is an “agency” as contemplated in the Administrative Procedures Act.

“Agency’ means any state board, commission, department, institution of higher education, or officer, authorized by law to make rules or to conduct adjudicative proceedings, except those in the legislative or judicial branches, the governor, or the attorney general except to the extent otherwise required by law and any local governmental entity that may request the appointment of an administrative law judge under chapter [42.41](#) RCW [Local Government Whistleblower Protection]. RCW 34.05.010 (emphasis added).

Clearly, Grant PUD, existing and operating as a municipal corporation under RCW Title 54, is not a “state board, commission, department, institution of higher education, or officer authorized by law to make rules or to conduct adjudicative proceedings.” As a local governmental entity, Grant PUD has not sought appointment of an administrative law judge to address whistleblower protection. Based upon a plain reading of the statute, Grant PUD is not an “agency” whose actions are subject to judicial review under the Administrative Procedures Act.

Finally, it is interesting to note BPA’s argument focuses on Washington state law and not federal law. Presumably, it is because BPA is familiar with the judgment entered in *Blocktree Properties, LLC, et al v. Public Utility District No. 2 of Grant County, Washington, et al*, 2020 WL 1217309 (United States District Court, E.D. Washington)(2020).¹¹ In a factually similar case, plaintiffs filed suit for injunctive relief and damages over Grant PUD’s creation of a new rate for evolving industries. They claimed the rate was not “fair and nondiscriminatory” and therefor violated federal law and the United States Constitution. In a well-reasoned opinion, the Court found plaintiffs’ claims that Grant PUD violated federal law or violated United States Constitutional provisions failed as a matter of law. The federal claims included violating substantive and procedural due process, the Dormant Commerce Clause, section 20 of the Federal Power Act and a violation of civil rights under 42 U.S.C. section 1983.

In summary, Grant PUD, through its elected Commissioners acting in their legislative capacity, has “full and exclusive” authority to set rates. Customers who object to rates set by Grant PUD have their constitutional right to address their elected Commissioners. They do not, however, have the right to thwart Grant PUD’s authority to set rates by seeking judicial review of Grant PUD’s legislative actions.

Financing Differences Between Grant PUD and BPA

BPA states that if it added an ROE to its cost to serve calculation, its rates would increase by 30%. This may be true, but staff does not have the necessary information to replicate BPA’s calculation. Within the

¹¹ While not ruling on Washington state law claims, the Federal Court acknowledged Washington law in stating: “Washington law is clear: RCW 54.24.080 does not provide utility users and licensees with a private, enforceable right to fair and nondiscriminatory utility rates.” *Id.*

Transmission COSS, the return component represents approximately 35% of the total cost to serve. Staff continues to believe that its return calculations are appropriate for the reasons discussed above, therefore, the return should be included in the Transmission COSS.

To further support its return calculation, it is worth noting the differences between how Grant and BPA finance its electric systems. Grant's long-term debt is handled through a combination of revenue financing and municipal bond issuances which require Grant to maintain certain debt coverage ratios and meet additional financial metric elements, such as a defined minimum amount of liquid cash on hand. Grant's debt issuances are Revenue Bonds and are not secured by assets in place, but instead is secured by Grant's projected revenue streams. Because of this, Grant's revenue stream is important in meeting the bond covenants and financial ratios to maintain its bond ratings on the debt, and further to maintain low interest rates.

In contrast, BPA operates its electric system with a reliance on US Treasury bonds. The original US Treasury bond funding was approximately \$7.7 billion. BPA supports its long-term debt issued by its system suppliers, such Energy Northwest and the Port of Morrow.¹² On February 12, 2020, Moody's downgraded BPA issuer rating to Aa2 from Aa1 and consequently downgraded BPA supported debt obligations to Aa2 from Aa1.

Moody's downgrading rationale included the following:

"...the steady erosion of BPA's internal and external liquidity since 2015 and expectation of continued declines. Over the last four years, BPA's reserves for risk has steadily declined to 73 days cash on hand at FY2019 which is less than half of the 152 days cash on hand at the end of FY2015. Looking forward, we expect continued deterioration of this metric trending to around BPA's minimum objective of 60 days cash on hand given BPA's plans to use a net \$51 million of its reserves for risk over the FY2020-2021 rate period. The low forecasted reserves for risk results in a high probability that BPA will breach its 60 days cash on hand target in an adverse situation such as below average hydrology. The downgrade further considers depletion of BPA's net availability under its US Treasury line on an adjusted basis (netting out deferred borrowing) to \$1.84 billion available at the end of FY2019 compared to \$3.34 billion at FY 2014 and BPA's forecast that net availability is likely to decline below the \$1.5 billion quantitative threshold previously outlined in past research for consideration of a downward rating action. Diminished net availability under the US Treasury line weakens a key US government support feature, reduces BPA's access to capital and lowers overall financial resiliency.

The downgrade also factors in BPA's extension of non-federal debt in exchange for the accelerated payment of debt owed to the federal government that effectively undermines the defacto subordination of federal debt to non-federal debt. Since 2013, BPA has accelerated the repayment of a net \$2.7 billion of higher cost subordinated, federal appropriations debt while extending

¹² Long-term debt consist of Port of Morrow POM transmission facilities lease revenue bonds, Idaho Energy Resources Authority's transmission facilities lease revenue bonds, Northwest Infrastructure Financing Corporation, transmission facilities lease revenue bonds, Lewis County Public Utility District 1, WA's Cowlitz Falls hydroelectric project revenue bonds, Energy Northwest, WA - Project 1's electric revenue bonds, Energy Northwest, WA - Project 3's electric revenue bonds, and Energy Northwest, WA - Project 2 (Columbia Generation Station)'s electric revenue bonds.

maturing debt on the Energy Northwest's (ENW)'s nuclear projects. On the look forward basis, we expect BPA will continue to extend the ENW debt as part of a broader plan to lessen the depletion of the US Treasury line availability.

The downgrade of BPA supported debt obligations to Aa2 from Aa1 reflects the downgrade of BPA's issuer rating to Aa2 and BPA's payment obligations under a long-term contract such as a lease, net billing or power purchase agreement that serves as the primary source of cash flow for the applicable bonds.”

The material difference between Grant and BPA's bond obligations is that Grant does not have US Treasury bond line of credit backing for funding if there is a revenue shortfall or unexpected expenses. As illustrated in Moody's ratings report, the original US Treasury bond balance was originally \$7.7 billion, that balance is \$1.84 billion at FY2019 and is expected to dip to \$1.5 billion.

Moody's further states that since 2013, BPA has accelerated the repayment of a net \$2.7 billion of higher cost subordinated, federal appropriations debt while extending maturing debt on the Energy Northwest's (a subsidiary) nuclear projects. On the look forward basis, we expect BPA will continue to extend the ENW debt as part of a broader plan to lessen the depletion of the US Treasury line availability. BPA's 2019 annual report states its debt to assets ratio is 82%, which could further lead to financial downgrade.

Grant does not have the financial backing of the Federal Government, instead Grant is reliant on its customers. Grant's debt is backed by its customer revenues, which requires a total system planning effort to assure Grant does not have a revenue shortfall. Grant has been able to maintain its bond rating with these planning efforts, while reducing its overall outstanding debt which in turn has provided Grant with an overall reduction to its borrowing rates. Grant's customers have been rewarded by these efforts which have helped Grant to maintain rate stability.

Grant's debt to asset goal is to maintain a ratio of between 55% to 60%, the proposed capital structure reflects debt at 60%. Thus, on the surface, it appears that Grant's financial position is favorable over BPA and the use of the ROE in the Transmission COSS will further enable Grant to maintain this financial advantage resulting in benefits to both retail and transmission customers.

Recommendation:

In summary, the ROE cash injection is necessary to fairly compensate retail customer's for their investment in the system through rate revenues, recognizes customer's opportunity costs and alternative uses of cash, supports rational rate of return analysis for capital projects, reduces PUD reliance on debt, and supports the PUD's net position growth and ongoing capital investment in infrastructure and facilities.

Staff's ROE recommendation is 9.80%, resulting in a rate of return on investment of 6.02%. This recommendation is based on the FERC-approved methodology and is reasonable and fair to the PUD's customers. This recommendation enables Grant PUD to maintain its business operations (emergency cash reserves), fund its capital improvements projects (thus requiring no additional debt), results in lower debt costs by enabling Grant PUD to negotiate lower interest rates, and will continue to allow the PUD to lower or maintain its current capitalization level of debt (60% or lower, resulting in lower interest cost).