

other capital costs when Southeastern is fully aware that under the current state of affairs there is no reasonable certainty that such capital costs will be incurred. TVPPA, on behalf of the TVA area preference customers, cannot support the continued collection of funds through the Southeastern rates that simply are sent to the U.S. Treasury, and ultimately either never used, or used for some purpose other than rehabilitating the projects for which they were collected. The inclusion in the rate design of such Phantom Capital Costs is contrary to statute. (TVPPA)

- By including the Phantom Capital Costs as stated above, Southeastern fails to charge the lowest possible rates to consumers consistent with sound business practices as required by statute. (TVPPA)

- We do not see any basis for attempting to recover, in the form of proposed increases in Southeastern rates in accordance with section 5 of the Flood Control Act of 1944, costs that have not yet been incurred (and which may never be incurred unless a contractual funding mechanism is implemented), except where Southeastern customers have agreed in accordance with the type of funding mechanisms referenced earlier. It seems challenging to justify use of rate-setting methodology that is based upon amortization and repayment of appropriation investments to recover, in rates charged to TVA, investments that have not yet been made, and which might never be made. (TVA)

- Given the financial impacts that assuming the financing responsibility for as much as \$260 million of Rehabilitation capital expenditures over the next 20 or more years will have on Southeastern customers, it appears appropriate that, as part of any funding mechanism, Southeastern customers should have approval and oversight rights with regard to those Cumberland Basin Project work items they would be financing. (TVA)

- Under any funding mechanism, it also would be more appropriate for the Rehabilitation funding component of Southeastern rates for any given year to be governed by the funding requirements of work items approved by Southeastern customers, and not by the amount of funding proposed for work items that are not yet approved. (TVA)

- Southeastern customers, by virtue of their assuming of future financing responsibility under a funding mechanism that offers no prospect of their being financially repaid, deserve a role in:

1. Helping determine what specific work items at the Cumberland Basin

Projects warrant the funding they will provide;

2. Exercising reasonable oversight over the performance of such work to help assure that it is completed as intended; and

3. Having appropriate guarantees to help assure that they will ultimately receive the intended value from the funding they will provide. (TVA)

*Response:* Based on the comments received, Southeastern has revised the projected hydropower replacement costs for the Cumberland System. The revised projections for the cost evaluation period will reflect the amount the Corps actually allocated to hydropower activities in the Cumberland System. After the cost evaluation period, projections will be based on a statistical projection of replacements from a Corps of Engineers depreciation study.

Section 10 (l.) of DOE Procedure RA 6120.2 requires that "Future replacement costs will be included in the repayment studies by adding the estimated capital cost of replacement to the unpaid Federal Investment in the year each replacement is estimated to go into service, and adding it to the allowable unamortized investment."

If an MOA is executed and the customers agree to fund the Corps' plan to rehabilitate the Cumberland projects, it may be necessary for Southeastern to file another rate adjustment.

2. It is TVA's understanding that approximately three-fourths of the proposed rate increase is designed to recover amounts to fund, over the next 20 or more years, approximately \$260 million of new projects for renewals, rehabilitations, and replacements (Rehabilitation) work at Corps hydroelectric projects in the Cumberland Basin System. (TVA)

*Response:* The comment overstates the impact of the Corps' Rehabilitation program on Southeastern's rates. Without including the Corps' 20-year plan for renewals, rehabilitations, and replacements, Southeastern will propose a rate increase of about fifteen percent (15%). The proposed rate adjustment, with the Corps' 20-year plan of renewals, rehabilitations, and replacements, is an increase of about twenty percent (20%). As such, the Corps' plan for rehabilitation of the Cumberland projects accounts for about one-fourth of the rate adjustment proposed in the **Federal Register** on March 25, 2003, (68 FR 14419).

3. Southeastern is proposing a rate that will satisfy expense and repayment requirements for capital additions over the next 50 years. However, Southeastern is not offering a 50 year contract or any guarantee that the

improvements will be made or the power will be available over the next 50 years. It would be more appropriate to propose a rate for a five-year period that provides revenue for projected expenses and repayment requirements over that same 5 years. (KU Municipals)

*Response:* To conform to requirements of RA 6120.2, the repayment study must extend to the end of the repayment life of the repayment period for the last investment in service. It is Southeastern's opinion that the proposal in this comment does not conform to the requirements of RA 6120.2.

#### *B. Comments Regarding Purchased Power Costs*

4. Southeastern received comments that Southeastern overstated the impact of replacement energy costs on the proposed rates. These comments included the following:

- There is little evidence to support the claim in the **Federal Register** Notice that the rate adjustment is driven by increased purchased power costs. (SeFPC)

- The SeFPC understands replacement energy expenditures have only amounted to a little over \$3.5 million since the implementation of the last rate increase in 1999. There appears to be little foundation therefore for Southeastern to raise rates over \$40 million for a five year period to account for purchased power costs that have averaged a little over \$1 million in each year since the last rate increase. (SeFPC)

*Response:* The **Federal Register** Notice reads "Existing rates have been in effect since July 1, 1999. The Cumberland System region has incurred a severe drought since that time. This has impacted repayment in two ways. First, revenues have been reduced because Southeastern has had less energy available for sale. Second, expenses have increased because it has been necessary for Southeastern to purchase replacement energy to meet its minimum energy obligations."

The notice further states, "The Corps of Engineers has provided Southeastern with a plan of capital expenditures necessary to rehabilitate the projects in the Cumberland System. These costs are included in the proposed rates."

Cumberland System purchased power totaled about \$3.5 million since rates for the Cumberland System were last adjusted in 1999. The 1999 rate adjustment for the Cumberland System included no estimate for purchased power. As such, the purchased power costs are a factor in the proposed rate adjustment. However, Southeastern does not claim that this proposed rate