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October 9, 1984

Morton Margulies, Esq.
Chairman, Atomic Safety and
Licensing Board
U. S. Nuclear Regulatory
Commission
Washington, D. C. 20555

Adm. Judge Frederick J. Shon
Atomic Safety and Licensing
Board
U. S. Nuclear Regulatory
Commission
Washington, D. C. 20555

Adm. Judge Richard F. Foster
Atomic Safety and Licensing
Board
U. S. Nuclear Regulatory
Commission
Washington, D. C. 20555

Re: Washington Public Power Supply System
(WPPSS Nuclear Project No. 3)
Docket No. 50-508-OL

Gentlemen:

Enclosed is Part 1 of a draft study report prepared by the Staff of the Bonneville Power Administration regarding the future construction schedule of WNP-3. The draft study report tentatively recommends that no funds for the construction of WNP-3 be included in BPA's budgets for fiscal years 1986 and 1987 or in its rate case for the period extending from July 1, 1985 to September 30, 1987. The draft study report also recommends that preservation costs for WNP-3 be included in FY-1986 and 1987 budgets and in BPA rates to preserve these assets as viable options. It explicitly rejects terminating the project.

Part 2 of the draft study report includes an explanation of the raw data used in its preparation. If it is of interest to the Board, we will supply a copy of it.

DS03

The draft study report will be subject to additional public meetings and comments and a final report is expected to be issued in early November.

We are providing copies of this material to the Board mindful of our obligation to apprise the Board of matters which bear on issues before it.

Sincerely,

Nicholas S. Reynolds
Counsel for Applicant

Enclosure

cc: Service List

Bonneville Power Administration
U.S. Department of Energy

BPA

DATE : SEP 24 1984

In reply refer to : D

UNITED STATES GOVERNMENT

Memorandum

TO : Administrator - A

FROM : James Curtis, Deputy Financial Manager - D
Gary Fuqua, Director, Division of Power Resources Planning - PR

SUBJECT: WNP 1 and 3 Draft Study Report

In May of this year, you asked us to develop a study and a public involvement process which would assist you in determining which cost and schedule assumptions for WNP 1 and 3 to include in BPA's Fiscal Year 1986 and 1987 budgets and in our 1985 rate case. Please find attached the Draft Study Report which is the result of the study and public involvement effort to date.

The Draft Study Report will be the subject of additional public meetings and comments from this date to October 19, 1984. We will then assess the public comments received, assess any changes in circumstances which have arisen, refine our analysis, and deliver a final report in early November.

Attachment

JCurtis:ljc:9-21-84 (WP-D-0219J)

cc:
Official File - D

Bonneville Power Administration

Department of Energy

BPA REVIEW OF WASHINGTON PUBLIC POWER SUPPLY SYSTEM PROJECTS 1 AND 3 (WNP 1 AND 3) CONSTRUCTION SCHEDULE AND FINANCING ASSUMPTIONS

DRAFT STUDY REPORT

PART 1

DRAFT STUDY REPORT

PART 1

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Tables

PREFACE

This Draft Study Report is divided into two parts. Part 1 contains a summary of the study background, tentative conclusions and recommendations, and a discussion of future assessment of WNP 1 and 3. Part 2 contains an explanation of the resource, rates, and financial analyses performed, related material, and a bibliography of sources used in the study. BPA will also have limited copies of an Appendix containing information from other sources that BPA drew upon and detailed study information that would have made the main Draft Study Report unduly long. All parts of the study are available from the BPA headquarters' Public Involvement office.

SECTION I. INTRODUCTION

In 1982 and 1983, the Bonneville Power Administration (BPA) performed analyses regarding construction schedules, costs, and financing availability for Washington Public Power Supply System (Supply System) Projects 1 and 3 (WNP 1 and 3). Those analyses led to BPA's recommendation to the Supply System that completion of the two projects be delayed for periods of up to five years and three years, respectively. These actions recognized then current circumstances regarding the need for power, the ability to finance continuation, and the legal and institutional environment surrounding these resources. Deferral allowed BPA to reduce the size of its 1982 and 1983 rate increases compared to what would have been required had WNP 1 and 3 not been deferred.

Earlier this year, BPA began a review of WNP 1 and 3. Current assumptions include restart of WNP 3 in July 1985 and restart of WNP 1 in July 1986, and the raising of construction funds through municipal bond issues. Significant factors in determining what assumptions are now appropriate include current Supply System financing opportunities, new estimates for WNP 1 and 3 completion costs and schedules, BPA's 1984 load forecast, and estimates of the cost and availability of alternative resources.

The primary purpose of BPA's study is to evaluate the constraints and risks of various assumptions in order to determine what assumptions should be used in the final rate proposal for the rate period extending from July 1, 1985 through September 30, 1987. Study results will also be used in preparing BPA budgets for fiscal years 1986 and 1987. The results of this study will be useful in planning for meeting BPA loads through the acquisition of conservation and other resources in fiscal years 1986 and 1987.

Because of its narrow scope--near-term rates and budgets--BPA's study will not serve as a definitive cost-effectiveness analysis of WNP 1 and 3. The current study will, however, provide insight into appropriate near-term assumptions regarding those projects.

SECTION II. PUBLIC INVOLVEMENT PROCESS

To help in the review of WNP 1 and 3, BPA developed a public involvement program:

- to provide BPA with outside technical review of its study plan;
- to receive suggestions about the study's methodology and results;
- to answer questions and respond to concerns about the study as well as nuclear energy issues in general; and
- to begin working toward consensus in the region on the best WNP 1 and 3 assumptions.

In the first step of the program, completed in June, townhall meetings and technical workshops were held in six Northwest cities to receive comments on the Draft Study Plan issued June 6. Those comments, together with written and telephoned responses, were evaluated and resulted in changes that appeared in the Revised Study Plan issued August 3.

Taking into consideration further comment on this revised plan, received at an August 8 technical meeting, BPA modified or added to its analyses where feasible. In early September, BPA held a second technical meeting to brief those interested in preliminary results of the analyses and to listen to comments.

The public is now invited and requested to comment on this Draft Study Report. Public comment will be used in developing the final study report and in determining what assumptions are the most appropriate for near-term budgets and the final 1985 rate proposal.

SECTION III. STUDY ENVIRONMENT

A number of important changes have occurred since the original decisions to delay construction of WNP 1 and 3. To a large extent, this study is a response to those changes. Briefly, the major changes are as follows:

A. New Load Forecast

In July, BPA issued the Bonneville Power Administration Forecasts of Electricity Consumption In the Pacific Northwest (long-term load forecast). Compared to BPA's 1983 long-term (20-year) load forecast, the new medium forecast is 1,038 average MW (megawatts) lower by year 2002, the high forecast is 63 average MW higher, and the low forecast is 2,196 average MW lower. More on the load forecasts can be found in Sections X and XI of this report.

B. Surplus Marketing

BPA has not assumed completion of either WNP 1 or 3 solely for the purpose of export sales of firm surplus power. Nonetheless, the market for this power outside the region affects the need for and value of the output of the projects. Much effort has recently gone into selling surplus power on a firm basis at rates more favorable to the Northwest. As yet, no agreements for large firm surplus sales have been reached, but efforts continue and success could make earlier completion of WNP 1 and 3 or other resources more attractive.

Recent changes in the surplus marketing environment include BPA's new Near-Term Intertie Access Policy and the increased likelihood of major expansions in the intertie capacity between the Pacific Northwest and California. Both those developments tend to improve revenues from export sales. For instance, BPA's Near-Term Intertie Access Policy will bring greater certainty to intertie availability for BPA and other parties. How these changes in the surplus marketing situation were addressed in the study is described in Section X.

C. New Resource Supply and Uncertainty

If conservation and other resources can respond to load growth more cheaply than completing WNP 1 and 3, then further delay or even termination may be the best assumption to make. The schedules for WNP 1 and 3 consequently are affected by the considerable uncertainty that exists about the quantity and cost of alternative resources. BPA and others have continued

their efforts to improve estimates of alternative resource supply. Techniques for addressing the uncertainty in resource supply have also improved somewhat. This study incorporates new supply estimates and new techniques for evaluating resource uncertainty. More on these subjects can be found in Section X.

SECTION IV. OVERVIEW OF BPA'S ANALYSIS PROCESS

A. Rationale for Selecting Scenarios

Due to the complexity and time constraints of this analysis, BPA limited detailed resource, rate, and financial analyses to three WNP 1 and 3 scenarios: (1) current assumptions for each project; (2) an additional 2-year delay for each project; and (3) termination of each project. BPA selected these scenarios to best encompass the range of possible alternatives for WNP 1 and 3 schedules and costs as they relate to BPA's next rate period and fiscal years 1986 and 1987 budgets. Similarly, BPA chose three assumptions that it believes reflect the range of possible alternatives for funding project costs. Municipal bond financing, short-term bank financing, and BPA revenue financing were used to perform rates and financial analyses on appropriate scenarios.

To provide further information for evaluating WNP 1 and 3, BPA analyzed other assumptions in less detail, including: (1) an additional 5-year delay for both projects; (2) termination of WNP 1 and completion of WNP 3 on its current schedule; (3) termination of WNP 3 and completion of WNP 1; and (4) completion of WNP 3 on its current schedule and subsequent completion of WNP 1 on an additional 5-year delay schedule (tandem construction). Again, BPA used alternative financing assumptions for purposes of rates and financial analyses of certain of these alternative construction schedules.

B. Study Questions

The next step in the study was to answer five basic sets of questions:

1. Are WNP 1 and 3 needed on the schedule defined in each scenario? Could other resources be substituted at lower cost? What combination of

WNP 1 and 3 and other resources meets the range of future situations at least cost? How do uncertainties about loads, project costs, alternative resources, and other factors affect the desirability of each scenario? This set of questions was addressed in the resource analysis segment of the study which can be found in Part 2 of this document. The results of the resource analysis are presented in Sections X and XI.

2. What changes would each scenario imply for BPA's 1986/87 budget levels for acquisition and development of other resources, as expressed in BPA's April 26, 1984, draft Resource Strategy? This question is addressed in section XI of the report. The analyses performed in this study are being incorporated in BPA's update of the Resource Strategy.

3. How would each scenario affect rates, and how would changes in rates affect loads? These questions are addressed in Sections XII and XIII of this report.

4. Is the financing for WNP 1 and 3 likely to be available as assumed in each scenario? What is the financial impact of the scenario on BPA, and on the four investor-owned utility co-owners of WNP 3? These questions are addressed in section XIV of the report.

5. Finally, what are the effects of each scenario on local communities and on the region's economy? On oil and natural gas depletion? On nuclear hazards to health? What major cost events could BPA be facing? These questions are addressed in section XV of the report.

In Section VI of the report, the conclusions of all analyses are drawn together into a summary of results for the study. In Section VII, BPA tentatively recommends what appear to it to be the best assumptions regarding WNP 1 and WNP 3 for BPA budgets and July 1985-September 1987 rates assumptions, based on the study results and on public comment received to date. Section VIII talks about future efforts which may be necessary to further clarify the role of WNP 1 and 3 in meeting regional energy needs.

SECTION V. DECISIONMAKING PROCESS

BPA expects to announce its WNP 1 and 3 assumptions in November 1984. Those assumptions will be used in the budget process and incorporated into the rate case.

BPA's determination of assumptions will largely depend on the following:

- the draft study results, which are intended to embody the best quantitative and qualitative information available;
- comments and recommendations of BPA's customers, the Supply System, the IOU co-owners of WNP 3, the Northwest Power Planning Council (Regional Council), and other interested parties as received in response to the draft study; and
- any additional analysis performed in response to comments received in October.

BPA's final determination must ultimately be an informed and open judgment, based upon the facts and advice received, as to which set of assumptions best meets BPA's responsibility to assure an adequate, economical, reliable, efficient, and environmentally acceptable electric power supply in the Pacific Northwest.

The final study may show a need to propose some new action with regard to WNP 1 and 3. If that need arises, BPA is committed and required by law to comply with the National Environmental Policy Act (NEPA). The compliance process may result in an Environmental Impact Statement (EIS) or other environmental document. The public will be kept informed of any proposal, of subsequent actions, and any public involvement program.

SECTION VI. TENTATIVE CONCLUSIONS

In this study, the choice of WNP 1 and 3 assumptions and resource strategy was evaluated from a number of standpoints: financial, economic, and others. The results of the study are presented in detail in Part 2 of the report, and in the supporting appendices. In this section, the basic draft conclusions of each segment of the study are summarized. The following section of the report presents BPA's tentative recommendations.

A. Resource Analysis Conclusions

1. Current Schedule Versus Delay

The resource analysis indicated that a need to complete WNP 1 and 3 on their current schedules is very unlikely to materialize. Even with high load

growth, there is a high degree of confidence that loads can be met if the projects are delayed. Delay is also highly likely to prove the least-cost alternative on a net present value basis, when all the factors influencing costs of meeting load are considered. The benefit of a 2-year delay compared to current schedule has a net present value of roughly $200- to $400-million. Delay also offers the opportunity to learn more about future loads and other key variables before making a large irrevocable commitment. This advantage of delay is only partially reflected in the net present value estimates because it was not practical to model the process of gaining more knowledge of variables other than loads.

2. 2-Year Versus 5-Year Delay

It is likely that a delay of 5 years could be handled without creating difficulty in meeting loads on a regional basis. Uncertainty about the shelf life of the project and the impact of extended delay on the cost of completion make the economic choice between 2- and 5-year delay difficult. If the Supply System's estimates of costs to complete with 5-year delay are used directly, then 5-year delay has a $400 to $600 million net present value advantage over 2-year delay. If large additional cost increases due to delay are assumed, this advantage is eliminated. Better information on the impact of 5-year delay on project costs is needed before a clear conclusion can be drawn.

3. Delay Versus Termination

It is not possible to predict the net benefit of completing WNP 1 and 3 precisely, because of uncertainties about load growth; the supply of alternative resources; and WNP 1 and 3 costs, capacity factors, and project lives. Table VI-1 shows a net benefit for completing the projects of $2.7 billion, using BPA's best estimates of all the variables. In other words, the benefits of completing the projects would exceed their life-cycle costs by $2.7 billion. But this estimate does not account for uncertainty. Net benefits were also estimated for a very wide range of combinations of the key uncertain variables. Table VI-1 shows the resulting estimates of the high, low, and average (expected) net benefits of completion, within an 80 percent confidence interval. The range of possible net benefits is very wide. The average of the estimates is positive, but well below the "base case" estimate.

Table VI-1

Net Benefit of Completing
WNP 1 and 3
5-year delay

"Base Case" net benefits, no allowance for uncertainty		+ $2.7 Billion	
Range of net benefit estimates, under uncertainty			
Study Group test assumptions	High + $5.500 Million	Average + $ 57 Million	Low - $6,000 Million
Alternative assumptions	+ $5,500 Million	+ $1,162 Million	- $5,000 Million

Because of the high degree of uncertainty, restart on current schedule is excessively risky, because the region could sustain large (up to $5-$6 billion) losses if the projects later proved non-cost-effective. Termination now would also be excessively risky, because it could force the region to pay for much more expensive replacement resources ($5.5 billion to as much as $10 billion more than WNP 1 and 3 costs). Delay avoids these large risks, and has the highest expected net benefits. However, the substantial chance that it may prove economic not to complete the projects after the delay period suggests that careful attention be paid to the magnitude of the preservation costs during the delay period.

4. Resource Strategy Alternatives

One possibility tested in this study was whether an aggressive conservation and alternative generating resource strategy, combined with WNP 1 and 3 termination, would be most economic. This was not found to be true. The resource analysis results suggested that if WNP 1 and 3 were terminated, then an aggressive resource strategy could be the most economic resource mix. But the results also indicate that an aggressive resource strategy combined with termination is not as economically attractive as delay of WNP 1 and 3 combined with more modest resource strategies. The resource analysis also lent little support to the low resource strategy. Overall, the resource analysis indicated that the development of moderate amounts of conservation

and other resources was appropriate in the near-term. Additional analysis is being performed in conjunction with revisions to BPA's Resource Strategy which ought to yield information on which of several program levels may prove most appropriate.

B. Rates Analysis Conclusions

From strictly a rate impact perspective and based on the scenarios examined, a delay in both plants of two years or more would provide the most favorable rate impacts for the region's electricity consumers. Financing the construction of WNP 1 and 3 on their current schedules from BPA revenues, while producing lower long-term wholesale and retail rates, would result in near-term rates that are as much as 25 percent higher for BPA's Priority Firm rate and almost 15 percent higher for residential rates.

Termination of both plants results in significant rate benefits in the near-term, but can result in significantly higher long-term rates due to increased levels of conservation and resource acquisitions. The uncertainty inherent in load forecasts and the potential for severe long-term rate impacts if high regional load growth is experienced argues against an irrevocable decision such as termination.

The 2-year delay scenario produces moderate rate benefits in the near-term and essentially the same long-term rate impacts as completing construction on the current schedule with conventional financing.

C. Financial Analysis Conclusions

The conclusions of BPA's financial analysis are consistent with and informed by the resource economic and rate analyses. This analysis is, in effect, a BPA financial perspective of the same fundamental data which was analyzed in the resource analysis and rates sections of this report.

BPA does not believe that conventional bond financing can reasonably be expected to be available to fund construction of WNP 3 in July 1985. What may be possible in July 1986 is uncertain. The rate analysis shows that preference customer rates could be 25 percent higher in the late 1980s if BPA

were to attempt to fund construction from revenues. Such severe rate shocks do not appear necessary or prudent, especially in light of the unlikely need for the projects on current schedules.

The review of BPA financial flexibility and debt structure under current assumptions, delay and termination scenarios demonstrates that delay of the projects increases our flexibility to respond to financial demands while not unduly incurring risk of high future expenditures to acquire replacement resources. In contrast, current schedules for WNP 1 and 3 construction, whether financed from revenues or bonds, results in large inflexible capital commitments that may prove unnecessary. Termination, on the opposite extreme, reduces near-term expenditures for resources but does expose BPA to expensive resource programs if high load growth occurs. Therefore, a prudent middle course appears to be a delay of WNP 1 and 3 related capital commitments while efforts to reduce current uncertainties proceed.

The general review of the financial posture of the WNP 3 investor-owned utility owners concluded that, while some of the utilities might prefer to make immediate and major capital decisions, some may find either course financially difficult. Therefore, a delay in construction expenditures and avoidance of a large write-off could give these utilities additional time to strengthen their financial posture.

D. Risk Management Conclusions

The choice of WNP assumptions and resource strategy must be guided not only by most-likely estimates and expected values, but also by consideration of the whole range of possible outcomes of each scenario, including the extremes. From this risk management perspective, delay of WNP 1 and 3 appears most advantageous. Delay reduces the risk of starting construction and later finding that the projects are uneconomic. Study results suggest that delay reduces the chance of incurring a negative net present value of 3.5 billion or more from about 30 percent to about 10 percent. Delay also preserves the option of realizing very large net benefits from completion, ranging to over $5.5 billion. Termination would eliminate the opportunity to realize these benefits.

The decision to delay can be compared to a decision to pay an insurance premium. In the case of WNP 1 and 3, the insurance premium is the preservation costs, which could range from $24 to $80 million per year for two projects. The potential payoff is over a $5.5 billion net benefit if the projects turn out to be needed and are completed. Paying the insurance premium likewise reduces the risk of taking a large economic loss on a decision to stay with the current schedule.

The insurance analogy is not perfect. The insurance premium could be higher or lower, depending upon actual preservation costs and the positive or negative effects of further delay on completion costs. The payoff is also uncertain, depending on BPA's ability to correctly interpret the signs in the future that dictate project completion, and the ability to bring the project on line within budget.

However, if even a moderate ability to learn from future experiences and act accordingly is granted, then delaying and maintaining the option to complete the projects appears to be the best assumption. Delay minimizes the large risk of resuming construction now and later finding that the decision was wrong. Likewise, delay reduces the equally-severe risk of large cost increases to pay for replacements for a terminated project. In today's situation, neither "getting the projects built as soon as possible" nor "getting them behind us" appear to be as prudent as delay.

E. Consistency with Previous BPA Reports

1. Changes in Data and Assumptions

BPA's last analysis of WNP 1 and 3 appeared in the WNP-3 Resource Economics and Construction Schedule Update, dated October 26, 1983. Changes in basic data and assumptions since that report was issued include:

- A new long-term load forecast, in which the high forecast is higher, and the medium and low forecasts are lower. Also, Regional Council model conservation building standards are now assumed to be in effect.
- Increases in Supply System O&M and other costs estimates, and a one percent increase in the assumed cost of financing, leading to an increase of approximately 4 mills/kWh in the levelized cost of the projects.

- A 40-year life is now assumed for both projects, consistent with the design life and the Nuclear Regulatory Commission (NRC) operating license for WNP 2. A 35-year life had been assumed previously.
- Resource supply estimates and computer models have changed somewhat, but these changes had minor effects on the base case estimates of benefits of completing the projects.

2. Changes in Conclusions

Under base case conditions, the October 1983 report showed a $2684 million net benefit in 1983 dollars for completion of both projects on their current schedules. This report shows a net benefit of $2023 million in 1984 dollars, also for current schedule under base case conditions. Hence, both reports show the projects to be cost-effective under base case conditions. However, the current report also shows a $200-$400 million additional net benefit for a further delay of the projects.

This report also addresses the net benefit of completion over the whole range of possible combinations of future load growth, alternative resource supply, project cost, and project performance. The average, or expected value, of the net benefits over all these possible future conditions depends on probability assumptions, but is less than the base case net benefit. This type of analysis was not included in the October 1983 report.

SECTION VII. TENTATIVE RECOMMENDATIONS

Based on the Draft Study Report conclusions, BPA makes the following tentative recommendations to be tested in the public review process.

1. BPA should include no funds for construction for WNP 1 and 3 in its fiscal years 1986 and 1987 budgets or in its rate case for the period extending from July 1, 1985, to September 30, 1987.
2. Preservation costs for both projects as currently estimated by the Supply System should be included in fiscal years 1986 and 1987 budgets and in BPA rates to preserve these assets as viable options. An adjustment clause should be included in BPA's rate design in order to adjust to new

estimates as preservation costs are reviewed, refined, and approved through the Supply System budgeting process. This would allow rates to be adjusted as the most efficient preservation plan is perfected.

3. BPA should work with the Supply System, the other WNP 3 owners, the Northwest Power Planning Council, and other appropriate parties in defining and perfecting preservation plans and restart assumptions.

4. BPA should perform periodic reviews of WNP 1 and 3 prospects on a schedule consistent with BPA resource planning and budgeting in order to assure scheduling of these resources consistent with regional resource requirements.

SECTION VIII. FUTURE EFFORTS

The BPA Draft Study Report demonstrates that, while WNP 1 and 3 can be expected to provide future regional power benefits, those benefits are subject to uncertainties. These include questions regarding: future loads; which utilities will bear those loads; the quantity and cost of alternative resources; and the efficiency with which nuclear plants and other power resources can provide cost-effective insurance against load and resource uncertainties.

Over the next year, BPA, the Northwest Power Planning Council, the region's utilities, and interested groups will be perfecting resource plans and load assessments which may provide additional insight regarding these uncertainties. The courts may be active, as well, in resolving the legal uncertainties surrounding the Supply System on such matters as the liabilities associated with the termination of WNP 4 and 5; the default on the WNP 4 and 5 bonds; the delay of WNP 3; and the validity of the net billing agreements. These activities can be expected to change and improve BPA's vision of the appropriate restart or ultimate disposition of WNP 1 and 3.

BPA believes that some uncertainties need to be addressed in the immediate future through activities designed to assure prudent management of WNP 1 and 3. These activities include:

- continued discussions with the contractors and labor unions regarding the cost at which WNP 1 and 3 may be completed if construction is delayed two to five years further;

- continued investigation with the NRC and others regarding the feasibility of continued delay and subsequent construction resumption of WNP 1 and 3;
- additional assessment of the supply of alternative resources in this Region, and of the amount and price of power purchases from Canada or the Pacific Southwest which could displace Northwest resource development in the post-1990 period; and
- additional investigation of the current impediments to Supply System financing and continuation of efforts to remove those impediments in the time now available, so that prudent financing is available when needed to fund construction of WNP 1 and 3 or to refund outstanding debt at rates less burdensome to ratepayers.

In any case, BPA, the Supply System, and the other WNP 3 owners must immediately begin to define the optimum preservation mode for those projects. BPA believes that a preservation mode which minimizes the financial burden of preservation on ratepayers while assuring the probability of economic and timely construction completion can and must be developed.

Finally, the costs and benefits of continued preservation, while of potential regional benefit, may not be equally shared among all regional utilities. A major problem in assessing the distribution of benefits and burdens resulting from preservation is BPA's current uncertainty about which regional loads will be placed upon BPA and which will be borne by individual utilities. Further resolution of these issues would enhance the ability of WNP 1 and 3 to serve as successful and economic regional resource options.