

BPA Regulatory Assets

February 26, 2020



Agenda

- Overview of Regulatory Assets
- Alliance of Western Energy Consumers Proposal
- Columbia River Fish Mitigation Program

What are Regulatory Assets?

- Regulatory assets are incurred costs that would generally be expensed by non-regulated entities. BPA may amortize these costs over many rate periods effectively treating it as a capitalized expenditure.
- Traditionally, regulatory accounting is used to shield customers from unexpected rate shocks rather than to deal with budgetary constraints or to manage financial outcomes.
- Regulatory accounting is allowed provided that rates are:
 - Established by an independent third-party regulator or a governing board empowered by statute to establish rates
 - At BPA, the administrator is the regulator.
 - Designed to recover costs of service
 - Set at levels that can be charged to and collected from customers
- Regulatory accounting requires that future revenue from rates will be at least equal to the incurred cost. Future revenue must be for the cost already incurred, not for similar future costs.

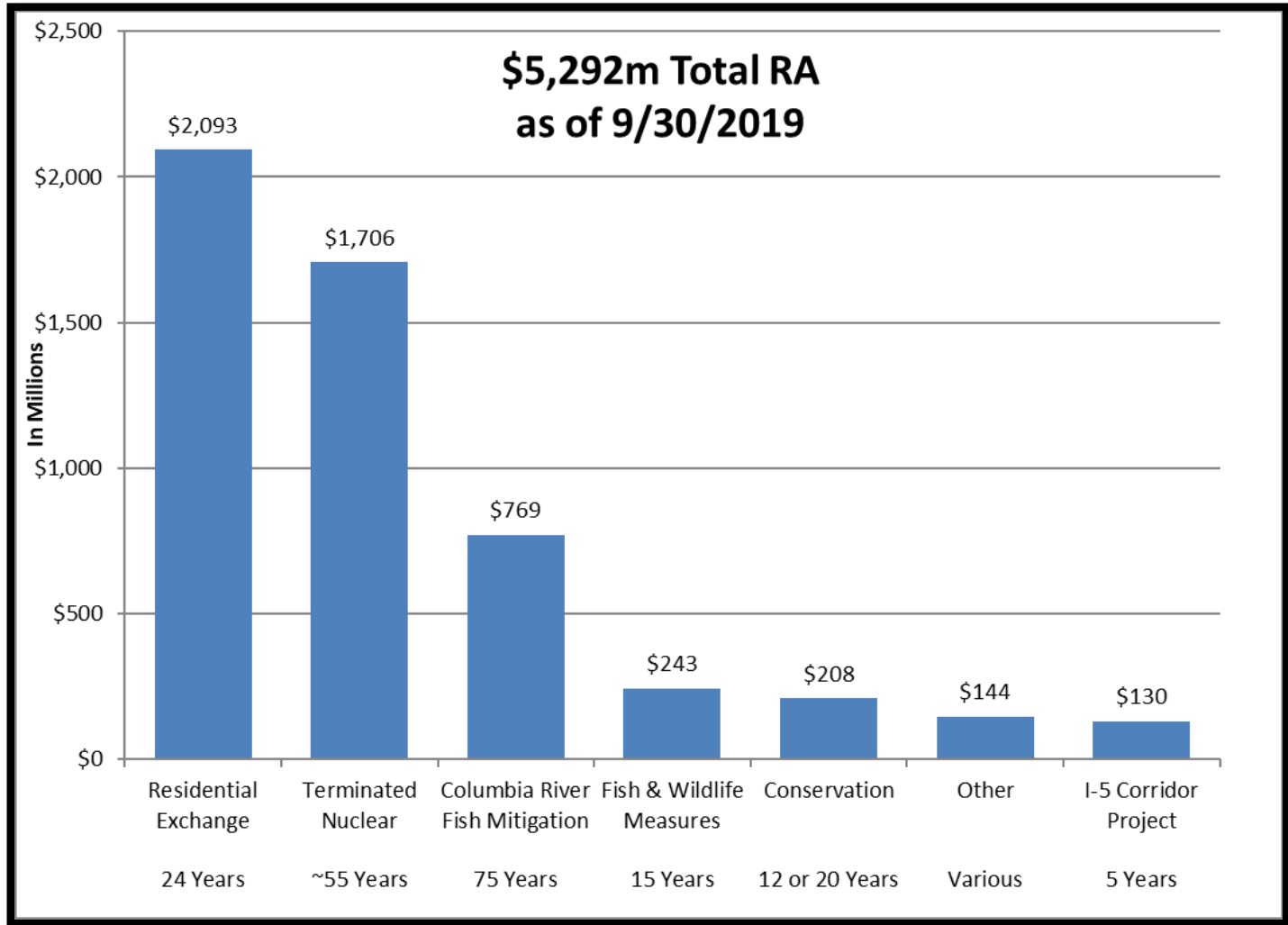
Regulatory Asset Examples

- Regulatory assets are generally created for large costs which were not anticipated in the rate case or for costs which change frequently. Common examples are:
 - Storm damage
 - Environmental cleanup costs
 - Asset impairment charges
- BPA also uses regulatory accounting on a programmatic basis. Generally, this is for spending on assets owned by a third-party that have long lives.
 - Fish & Wildlife spending for hatcheries, land, passage improvements
 - Energy Efficiency spending (no longer treated as a regulatory asset) on improvements consistent with the Council plan.
- BPA has also used regulatory accounting for other programs.
 - Columbia River Fish Mitigation Program (CRFM) studies expensed by the Corps of Engineers.
 - Replacement of failed spacer-dampers

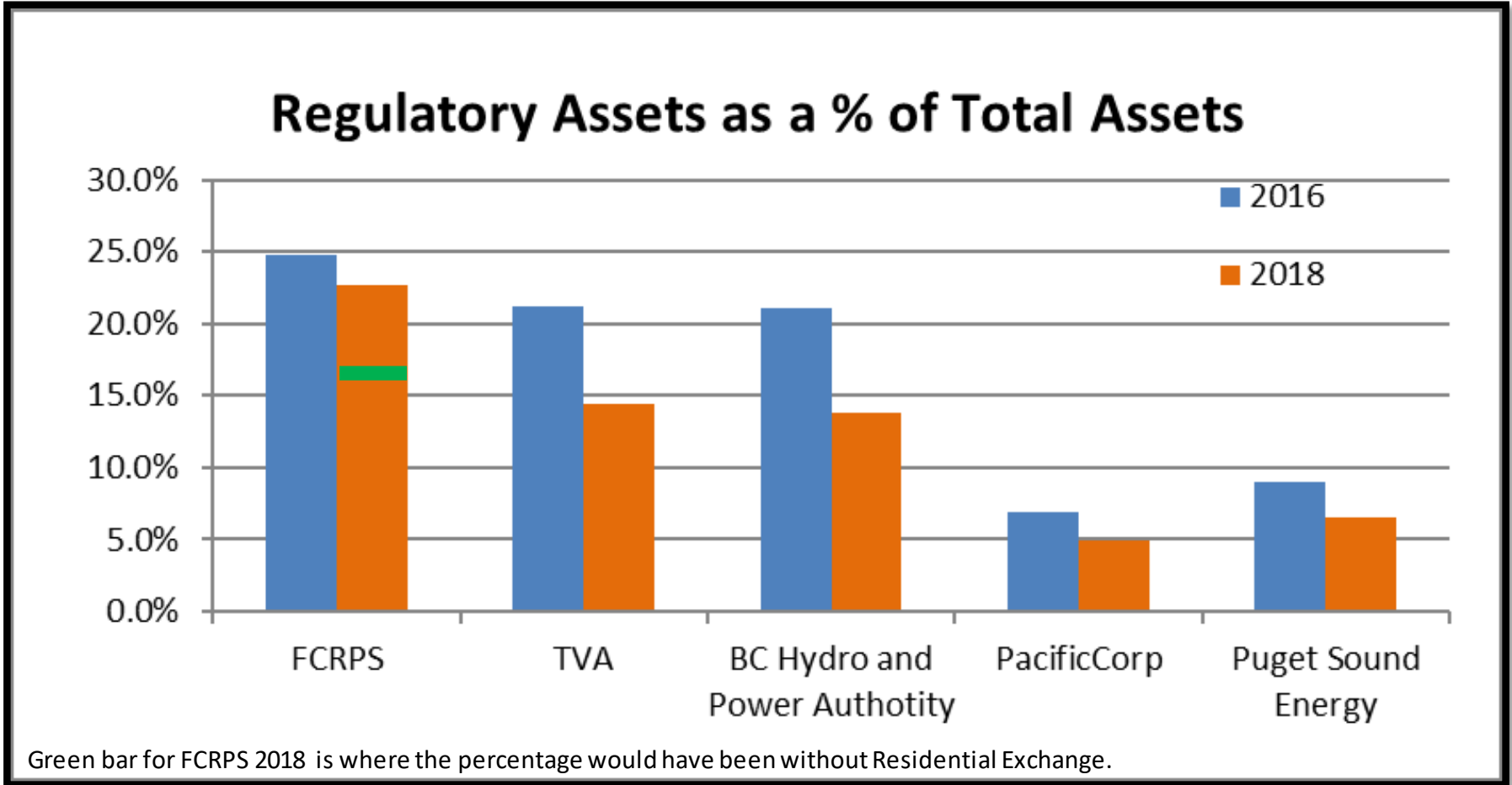
Treatment of Regulatory Assets

- The cost will be removed from expense and capitalized on the balance sheet.
- The cost will be amortized over a fixed period selected by the Administrator.
 - This will increase amortization expense on the income statement.
 - The regulatory asset balance will decline by the annual amortization.
- Since the cost must still be paid, capitalization of the cost allows BPA to borrow for it. If we borrowed for the spending, it would:
 - Increase debt on the balance sheet
 - Increase interest expense on the income statement.
- Regulatory asset treatment does not create an obligation to borrow for the cost.
 - For example, Residential Exchange is an annual expense governed by the terms of the settlement agreement. BPA did not borrow for this regulatory asset.
- Regarding the debt-to-asset ratio, debt associated with a regulatory asset is included in the numerator. The regulatory asset is not included in the denominator.

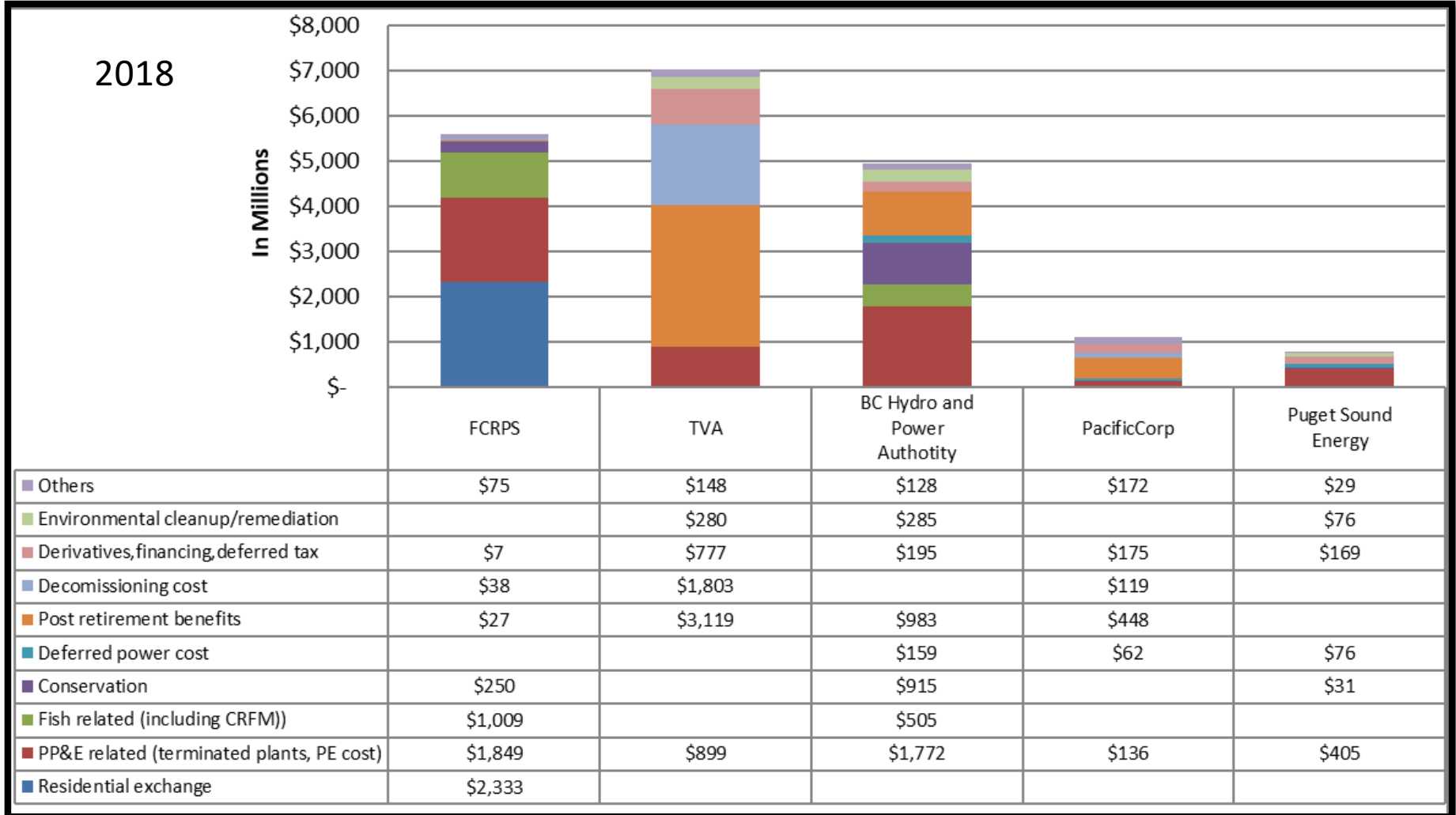
BPA Regulatory Assets



Comparison with Other Utilities



Comparison by Type



AWEC Proposal

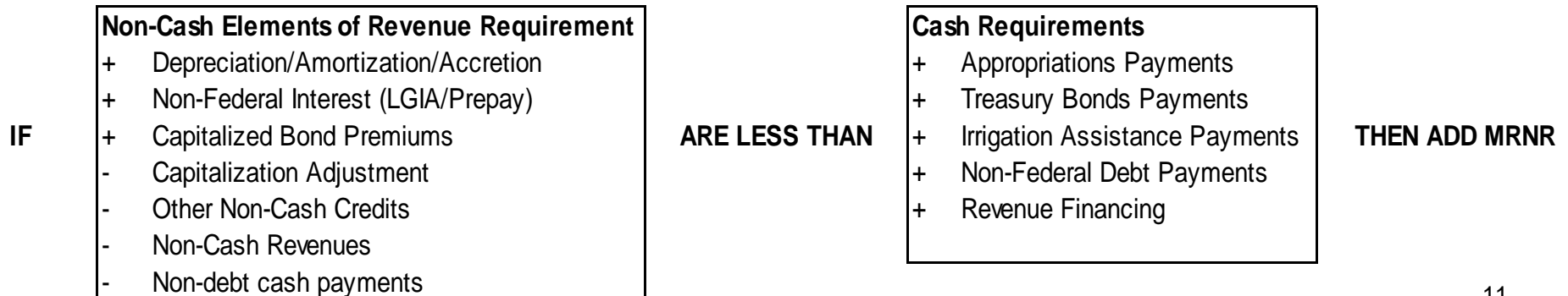
- AWEC proposed in BP-20 that we accelerate the amortization schedule of the Energy Efficiency (EE) regulatory asset.
 - Acceleration of amortization expense would be offset by matching reductions to minimum required net revenues (MRNR).
 - It would reduce future costs as we approach the end of the Regional Dialogue contract period.
- BPA did not object to the proposal but wanted more time to assess it in a broader context.

What is MRNR?

- MRNR can be viewed different ways:
 - Recognition that accrued expenses do not reflect all of Bonneville's costs
 - A “cost” created in rate setting to ensure cash flow is sufficient to meet all debt payments
 - A net revenue target
- MRNR is not:
 - A charge for future costs – It is calculated for the year it is needed. If it is \$100 in year X, it means that we need \$100 for debt payments in year X. It does not accumulate for future use.
 - A type of revenue – It represents needed net revenues. There is no revenue stream labeled MRNR. It will never appear in operating year financial statements. Actual net revenue is the best comparison.

Calculating MRNR

- Revenues from rates must be at least equal to meet all expenses and produce enough cash to ensure the repayment of the Federal investment.
- The starting assumption is that forecast revenues will perfectly match total expenses.
- Next, we analyze the cash flows under this assumption, comparing it to the cash needed to make debt payments.
- If the resulting cash flow is inadequate, we add a line item, minimum required net revenues (MRNR), to the revenue requirement income statement until cash flow is adequate.
- MRNR is a net revenue target for the rate case, calculated as:



MRNR Example

Example: Power BP20		
Non-Cash Elements	FY20	FY21
Non-Fed Int Exp - Prepay	\$9,826	\$8,863
Deprec/Amort	\$518,295	\$525,414
Trust Fund Inc/Gains/Losses	(\$13,870)	(\$14,332)
Capitalization Adjust	(\$45,937)	(\$45,937)
Non-Cash Rev - Prepay	(\$30,600)	(\$30,600)
Other	\$12,490	\$11,585
Total Non-Cash Items	\$450,204	\$454,993
Cash Requirements		
US Treasury Bond Repayment	\$173,072	\$518,065
Non-Federal Principal Repayment	\$268,581	\$22,871
Irrigation Assistance	\$24,331	\$14,747
Total Cash Needs	\$465,984	\$555,683
Cash Needs > Non-Cash Items	\$15,780	\$100,690

MRNR is required in both fiscal years, an average of \$58m over the rate period.

Context

- Between 2022 and 2028, EE amortization expense will total \$123 million. The regulatory asset will be fully amortized in 2028.

(\$000s)						
2022	2023	2024	2025	2026	2027	2028
42,078	32,975	22,255	16,422	8,450	1,132	55

- Based on the last IPR and assumptions in BP-20, MRNR is currently expected to be fairly large through 2028.

(\$000s)						
2022	2023	2024	2025	2026	2027	2028
121,859	164,400	148,644	146,676	154,375	87,035	246,477

What Happens With Acceleration of EE?

- The current forecast of MRNR does provide space to accelerate EE amortization.
 - The 2022 MRNR estimate is large enough to accommodate the \$81 million of EE amortization expected in 2023-28.
 - Amortization expense would go up by \$81 million and MRNR would go down by \$81 million.
 - Amortization expense and MRNR in 2023-2028 would also change.
- The result is no net change in the revenue requirement. The change to amortization expense would produce an offsetting adjustment to MRNR resulting in no change to total costs.

	(\$000s)						
Base	2022	2023	2024	2025	2026	2027	2028
Amortization Expense	342,396	337,316	334,437	336,851	331,999	331,098	338,480
MRNR	<u>121,859</u>	<u>164,400</u>	<u>148,644</u>	<u>146,676</u>	<u>154,375</u>	<u>87,035</u>	<u>246,477</u>
Total	464,256	501,716	483,082	483,527	486,374	418,133	584,957
Amortize all in 2022	2022	2023	2024	2025	2026	2027	2028
Amortization Expense	423,686	304,340	312,183	320,429	323,549	329,966	338,425
MRNR	<u>40,570</u>	<u>197,376</u>	<u>170,899</u>	<u>163,098</u>	<u>162,825</u>	<u>88,167</u>	<u>246,533</u>
Total	464,256	501,716	483,082	483,527	486,374	418,133	584,957
Difference	2022	2023	2024	2025	2026	2027	2028
Amortization Expense	81,290	(32,975)	(22,255)	(16,422)	(8,450)	(1,132)	(55)
MRNR	<u>(81,290)</u>	<u>32,975</u>	<u>22,255</u>	<u>16,422</u>	<u>8,450</u>	<u>1,132</u>	<u>55</u>
Total	0	0	0	0	0	0	0

Impact on Repayment

- BPA applies the provisions of DOE Order RA 6120.2 to regulatory assets.
 - The repayment period is a maximum of 50 years.
 - If the life of the underlying investment is shorter than 50 years, the repayment period will match the life of the investment.
- The EE amortization period and repayment period match today. The 12 year amortization period results in a 12 repayment period.
- Arguably, shortening the life of an existing regulatory asset should mean shortening the repayment period to match it.
- Bonneville probably has capacity to do this because of the upcoming RCD2 transactions which will accelerate the repayment of Power's Treasury bonds.
- We have not studied the accelerating the repayment of EE debt. It is possible that it could result in premiums.

Conclusion about Accelerating EE

- While it is possible to accelerate EE amortization, there is no benefit to rate payers.
- Bonneville does not intend to pursue this option since it produces no benefits for customers or for Bonneville.
- But ... the AWEC proposal caused staff to think about the treatment of other regulatory assets.
 - Should regulatory asset treatment be continued for future spending
 - Reassessment of existing regulatory assets

Considerations for Regulatory Treatment

- Staff are examining BPA's regulatory asset practices through principled and strategic lenses.
- Issues to consider
 - Are the costs unexpected or forecastable?
 - What is the purpose of the regulatory asset treatment? Is this being done to shield customers from rate shock?
 - What do statutes, rules, or accounting standards allow?
 - What do others do?
 - What are the risks of change?
 - What is the potential rate impact?

Columbia River Fish Mitigation Program

- What is it?
 - It was created in the 1990's to fund Corps of Engineers fish passage improvements at the Columbia and Lower Snake River dams, and has expanded to cover spending in the Columbia River estuary and Willamette River.
 - The Corps determines the amount spent, which projects are affected, and whether the spending is likely to result in a physical asset.
- Regulatory treatment of studies began in 2006.
- BPA amortizes the regulatory asset over 75 years with a 50 year repayment period, the same as the physical asset.
- The CRFM regulatory asset balance, net of accumulated amortization, was \$769 million at the end of FY 2019.
- Staff are focusing on two issues:
 - Continuing regulatory asset treatment on a programmatic basis for future study spending
 - Shortening the amortization period for the existing regulatory asset

Next Steps

- BPA will continue to consider regulatory asset practices, including CRFM.
- A decision to discontinue regulatory asset treatment would affect program spending and would be discussed at the IPR.
- Changes to the existing CRFM regulatory asset would be discussed at either the IPR or a pre-rate case workshop this summer.

Appendix

Power MRNR

		Rate Period Average -- Base Case		
(\$000s)		BP-22	BP-24	B-26
1	Sources of Cash (Cash from Operations)			
2	Non-Federal Interest (Prepay)	7,326	5,116	2,045
3	Depreciation/Amortization	485,943	488,002	496,267
4	Non-Cash Expenses (Decomm Trust Interest & Gains/Losses)	(15,059)	(16,086)	(17,480)
5	Capitalization Adjustment	(45,937)	(45,937)	(45,937)
6	Non-Cash Revenues (Prepay)	(30,600)	(30,600)	(30,600)
7	Cash Contribution to Decommissioning Trust	(4,561)	(4,934)	(5,444)
8	Cash Free-up (DSR)	<u>16,688</u>	<u>8,625</u>	<u>0</u>
9	Total Sources of Cash	413,800	404,187	398,851
10				
11				
12	Uses of Cash (Repayment of Debt)			
13	Repayment of Non-Federal Obligations	(34,994)	(43,927)	(17,376)
14	Repayment of Treasury Bonds	(277,960)	(483,182)	(529,982)
15	Repayment of Appropriations	(219,368)	0	0
16	Payment of Irrigation Assistance	<u>(14,456)</u>	<u>(14,331)</u>	<u>(12,695)</u>
17	Total Uses of Cash	(546,778)	(541,439)	(560,053)
18				
19	Change in Cash Flow (Row 9 + Row 17)	(132,978)	(137,253)	(161,202)
20				
21	Minimum Required Net Revenues Needed	132,978	137,253	161,202

Based on BP-20 Final Proposal with adjustment to amortization of non-Federal assets.

Financial Disclosure

This information has been made publicly available by BPA on February 24, 2020 and does not contain Agency-approved Financial Information.