BP-18 Rate Case Workshop

September 14, 2016

Revised Slides 17-18 on September 19, 2016

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Agenda

- Error Correction Proposal
- Financial Reserves Policy
- Revenue Requirement Updates

Error Correction Proposal

August 10 Workshop: Error Correction Proposal Response

- At the August 10 BP-18 workshop, BPA responded to the Snohomish error correction proposal.
- Instead of a policy that the Administrator would adopt, BPA proposed guidelines that Staff would use to evaluate errors.
- The guidelines would help BPA Staff develop BPA's Initial Proposal position in a general 7(i) hearing on whether to apply a prospective adjustment to correct for a past rate case error.
- While the guidelines would inform BPA Staff's initial position, they would not preclude rate case parties from proposing other treatments, prohibit Staff from considering other parties' proposals, nor diminish the Administrator's responsibility to make the final decision in the ROD.

Customer Comments

- BPA requested comments from customers on their preference regarding error correction -- six comments were submitted (posted on BP-18 website under “Customer Comments”).
- Comments received:
  - One party does not support the adoption of a policy or guidelines.
  - One party supports the adoption of guidelines.
  - Three parties could support the adoption of guidelines with certain changes/additions.
  - One party posed a number of questions but did not express an opinion on the proposal.

Customer Comments (continued)

- Generally, customers that could accept guidelines also:
  - Recommended a lower threshold
  - Expressed concern about the possible disproportionate effects of errors on small customers

BPA Guidelines for Initial Proposal

- Use the guidelines as proposed by Staff on August 10, but reduce the threshold for which BPA Staff would recommend adjusting prospective rates for past errors to $5 million/year.
- Customers may ask BPA Staff to review the effect of errors below this level if they are concerned that certain errors have caused disproportionately large impacts on smaller customers. If so, Staff could recommend correction of an error that falls below the $5 million/year threshold.
- BPA and customers can evaluate the effectiveness and practicality of the guidelines in the BP-18 rate case.

BPA Guidelines for Initial Proposal

Rationale for guidelines

- The “guidelines” approach appears to be acceptable to several customer groups, given the interest in maintaining the Administrator’s discretion.
- However, customers are very concerned about the possible disproportionate effects of errors on small customers.
  - The criteria proposed by customers focus on the effects on individual customers’ bills.
  - BPA Staff has concerns that a criterion requiring it to analyze effects on individual customers would be burdensome to implement.
  - However, BPA would be responsive to customers if they identify such an effect.

Error Correction Summary

- BPA will correct all errors that are discovered on a prospective basis.
- BPA Staff will use the guidelines to determine whether to propose a prospective rate adjustment to compensate for the past rate error.
- Guideline Specifics
  - The guidelines would apply to ministerial cost allocation and calculation errors.
  - The error must exceed an annual average of $5 million/year for the rate period for Staff to propose a prospective rate adjustment to compensate for a past rate error.
    - Staff could recommend correction of an error that falls below the $5 million/year threshold for compelling reasons; e.g., if there are disproportionate impacts on small customers.

Error Correction Summary (cont'd)

- **Guideline Specifics, continued**
  - Errors in only one rate period are eligible for adjustment (i.e., if an error is discovered in BP-14 and BP-16 rates, the BP-18 rates would be adjusted to compensate only for the error in BP-16).
  - The adjustment would be effectuated in the next general rate case (rates reduced/increased to offset error).
  - Adjustments would be rate class (not customer) specific.
  - Staff's guideline recommendations would be included in the Initial Proposal for consideration by parties and the Administrator; i.e., the guidelines would not preclude rate case parties from proposing other treatments, prohibit BPA Staff from considering other parties' proposals, nor diminish the Administrator's responsibility to make the final decision in the ROD.

Applicability to BP-18 Power Rates Error

- Power recently identified a cost allocation error that has been in effect since BP-12.
  - Since BP-12, Slice customers should have paid about $3.5 million ($0.6 million/year), which is their share of a $12.8 million cost to move Federal generation to BPA's balancing authority area during the 6-year period (FY 2012-2017).
  - The correct allocation will be used in BP-18.
- Error Correction Proposal in BP-18 Using the Guidelines
  - Using the guidelines, BPA Staff's initial proposal would be to NOT adjust BP-18 rates to compensate for the past allocation errors.
  - Only look back one rate case (BP-16), which results in an error of $0.6 million/year.
  - Prior rate case error of $0.6 million/year is less than the $5 million/year threshold.

Financial Reserves Policy Update

Background

- In prior rate cases, and again in BP-16, BPA and customers debated the approach to managing levels of financial reserves.
- BPA had no comprehensive policy to guide decisions for managing levels of financial reserves.
- The status quo Treasury Payment Probability framework is limited in scope, only mitigating business line financial risk; it does not address the prudent minimum level of financial reserves for both business lines, the importance of financial reserves to BPA's credit rating, the appropriate balance of reserves between business lines or when business line and Agency reserves are robust enough to be considered for other high value purposes.
- The Administrator decided not to adopt new policies or practices on financial reserves in the BP-16 rate case, and to hold workshops after the rate case to discuss a financial reserves policy.
- BPA held three workshops throughout the spring of 2016 to discuss goals and options for a financial reserves policy.
- Following the workshops, BPA received comments from stakeholders to help inform BPA's BP-18 initial proposal position on financial reserves.

Initial Proposal Financial Reserves Policy

Policy:

- Reserves targets for each business line should be calculated independently based on the higher of what is necessary to meet the status quo TPP test or 90 days cash on hand. The Agency reserves target is the sum of the business line targets.

- The lower threshold should be calculated independently for Power and Transmission on a rate period basis, based on the reserves equivalent of 30 days cash on hand below the reserves target. For each business line, if reserves fall below the lower threshold, a CRAC recovers the amount of the shortfall the following fiscal year.

- The upper threshold should be calculated independently for Power and Transmission on a rate-period basis, based on the reserves equivalent of 30 days cash on hand above the reserves target. The Agency upper threshold is the sum of the business line upper thresholds. If business line reserves and Agency reserves are above their respective upper thresholds, the above-threshold reserves should be considered for other high-value purposes such as debt retirement, incremental capital investment, or rate relief (e.g., DDC or reducing the rate case revenue requirement).

Initial Proposal Financial Reserves Policy

- Features to be implemented fully in BP-18: the Transmission reserves target, lower and upper thresholds, Power reserves target and upper threshold and Agency upper threshold.

Phase-in:

- The Power lower threshold will be phased in over 10 years in equal increments each rate period so long as the average non-Slice Power rate increase*, including the increase caused by the CRAC, is less than a specified percentage.
  - BPA has not yet decided what the lower threshold increase nor the specified rate increase percentage will be for the Initial Rate Proposal. BPA Staff has proposed that the lower threshold would be $60m for FY 2018 and 2019, $120m for FY 2020 and 2021, and so on.
- The Administrator reserves the right to accelerate the phase-in of the Power lower threshold if Power reserves accrue more quickly than anticipated.

* Average non-Slice Power rate increase = the Average Non-Slice Tier 1 Rate increase for the rate period as calculated using the Final Proposal plus any first-year CRAC impacts.

Impacts for Transmission

- Cost Recovery Adjustment Clause (CRAC) equal to 30 days cash on hand below the reserves target (based on BP-16 numbers equivalent to $100m)
- CRAC applies to these Transmission Rates:
  - Network Integration Rate
  - Point-to-Point Rate
  - Formula Power Transmission Rate
  - Southern Intertie Point-to-Point Rate
  - Utility Delivery Rate
  - Scheduling, Control, and Dispatch Rate
  - Integration of Resources Rate
  - Montana Intertie Rate
  - Utility Delivery Rate
  - Ancillary and Control Area Services Rate except for the Balancing Capacity Rates
- Establishes new guidance for reserves distributions when Transmission reserves and Agency reserves are above the upper threshold; upper thresholds are equivalent to 30 days cash on hand above the respective reserves targets (based on BP-16 numbers equivalent to $200m for Transmission and $800m for the Agency)
  - Reserves distribution (e.g., DDC) applies to the same rates as the CRAC listed above.
- ~7% chance Transmission and Agency reserves are above the upper thresholds in BP-18.
- ~77% chance Transmission and Agency reserves are above the upper thresholds at some point over the next 10 years.

Impacts for Power

- Establishes new guidance for reserves distributions when Power reserves and Agency reserves are above the upper threshold; upper thresholds are equivalent to 30 days cash on hand above the respective reserves targets (based on BP-16 numbers equivalent to $600m for Power and $800m for the Agency).
- Assuming a CRAC threshold equal to $60m in FY 2018 and 2019:
  - There is a 36% probability of a CRAC on FY 2018 rates with an expected value of $32m.
  - Average rate pressure of 2.2% over the rate period compared to 1.6% under the status quo (with a CRAC threshold of $0).
- These results do not factor in the effect of an overall rate increase cap that is to be determined, which could have the effect of limiting any potential rate pressure caused by increasing the CRAC threshold above $0.

Preliminary CRAC Statistics

Table 1: $0/$0 CRAC Thresholds, *status quo*

		a	b	c
		2018	2019	Total
1	CRAC Probability	23%	40%	49%
2	Avg. Revenue	$18m	$45m	$62m
3	Standard Deviation of CRAC Revenue	$40m	$67m	$87m
4	Rate Pressure (using $20m = 1% rule of thumb)	0.9%	2.2%	1.6%

Table 2: $60m/$60m CRAC Thresholds, *initial proposal*

		2018	2019	Total
5	CRAC Probability	36%	48%	61%
6	Avg. Revenue	$32m	$58m	$89.5m
7	Standard Deviation of CRAC Revenue	$54m	$74m	$102m
8	Rate Pressure (using $20m = 1% rule of thumb)	1.6%	2.9%	2.2%

Table 3: Delta ($60m/$60m less $0/$0), *initial proposal less status quo*

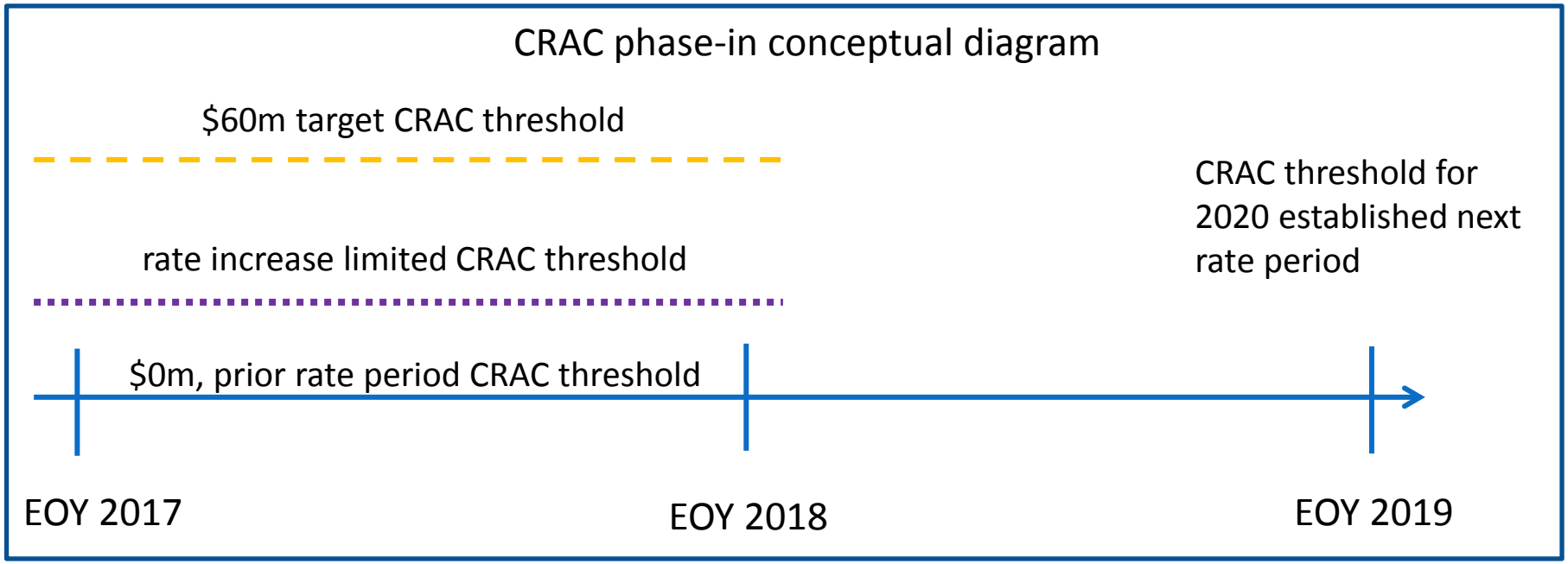
		2018	2019	Total
9	CRAC Probability	13%	8%	12%
10	Avg. Revenue	$14m	$13m	$27m
11	Standard Deviation of CRAC Revenue	$13m	$7m	$15m
12	Rate Pressure (using $20m = 1% rule of thumb)	0.7%	0.6%	0.7%

- Estimates use FY 2016 3rd quarter vintage forecast data
- Estimates assume $60m CRAC threshold and also assume no impact from the overall rate cap provision.

Slide Revised 9/19/16

CRAC Phase-in Details (Staff proposal)

- The CRAC that applies to FY 2018 and 2019 rates triggers on reserves balances at the end of FY 2017 and 2018, respectively.
- At the time of the final proposal (June/July 2017), the amount of the FY 2018 CRAC will be known.
- For this example, assuming a target of a $60m CRAC threshold for FY 2018 and 2019, we will ratchet up the threshold from $0 to the point where the overall non-slice Power rate increase is below the overall rate increase cap. The cap will not limit the amount of CRAC revenue that would have been generated under the threshold established the prior rate period (in BP-16 this was the equivalent of $0).
- Rule: if the average non-slice Power rate increase plus the rate increase resulting from the first year of the rate period CRAC (calculated using the prior rate period threshold) is less than the overall rate percentage cap set by the administrator, increase the CRAC threshold (starting from the prior rate period CRAC threshold) to the point where the overall rate increase percentage cap is reached or to the point where the target CRAC threshold is reached, whichever is lower. Apply the CRAC threshold from the first year of the rate period to the second year of the rate period.



CRAC Phase-in Example

- **Example 1:**
  - Assume we anticipate ending FY 2017 with $20m in Power reserves for risk.
  - Assume also the base rate increase is 3% and the overall cap set by the administrator is 4%.
  - In the prior rate period, the CRAC threshold was $0, if that threshold was used again, no CRAC would apply to FY 2018 rates because reserves in this example are above $0, at $20m.
  - The average non-slice Power rate increase = 3% + cost of CRAC using the prior rate period target CRAC threshold = 0%, thus there is 1% headroom under the 4% overall rate cap to increase the CRAC threshold.
  - Using $20m = 1% rate increase rule of thumb, the CRAC threshold could be raised up to $40m but no higher.
  - A $40m CRAC threshold would trigger a $20m CRAC on FY 2018 rates, equivalent to 1% rate increase.
  - It is difficult to pin down the actual cost of a particular CRAC threshold in the 2nd year of a rate period because reserves are highly uncertain. Because of this we will set the second year CRAC threshold equal to the first year CRAC threshold.
- **Example 2:**
  - Assume we anticipate ending FY 2017 with -$20m in Power reserves for risk.
  - Assume also the base rate increase is 3% and the overall cap set by the administrator is 4%.
  - In the prior rate period, the CRAC threshold was $0, if that threshold was used, a $20m CRAC would apply to FY 2018 rates equivalent to a 1% rate increase.
  - The average non-slice Power rate increase = 3% + cost of CRAC using the prior rate period target CRAC threshold = 1%, thus there is 0% headroom under the 4% overall rate cap to raise the CRAC threshold from $0 to the target of $60m.

Revenue Requirement Updates

Interest Expense -- Background

- The variance between the forecast of interest expense in rate cases and actual expense was raised as an issue by Transmission customers in the BP-16 rate case. In fiscal years 2014 and 2015, for example, actual interest expense in each year for Power and Transmission was over $30 million lower than in the rate case.
- Refinancings can have a major influence on the variance. Over one-half of Transmission's FY 2014 variance was due to a refinancing in that year and most of that was non-cash due to the recognition of the discount on the refinancing. The interest savings due to the refinancing continued into FY 2015.
- From a Power perspective, how transactions are modeled in the rate case can be a major driver. In the rate case, Regional Cooperation Debt transactions are not modeled directly in the revenue requirement. Instead, the effects of these transactions are calculated and applied as a revenue requirement reduction in the Other Income & Expense line. This can lead to significant variances in interest expense because expected reductions in interest are rolled up in the adjustment that appears in the Other Income & Expense line.
- While the relative shares of responsibility vary from year to year, the remaining variances are largely due to differences in interest rates, capital spending, the timing of borrowing, and unusual or unplanned events such as significant refinancings.
- While Transmission was the focus of this issue in BP-16, changes adopted to address the Transmission variances will also affect interest expense modeling for Power.

Interest Expense -- Background

- As of the third quarter, the forecast of FY 2016 interest variances are smaller than in the recent past ($6 million for Transmission and $2 million for Power).
- Actions taken in repayment modeling to reduce the variance include:
  - Tightening the borrowing rate forecast, lowering the yield curve due to persistent low market rates, and using three borrowing rate forecast options instead of one as in prior rate cases.
  - Setting maturities for planned investments to match the borrowing plan. For BP-18, borrowing plan development has become an iterative process to place projected debt where the model is making discretionary payments. This was described in the July revenue requirement workshop.
  - Applying an average six-month rate forecast to variable rate debt in the repayment model.
- The main drivers for the remaining variances are:
  - Changes in capital spending from projections
  - Differences between the official Agency interest rate forecast and actual market rates
  - Not modeling Lease Purchase in the repayment model
  - Timing differences between projected borrowing and actual borrowing
  - Unusual borrowing actions such as bridge financing

Additional Steps for BP-18

- Delay borrowing to the end of the year.
  - BPA expects to lose the Interest Offset Credit (IOC) at the end of this year leaving investments in market-based specials, with very low rates, as the only way to earn income on reserves.
  - To mitigate the loss of the credit, staff proposes to delay borrowing to the last few months of the year. This will reduce interest expense and minimize the influence of other variables such as the amount borrowed and interest rates.
- Assume Lease Purchase (LP) for Projected Transmission Investments
  - The LP program has become a significant financing tool.
  - The short-term interest rates on the LP lines of credit are lower than the interest rates on longer term Treasury bonds.
- Impact on Revenue Requirement
  - Transmission: $8-9 million/year reduction
  - Power: $4 million/year reduction

Update to BP-18 TS Revenue Requirement

- In the July revenue requirement workshop, there was some discussion about fixing Transmission repayment at a predetermined level to avoid accumulating cash (AAC). This has been done for several rate cases for Power. This added about $1.2 million to the FY 2019 repayment level.
- Staff discovered after the workshop that adjusting for the AAC was unnecessary. The revenue requirement was over-estimating cash flows from the income statement by including the $15 million/year of reserve financing. This overstatement caused minimum required net revenues for the rate period to be too low, by $15 million in FY 2018 and $13.8 million ($15m - $1.2m = $13.8m).
- This update will increase the revenue requirement by $13 million/year.

Effect on BP-18 TS Revenue Requirement

	2016 Initial IPR/CIR	2016 Updated IPR/CIR	Delta of Updated Less Initial IPR/CIR
Average of	*2018/2019*	*2018/2019*	*2018/2019*
Depreciation / Amortization Expense	287,456,000	287,456,000	-
Net Interest Expense	174,584,000	174,378,000	(207,000)
Minimum Required Net Revenue (MRNR)	901,000	14,182,000	13,280,000
Total Capital Related Costs	**462,941,000**	**476,015,000**	**13,074,000**

Next Steps