INDEX

SUPPLEMENTAL TESTIMONY OF

RICHARD Z. (ZACH) MANDELL, DANIEL H. FISHER,

REBECCA E. FREDRICKSON AND ALEXANDER LENNOX

Witnesses for Bonneville Power Administration

SUBJECT: Metrics for Risk Adjustment Mechanisms

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SUBJECT: Metrics for Risk Adjustment Mechanisms

Section 1: Introduction and Purpose of Testimony

Q. Please state your names and qualifications.

A. My name is Richard Z. (Zach) Mandell, and my qualifications are contained in BP-20-Q-BPA-26.

A. My name is Daniel H. Fisher, and my qualifications are contained in BP-20-Q-BPA-08.

A. My name is Rebecca E. Fredrickson, and my qualifications are contained in BP-20-Q-BPA-10.

A. My name is Alexander Lennox, and my qualifications are contained in BP-20-Q-BPA-23.

Q. What is the purpose of your testimony?

A. The purpose of our testimony is to describe a change from our Initial Proposal on the proposed metric used to trigger BPA's risk adjustment mechanisms for Power and Transmission. The risk adjustment mechanisms are the Cost Recovery Adjustment Clause (CRAC), the Reserves Distribution Clause (RDC), and the Financial Reserves Policy (FRP) Surcharge. Our Initial Proposal was to use Accumulated Net Revenue (ANR) as the metric to trigger the risk adjustment mechanisms. Mandell *et al.*, BP-20-E-BPA-18, § 4.3. We now propose to use Accumulated Calibrated Net Revenue (ACNR), which is the same metric used during the BP-16 and the current BP-18 rate periods. This testimony also describes proposed changes to the transmission risk analysis to account for use of transmission financial reserves included in the transmission rates settlement.

Section 2: Proposed Changes to the Initial Proposal

Q. Please provide a brief overview of your original proposal.

A. Our original proposal was to remove the "calibration" component of the net revenue metric used in current BP-18 rates. This proposal was intended to simplify the metric and to directly align it with the standard business metric BPA routinely uses to report forecast and actual values through the year. We believed that, although deviations between ANR and financial reserves were likely, those deviations would be relatively small going forward because of the change in Energy Northwest debt accounting. That is, we felt that the need to calibrate for deviations would be very limited and small in amount, and that the gained simplicity outweighed the lost precision.

Q. What are you now proposing as the metric to trigger risk adjustment mechanisms?

A. We propose to have risk adjustment mechanisms trigger based on end-of-year actual ACNR. We propose that calibration events be calculated in a similar manner as in BP-16 and BP-18 rates, including a $5 million *de minimis* threshold.

Q. Why did BPA previously calibrate ANR?

A. Calibrations account for divergences between net revenue (an accrual-based metric) and financial reserves (a cash-based metric).

In BP-16 and BP-18 rates, the risk adjustment mechanisms were targeted at specific levels of financial reserves, but set to trigger off of an accrual-based metric. In order to set the thresholds for these accrual-based metrics, BPA translated financial reserves-based thresholds into accrual-based thresholds that were forecast to be equivalent. One reason we chose to translate financial reserves values to net revenue values was that most of BPA's financial systems and reports are accrual-based.

Typically, changes in cash and accruals track each other quite well during a rate period; an increase or decrease in net revenue often equates to an equal increase or decrease in financial reserves. Therefore, an accrual-based risk adjustment mechanism

trigger would reasonably approximate a cash-based trigger. However, there are accounting and other financial events—such as changes in depreciation, changes in debt repayment, and cash contract settlements—that can cause accrual-based changes that do not have a commensurate impact on BPA's financial reserves, or vice versa.

During prior rate periods, the largest cause of these divergences was Regional Cooperation Debt refinancing. These transactions generally resulted in large increases to net revenue but no change to financial reserves due to differences in how BPA accounted for Federal and non-Federal debt. Calibrating for these events kept the relationship between ACNR and financial reserves from diverging. For these reasons, BPA included in BP-16 and BP-18 rates the ability to calibrate net revenue in the event that such financial events caused net revenue and financial reserves to diverge.

Q. How were calibration events calculated in BP-16 and BP-18?

A. Calibration events were calculated by subtracting the impact of the event on a business line's net revenue from the impact of the event on that business line's financial reserves. If this difference is greater than or equal to the *de minimis* threshold of $5 million (positive or negative), it is added to the Net Revenue Calibration. If the difference is less than the *de minimis* threshold, it is not considered a calibration event and does not affect the Net Revenue Calibration.

This is the same method we are proposing to use in BP-20. See Attachment 4, Proposed Changes to Power and Transmission Risk Study Documentation, BP-20-E-BPA-05A, Example 1: Calibrated Net Revenue Calculations ("Example 1"), for examples of calibration events and how calibration amounts are calculated.

Q. What has changed since the Initial Proposal that caused you to now propose retaining the ability to calibrate net revenue for the BP-20 rate period?

A. We always recognized that net revenue and financial reserves would not track each other perfectly, but expected the deviations going forward to be much smaller than in the past. The largest driver for deviations—Regional Cooperation Debt refinancing—has been largely addressed through accounting changes. Having addressed the largest foreseeable deviation, we expected deviations to be much smaller than they have been in the past. Given the expectation of small deviations, we determined that the lost precision would be outweighed by gained simplicity.

Since that original evaluation, we have recognized the potential for additional unexpected deviations. For example, following publication of the Initial Proposal, we became aware of discussions about changes in how BPA accounts for the Columbia Generating Station decommissioning fund that, if implemented after final rates were set, would likely cause a significant deviation between an accumulated net revenue metric, which is uncalibrated, and financial reserves. The precise accounting changes and the impact on net revenues remain uncertain. BPA's preliminary thinking is that the potential accounting changes would be non-cash, which would cause net revenue to decrease but would have no impact on BPA's financial reserves, nor would it impact cost recovery.

Our proposal in this supplemental testimony is not to solve for any specific, anticipated calibration event. Rather, we were presented with an example of an unforeseen potential event that could cause a large deviation. We did not want potential impacts to risk adjustment mechanisms—that could result from deviations between net revenue and financial reserves—to be a consideration in otherwise unrelated

decisionmaking. It therefore seemed prudent to retain the ability to calibrate in the event that net revenue and financial reserves deviate.

With this new information, we no longer believe the simplicity of uncalibrated ANR outweighs the loss in precision. Regardless of whether and when such an accounting change might occur, the possibility of unwarranted effects on risk adjustment mechanism triggers convinced us to revisit the Initial Proposal and retain the ability to calibrate.

Q. *What changes are you proposing to the Power and Transmission GRSPs, compared to the BP-20 Initial Proposal?*

A. We have updated the proposed Power and Transmission GRSPs to include ACNR language from the BP-18 GRSPs, with a few minor changes. We have simplified the definition of Net Revenue (NR) Calibration. This language update is not intended to change the meaning or calculation of NR Calibration. This language includes a non-exclusive list of events that may qualify for calibration. Our intent in including this language is to illustrate by example some of the events that may differently impact NR and financial reserves. However, *any* financial event not forecast in the BP-20 rate case that differently impacts NR and financial reserves may be an event that gives rise to a calibration. By including this clarifying language, we are not proposing to expand or contract the events that may qualify for calibration. The methodology for determining whether an event has occurred remains the same as in prior rate cases.

We have also proposed a change to the financial performance status reports language in the GRSPs. For example, Section II.O.2(a) of the 2018 Power GRSPs states: "For the Second and Third Quarter Reviews, BPA shall post to its external website (www.bpa.gov) the preliminary, unaudited, end-of-year forecast of Power ACNR." Instead of posting ACNR, we are proposing to post a preliminary forecast of the Power

CRAC, RDC, and FRP Surcharge Amounts. This change allows BPA to provide customers with the information they need to plan for possible rate changes due to the risk adjustment mechanisms, and reduces confusion about which fiscal year the ACNR value is calibrating and accumulating from. This change to the financial performance status reports has also been made in the Transmission GRSPs.

Q. What changes are you proposing to the Power and Transmission Risk Study Documentation, compared to the BP-20 Initial Proposal?

A. We have added "Example 1" to the Power and Transmission Risk Study Documentation, BP-20-E-BPA-05A-CC01. Example 1 gives examples of how certain calibrations would be calculated. This is the same document that was included in the BP-18 Risk Study Documentation, with a few minor changes. Certain terminology has been updated to reflect the GRSP changes described above. Additionally, Example 1 no longer includes BP-18's example regarding EN debt service because, as stated above, changes to BPA's accounting treatment of third-party debt and assets eliminated the large deviations that would occur with Regional Cooperation Debt refinancing.

Q. What documents are impacted by your proposed change?

A. This supplemental proposal requires changes to:

1. 2020 Power Rate Schedules and General Rate Schedule Provisions, BP-20-E-BPA-10;
2. 2020 Transmission, Ancillary, and Control Area Service Rate Schedules and GRSPs, BP-20-E-BPA-11;
3. Power and Transmission Risk Study, BP-20-E-BPA-05; and
4. Power and Transmission Risk Study Documentation, BP-20-E-BPA-05A.

The changes in these documents are shown in Attachments 1– 4 of this testimony.

Q. Are there other areas that are changing from the Initial Proposal?

A. Yes. As was briefly described at the January 22, 2019, clarification session, the use of $29 million of transmission reserves in the transmission revenue requirement to support the transmission rate settlement (Transmission Revenue Requirement Study Documentation, BP-20-E-BPA-09A, at 11) was not incorporated into the transmission risk analysis. We have now corrected this error by decreasing the FY 2020 and FY 2021 Non-Cash Adjustments in the Transmission Net Revenue to Cash Adjustments table by $29 million to reflect this change. These corrections can be seen in Attachment 4, Proposed Changes to Power and Transmission Risk Study Documentation, BP-20-E-BPA-05A, Table 27.

This correction results in decreases in forecast Transmission financial reserves in FY 2020 and FY 2021 and a decrease in the expected value Transmission RDC amount in FY 2021. The expected value Transmission RDC amount in FY 2020 remains the same because that RDC is based on end-of-FY 2019 results. These results can be seen in redline on Attachment 3, Proposed Changes to Power and Transmission Risk Study, BP-20-E-BPA-05, Table 15, and on Attachment 4, Figure 13 and Table 29.

This correction also affects the Agency RDC Thresholds, Transmission CRAC Thresholds, Transmission RDC Thresholds, and Transmission FRP Surcharge Thresholds. The updated thresholds can be found in redline on Attachment 3, Proposed Changes to Power and Transmission Risk Study, BP-20-E-BPA-05, Tables 7, 12, 13, and 14. The same tables are shown in redline on Attachment 1, Proposed Changes to 2020 Power Rate Schedules and General Rate Schedule Provisions, BP-20-E-BPA-10, II.O-Q, and on Attachment 2, Proposed Changes to 2020 Transmission, Ancillary, and Control Area Service Rate Schedules and GRSPs, BP-20-E-BPA-11, II.G-I. Changes to

these values also affect the Toolkit inputs shown in Attachment 4, Proposed Changes to Power and Transmission Risk Study Documentation, BP-20-E-BPA-05A, Figure 12.

Q. Does this conclude your testimony?

A. Yes.