

# ADMINISTRATOR'S RECORD OF DECISION

## Leverage Policy

September 2018





**ADMINISTRATOR’S RECORD OF DECISION**

**LEVERAGE POLICY**

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APPENDIX 1: Leverage Policy



## COMMONLY USED ACRONYMS AND SHORT FORMS

AAC	Anticipated Accumulation of Cash
AWEC	Alliance of Western Energy Consumers
BPA	Bonneville Power Administration
CRAC	Cost Recovery Adjustment Clause
CWIP	Construction Work in Progress
EE	Energy Efficiency
EN	Energy Northwest, Inc.
EWEB	Eugene Water & Electric Board
F&W	Fish and Wildlife
FADS	Funds Available for Debt Service
FCRPS	Federal Columbia River Power System
FERC	Federal Energy Regulatory Commission
FRP	Financial Reserves Policy
FY	fiscal year (October through September)
GRSPs	General Rate Schedule Provisions
IPR	Integrated Program Review
IRPL	Incremental Rate Pressure Limiter
MSR	M-S-R Public Power Agency
NIPPC	Northwest and Intermountain Power Producers Coalition
NRU	Northwest Requirements Utilities
NWPA	Pacific Northwest Electric Power Planning and Conservation Act
PGE	Portland General Electric Company
PNRR	Planned Net Revenues for Risk
PPC	Public Power Council
PSE	Puget Sound Energy, Inc.
PUD	public or people's utility district
RCD	Regional Cooperation Debt
RDC	Reserves Distribution Clause
ROD	Record of Decision
TPP	Treasury Payment Probability
WPAG	Western Public Agencies Group



## LEVERAGE POLICY

### ADMINISTRATOR'S RECORD OF DECISION

#### 1. INTRODUCTION

The Bonneville Power Administration (Bonneville) is a Federal power marketing administration that owns and operates more than 15,000 miles of high-voltage transmission lines and provides roughly 28 percent of the electric power used in the Pacific Northwest.<sup>1</sup> Bonneville is self-financing; it covers all of its costs by selling power and transmission services. Among other obligations, Bonneville is required by law to market Federal power and establish rates that recover its costs consistent with sound business principles. To that end, Bonneville has been granted an expansive mandate to operate as a business and to take such actions as will ensure that Bonneville meets its various statutory obligations, including its debt repayment obligations to third parties and the U.S. Treasury.<sup>2</sup>

Meeting Bonneville's myriad statutory duties requires a substantial amount of capital. The need for capital investments to replace and modernize aging Federal power and transmission infrastructure and support fish and wildlife restoration has grown to an unprecedented level. As of FY 2017, Bonneville had \$15.3 billion in outstanding debt.<sup>3</sup> This number is expected to grow by an additional \$1.6 billion over the next six years.<sup>4</sup> Controlling the growth of this outstanding debt, in relation to the value of the underlying Federal assets, is vital to ensuring the long-term financial health and viability of the Federal Columbia River Power System (FCRPS) for Bonneville's customers and their communities.

This Record of Decision supports Bonneville's development of a new financial policy—a Leverage Policy—that provides guidance on managing one aspect of the agency's accumulation and repayment of debt. Specifically, this policy sets near-term, mid-term, and long-term business-line debt-to-asset ratio targets that limit the accumulation of additional debt that would increase Bonneville's debt-to-asset ratio. Bonneville's debt-to-asset ratio (also known as the leverage ratio) measures the amount of total debt compared to revenue-producing assets that ultimately will repay all debt. The debt-to-asset ratio is a business metric commonly used to measure the financial health of an entity's ability to repay debt obligations.<sup>5</sup> The Leverage Policy described herein will help build Bonneville's financial resiliency, which in turn supports Bonneville's ability in the long-term to meet its many statutory responsibilities and to set rates as low as possible consistent with sound business principles.

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<sup>1</sup> Leverage Policy Presentation at 3 (March 2, 2018), available at <https://www.bpa.gov/Finance/FinancialPublicProcesses/Financial-Reserves-Leverage/frpdocs/Leverage%20Policy%20Public%20Workshop%203.02.2018%20FINAL.pdf> (“Bonneville March 2 Leverage Presentation”).

<sup>2</sup> See *Ass'n of Pub. Agency Customers, Inc. v. Bonneville Power Admin.*, 126 F.3d 1158, 1171 (9th Cir. 1997).

<sup>3</sup> Bonneville March 2 Leverage Presentation at 4. (References to Bonneville, FCRPS, or agency debt or financial data all refer to the same.)

<sup>4</sup> *Id.* at 8 (Transmission adds \$1.9 billion and Power repays \$300 million for a net \$1.6 billion in added debt).

<sup>5</sup> *Id.* at 6.

## 2. BACKGROUND

### 2.1. Bonneville Needs Capital to Support its Statutory Mission

Among other statutory obligations, Bonneville (along with the U.S. Army Corps of Engineers and the U.S. Bureau of Reclamation) is directed to operate and maintain the FCRPS.<sup>6</sup> The FCRPS is the nation's largest hydroelectric producer of carbon-free electricity. Among the resources that produce power marketed by Bonneville is the output of the region's only commercial nuclear plant, the Columbia Generating Station.<sup>7</sup> Bonneville is also directed to maintain and operate the Federal Transmission System, an interconnected system of high-voltage transmission lines that spans 15,000 circuit miles in six states. Together, Bonneville's power and transmission system produces more than \$3 billion in annual sales.<sup>8</sup> The FCRPS power and transmission assets play a central role in the region's electrical system, and managing them in a cost-effective and economically efficient manner is a core part of Bonneville's statutory mission.

Supporting these assets requires significant capital. Originally, Congress appropriated funds to the Corps of Engineers and Bureau of Reclamation for construction of hydroelectric projects, for which Bonneville was (and remains) responsible for repaying the portion attributable to power purposes. For many years, Bonneville also received appropriations from Congress for construction of the transmission system. By the early 1970s, Congress recognized that Bonneville would need a ready source of capital apart from appropriations to facilitate continued investment in transmission facilities.<sup>9</sup> In the Transmission System Act of 1974, Congress authorized Bonneville to issue bonds and other debt securities to the U.S. Treasury (Treasury). This authority is now referred to by Bonneville as Treasury borrowing authority.<sup>10</sup> The Treasury borrowing authority is a revolving line of credit, meaning that the borrower may re-borrow on the line of credit up to the limit amount if it repays prior borrowings. Over time, Congress expanded the uses for the Treasury borrowing authority and increased the amount available, which is currently limited to \$7.7 billion. The proceeds of bonds issued to the Treasury are available to finance capital investments needed to meet Bonneville's statutory obligations.<sup>11</sup> Bonneville may also raise revenues through rates to pay for capital investments outright (referred to as revenue financing) and to enter into lease-purchases with third parties to finance investments in transmission facilities over time.<sup>12</sup>

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<sup>6</sup> Federal Columbia River Transmission System Act, 16 U.S.C. § 838b (2018) ("Transmission System Act.")

<sup>7</sup> Bonneville Power Administration 2018-2023 Strategic Plan at 23 (January 30, 2018), *available at* <https://www.bpa.gov/StrategicPlan/StrategicPlan/2018-Strategic-Plan.pdf> ("2018-2023 Strategic Plan.")

<sup>8</sup> *Id.*

<sup>9</sup> Transmission System Act, § 838(a) ("... it is desirable and appropriate that the revenues of the Federal Columbia River Power System and the proceeds of revenue bonds be used to further the operation, maintenance, and further construction of the Federal transmission system in the Pacific Northwest.")

<sup>10</sup> Transmission System Act §13(a), 16 U.S.C. 838k(a).

<sup>11</sup> *Id.*

<sup>12</sup> Northwest Power Act §6, 16 U.S.C. 839d; Transmission System Act §11(b)(5), 16 U.S.C. 838i(b)(5).

## 2.2. Current Debt Portfolio

At the end of FY 2017, Bonneville had outstanding \$15.3 billion in debt for its power and transmission assets.<sup>13</sup> Approximately \$9.7 billion is attributable to Bonneville's power service operations (Power Services). Of this amount, \$3.9 billion is Federal debt composed of Treasury bonds and outstanding Federal appropriations repayment obligations, while the remaining \$5.8 billion is made up of bonds and similar instruments issued by non-Federal entities (non-Federal debt) and backed financially by Bonneville. The largest portion of non-Federal debt used to support Power Services is debt issued by Energy Northwest, a joint operating agency established under Washington law. Energy Northwest originally incurred this debt to finance construction of three planned nuclear generating stations, the project capability of which Bonneville contracted to take delivery of and to meet all of the costs of. Only one of the three projects was constructed to completion: Columbia Generating Station.<sup>14</sup> It is the only operating commercial nuclear generating station in the Region. Bonneville resells all of the power from the project.

The Federal debt that Bonneville incurred to support its Power Services has financed the original construction of and replacements, renewals, and improvements to the facilities of the Federal hydro system, including generation equipment that produces electric power, conservation, and fish and wildlife mitigation investments.<sup>15</sup>

Bonneville's transmission service operations (Transmission Services) account for approximately \$5.6 billion of the agency's total debt obligation, of which \$3.1 billion is in Federal debt, and \$2.5 billion is non-Federal debt.<sup>16</sup> The vast majority of the non-Federal component of Transmission Services' debt consists of lease-purchase obligations issued by Bonneville's non-Federal partners and repaid with payments by Bonneville. Transmission Services' non-Federal debt also includes the repayment responsibility for some Energy Northwest debt through the Debt Service Reassignment program. Transmission Services' debt is used to sustain program investments in aging transmission equipment and systems, and to expand the existing system to increase capacity and capability.<sup>17</sup>

## 2.3. Statutory Context for Recovering the Cost of Debt in Rates

All of this debt must eventually be paid back by Bonneville through the rates it charges its customers. This follows from Congress's direction that the costs of operating the FCRPS be funded by revenues from power and transmission customers.<sup>18</sup> The Transmission System Act places Bonneville on a self-financing basis, meaning Bonneville funds its operations with revenues from power and transmission customers and does not depend on further appropriations from Congress.<sup>19</sup> Bonneville is rare among Federal agencies in this regard.

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<sup>13</sup> Bonneville March 2 Leverage Presentation at 4.

<sup>14</sup> *Id.* at 4-5.

<sup>15</sup> *Id.* at 5.

<sup>16</sup> *Id.* at 4.

<sup>17</sup> *Id.* at 5.

<sup>18</sup> Northwest Power Act, § 7(a)(1), 16 U.S.C. § 839e(a)(1).

<sup>19</sup> Transmission System Act §11(a), 16 U.S.C. 838i(b).

All of Bonneville’s receipts in cash are deposited into the Bonneville Fund, an account held by the Treasury, and Bonneville uses the amounts in the Bonneville Fund to make cash payments for its operations.<sup>20</sup>

Bonneville establishes its rates to recover its total costs, in accordance with three general principles:

- to encourage the widest possible diversified use of electric power at the lowest possible rates to consumers, consistent with sound business principles;
- to recover the cost of producing and transmitting such electric power, including the amortization of the capital investment allocated to power over a reasonable period of years; and
- to produce such additional revenues as may be required, in the aggregate with all other revenues of the Administrator, to pay Bonneville’s bond debt to Treasury.<sup>21</sup>

Through these directives, Bonneville’s customers and their consumers—rather than taxpayers—bear the cost of the FCRPS.

#### **2.4. Bonneville’s Current Debt Repayment Policies and Practices**

Bonneville’s rates must be sufficient to assure repayment of the cost of servicing its Federal and non-Federal debt, among other costs. The amount of Federal repayment in a rate period is required to be consistent with repaying the Federal debt over a “reasonable period of years.”<sup>22</sup> Historically, a “reasonable period of years” has been a repayment period of a maximum of 50 years.

For rate setting purposes, Bonneville uses a repayment methodology that seeks to establish the lowest level of total debt service over the allowable repayment period for Federal investment.<sup>23</sup> The repayment methodology sets the minimum amount of payments (cost) Bonneville must recover in its revenue requirement used to set its rates.<sup>24</sup> Because Federal repayment has the lowest priority of payment, the repayment model will schedule the repayment of Federal debt around the planned non-Federal repayment, within the maximum constraints defined above. The maximum repayment period for power assets is 50 years. For transmission assets, Bonneville sets the maximum repayment period at 35 years. Since the BP-14 rate case, Bonneville has chosen to ensure that Federal repayment is not less than the cash generated by the revenue requirement (*e.g.*, depreciation and

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<sup>20</sup> Transmission System Act §11(a), 16 U.S.C. 838i(a) (establishing Bonneville Fund).

<sup>21</sup> See Transmission System Act, § 9(1)-(3), 16 U.S.C. § 838g(1)-(3) (2016). See also Northwest Power Act, § 7(a)(1), 16 U.S.C. § 839e(a)(1) (2016); Flood Control Act of 1944, 16 U.S.C. § 825s (2016).

<sup>22</sup> Bonneville Project Act, 16 U.S.C. § 832f (2016).

<sup>23</sup> Bonneville March 2 Leverage Presentation at 7. See *United States Dept. of Energy – Bonneville Power Admin.*, 141 FERC P 62,234, at P 64,701 (December 31, 2012); see also RA 6120.2.

<sup>24</sup> Bonneville March 2 Leverage Presentation at 7.

amortization expense plus other non-cash adjustments).<sup>25</sup> This practice creates a minimum level of Federal repayment. Federal repayment will adjust from rate period to rate period based on actual and forecast non-Federal debt service, capital spending, borrowing, and prior repayment.

The repayment methodology reasonably ensures that Bonneville sets its rates high enough to make its payments to the Treasury on time and in full. And, because debt service payments on Federal debt are subordinate to payments on non-Federal debt, assuring rates are sufficient to meet Federal debt implicitly assures that rates are sufficient to meet Bonneville's required payments to non-Federal debt holders. In 2017, Bonneville made its 34th consecutive annual payment to the Treasury.<sup>26</sup>

## **2.5. Current Policies Do Not Consider Other Reasons to Manage Debt**

### *Bonneville is Highly Leveraged*

While the repayment methodology ensures Bonneville repays its obligations, it does not take into account other reasons to manage Bonneville's debt and asset portfolio. For instance, Bonneville has historically used debt to finance nearly all capital investments. The repayment methodology establishes the lowest level of repayment to ensure that all Federal debt is repaid within the allowable maximum period.<sup>27</sup> The consequence of this practice is that Bonneville today is highly leveraged. Leverage compares a business's debt with its revenue-producing assets (debt-to-asset ratio), which is a common metric used in the utility industry to gauge financial health.<sup>28</sup> A higher percentage of leverage is generally viewed as less healthy than a lower percentage because a highly leveraged business has increased fixed costs (principal and interest) and less flexibility to address uncertainty and risk.

Bonneville's leverage position at the end of FY 2017 was 90 percent.<sup>29</sup> Bonneville's power business line (Power Services) was at 98 percent, and its transmission business line (Transmission Services) was at 79 percent.<sup>30</sup> The average leverage of similar utilities (*i.e.*, utilities in the sector Bonneville is commonly measured against by credit rating agencies) is 54 percent.<sup>31</sup> Bonneville is the second-highest leveraged entity out of the 20 largest in its sector.<sup>32</sup>

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<sup>25</sup> *Id.*

<sup>26</sup> *Id.* at 3.

<sup>27</sup> *Id.* at 7.

<sup>28</sup> *Id.* at 6; *see also* 2018-2023 Strategic Plan, at 16; Bonneville Power Administration 2018 Financial Plan at 11 (February 6, 2018), available at <https://www.bpa.gov/Finance/FinancialInformation/FinancialPlan/Documents/Financial-Plan-2018.pdf>. ("2018 Financial Plan").

<sup>29</sup> Bonneville March 2 Leverage Presentation at 10.

<sup>30</sup> *Id.* at 24.

<sup>31</sup> *Id.* at 16.

<sup>32</sup> *Id.*

Bonneville has traditionally not emphasized leverage as a measure of financial health for either the agency as a whole, or for its Power and Transmission business lines. As a Federal entity, Bonneville cannot employ certain other traditional methods of raising capital, such as issuing equity, so having a higher leverage position than private utilities is not manifestly unreasonable. Moreover, after the termination of Energy Northwest's WNP-1 and WNP-3 nuclear projects, Bonneville had a very high debt-to-asset ratio, at one point over 150 percent.<sup>33</sup> Nonetheless, for many years Bonneville has been on a steady march to reduce its debt ratio. This deleveraging has occurred on an *ad hoc* basis over the years through accelerated debt repayment, shortened maturities of outstanding debt, and the use of current revenues to fund assets (revenue financing).<sup>34</sup>

Currently, as shown in Figure 1 below, Power Services is deleveraging, meaning the amount of outstanding debt is declining relative to the value of the assets included in the debt-to-asset ratio. One of the main ways Power Services is accomplishing this is by paying off more debt in each rate period than Bonneville is incurring for that business line.<sup>35</sup> At the same time, as also shown in Figure 1 below, Transmission Services is becoming more leveraged. This is occurring primarily because Transmission Services' outstanding debt is increasing, mainly due to borrowing more debt than it repays, relative to the value of assets included in the debt-to-asset ratio.<sup>36</sup> While Bonneville's total leverage position is decreasing because of the decline in Power Services' ratio, the effect is being dampened by the increased leverage from Transmission Services. Contributing to the mounting leverage position of Transmission Services is the practice of debt financing both replacement investments (sustain) and new capital projects (expand). In contrast, most utilities use cash produced by a higher revenue requirement in rates to fund some replacement costs.<sup>37</sup>

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<sup>33</sup> Leverage & Financial Reserves Policy Comments and Responses, at 6 (March 19, 2018), *available at* <https://www.bpa.gov/Finance/FinancialPublicProcesses/Financial-Reserves-Leverage/frpdocs/March%20%20Comments%20and%20Responses%20FINAL.pdf>. ("Bonneville March 19 Response To Comments").

<sup>34</sup> *See, e.g.*, 1996 Wholesale Power and Transmission Rate Proposal, Administrator's Final Record of Decision, WP-96-A-01, June 1996, at 76-77:

Congress also is concerned about BPA's capital structure. In a 1994 Senate Appropriations Committee report, the Senate stated, "BPA's reliance on debt financing for capital programs is risky and leaves the agency with little flexibility in meeting future challenges." The Senate report goes on to say that BPA is "too highly leveraged and [the Committee] directs Bonneville to begin rectifying the situation. . . ."

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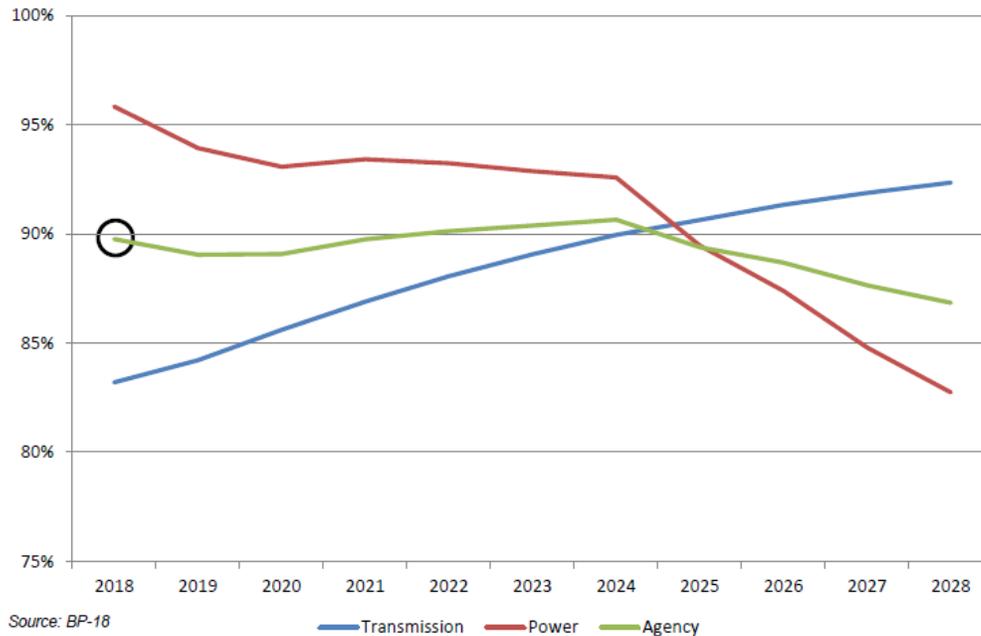
BPA believes it is very important to address the concerns of the GAO and Congress through specific measures, including pursuit of revenue financing. In addition to revenue financing, BPA has pursued several other avenues to reduce its reliance on debt financing and to improve its financial position, including heavy cost cutting in capital programs, joint project development, third party financing of new resource acquisitions, and shifting of some debt between the two existing borrowing authority caps.

<sup>35</sup> Bonneville March 2 Leverage Presentation at 8.

<sup>36</sup> *Id.*

<sup>37</sup> Bonneville March 2 Leverage Presentation at 14; *see also* Bonneville March 19 Response To Comments at 7-8.

Currently, Bonneville revenue finances none of Transmission Services' capital investments.<sup>38</sup>



**Figure 1 - Bonneville and Business Line Leverage Ratios**

*High Leverage Ratio Affects Borrowing Capacity*

Bonneville expects that its capital program will grow substantially over the next 12 years as aging Federal assets will require substantial amounts of new funding to maintain the existing system. Over half of the FCRPS is more than 50 years old, and additional investments will be needed to assure existing system capabilities.<sup>39</sup> Bonneville anticipates that through the FY 2018-2026 period, capital funding needs will be approximately \$600 million per year to sustain existing assets and approximately \$200 million per year for new capital investments.<sup>40</sup>

This concentrated demand on the agency's capital program will be coming at a time when Bonneville's Treasury borrowing authority will be near its limit. Of the \$7.7 billion in authorized Treasury borrowing authority, \$5 billion has already been committed.<sup>41</sup> Bonneville's scarce borrowing authority will be further consumed if either Power Services or Transmission Services become more leveraged. Bonneville anticipates that if no policy

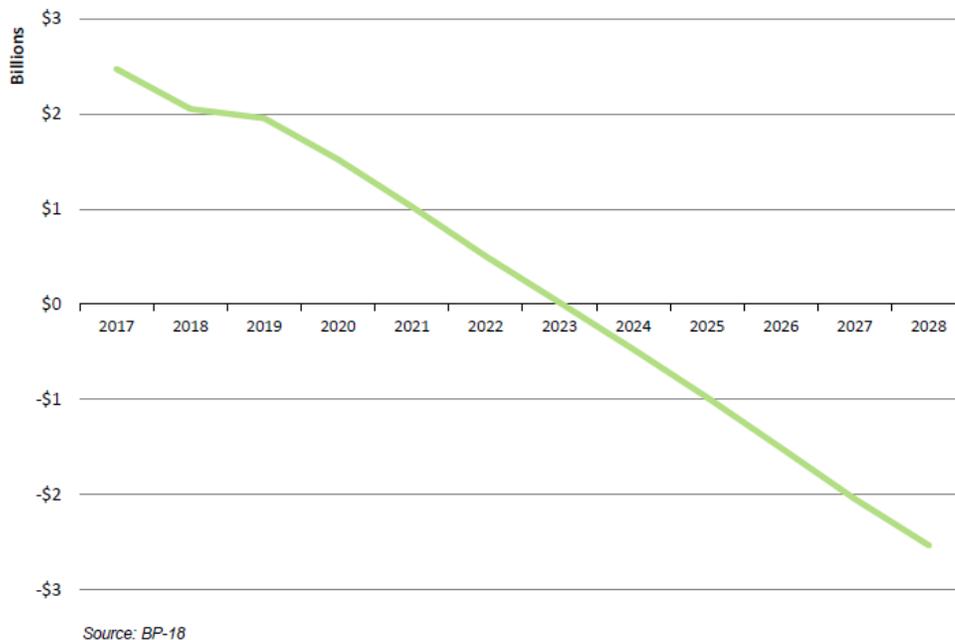
<sup>38</sup> Transmission Services has used \$15 million per year of financial reserves to pay towards its \$300 million to \$500 million capital program since the mid-2000s.

<sup>39</sup> 2018-2023 Strategic Plan at 46.

<sup>40</sup> Bonneville March 2 Leverage Presentation at 14.

<sup>41</sup> 2018 Financial Plan at 12.

changes are made to the current pace of net borrowing for Transmission Services capital needs, the Federal borrowing limit of \$7.7 billion will be reached by 2023 (see Figure 2 below).<sup>42</sup> Bonneville has already conducted workshops to address the overall issue of limited Treasury borrowing authority. Establishing a policy on leverage applicable at the business line level, while not solving Bonneville’s access to capital issues, will help preserve and replenish Bonneville’s limited Treasury borrowing authority.



**Figure 2 - Available Borrowing Authority**

### *High Leverage Affects Credit Rating*

Limited borrowing authority will make reliance on the non-Federal debt market all the more critical to support future capital investments. Bonneville’s ability to access the private market through its non-Federal partners for debt on competitive terms and rates is dependent upon the agency’s credit rating. Bonneville’s credit rating for non-Federal debt is very healthy, with all three major reporting agencies rating Bonneville at the high end of investment grade.<sup>43</sup> In rating Bonneville-backed non-Federal debt at this high level, the credit rating agencies consider (among other factors) Bonneville’s overall leverage position. Recently, however, some of the credit rating agencies have expressed concerns with Bonneville’s high leverage.<sup>44</sup> Entities with a leverage position similar to Bonneville’s (90 percent) are graded at a Baa rating, which is a lower medium grade, the lowest tier of

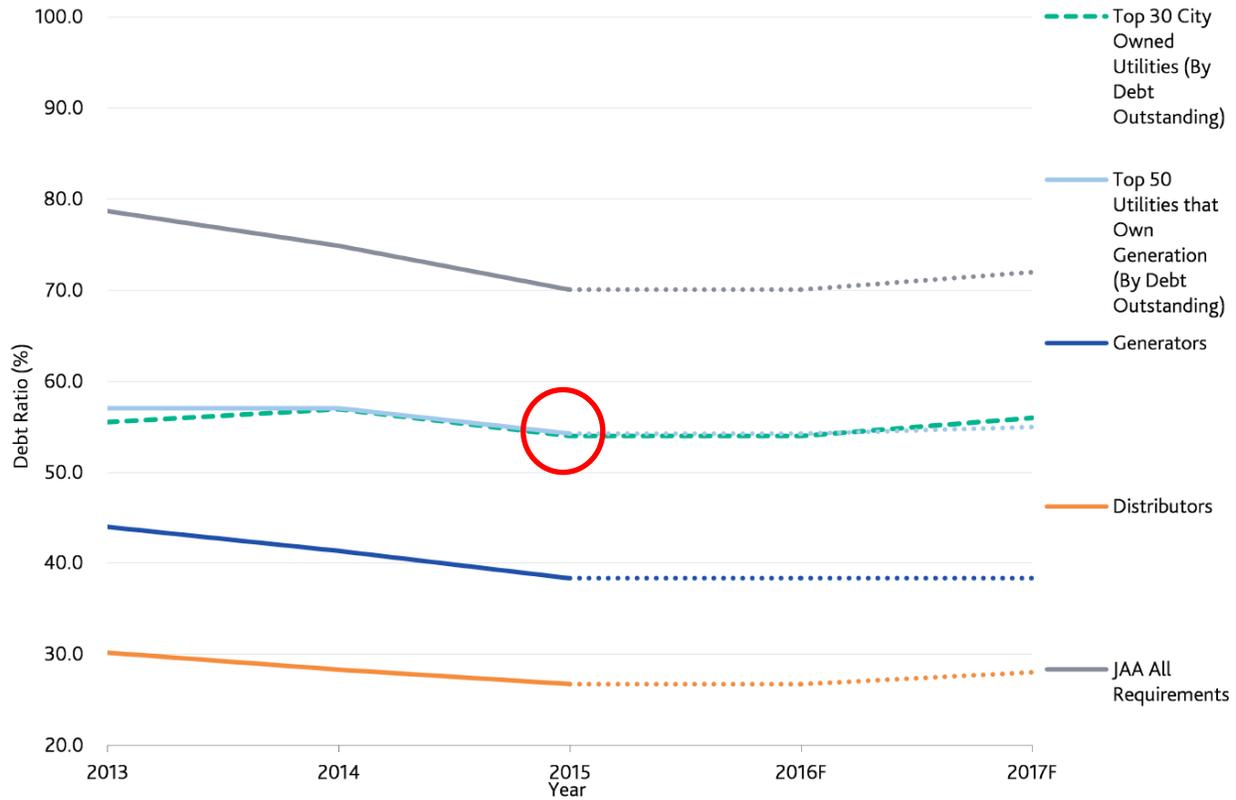
<sup>42</sup> Bonneville March 2 Leverage Presentation at 15.

<sup>43</sup> 2018 Financial Plan at 14.

<sup>44</sup> Bonneville March 2 Leverage Presentation at 17.

investment grade (see Figure 3 below).<sup>45</sup> A downgrade in Bonneville’s credit rating on its non-Federal debt would result in bond terms with higher interest rates, which would increase interest costs. Managing Bonneville’s leverage below current levels would help maintain this high investment grade rated debt and keep interest costs low.

Exhibit 3  
Debt Ratios Continue Recent Declines in Fiscal 2015  
Median debt ratio in fiscal 2013-15, dotted lines represent forecasts for fiscal 2016 and 2017



Source: Moody's Investors Service

Ratings	Top 30 City Owned Generators (By Debt Outstanding)				Top 50 Utilities that Own Generation (By Debt Outstanding)			
	All	Aa	A	Baa	All	Aaa/Aa	A	Baa
<b>Balance Sheet Ratios</b>								
Debt Ratio (%)	54.0	53.5	45.0	95.7	54.3	51.9	55.0	84.1
Days Cash on Hand	214	214	269	115	207	214	254	109
Adjusted Days Liquidity on Hand	242	242	269	115	241	242	262	109

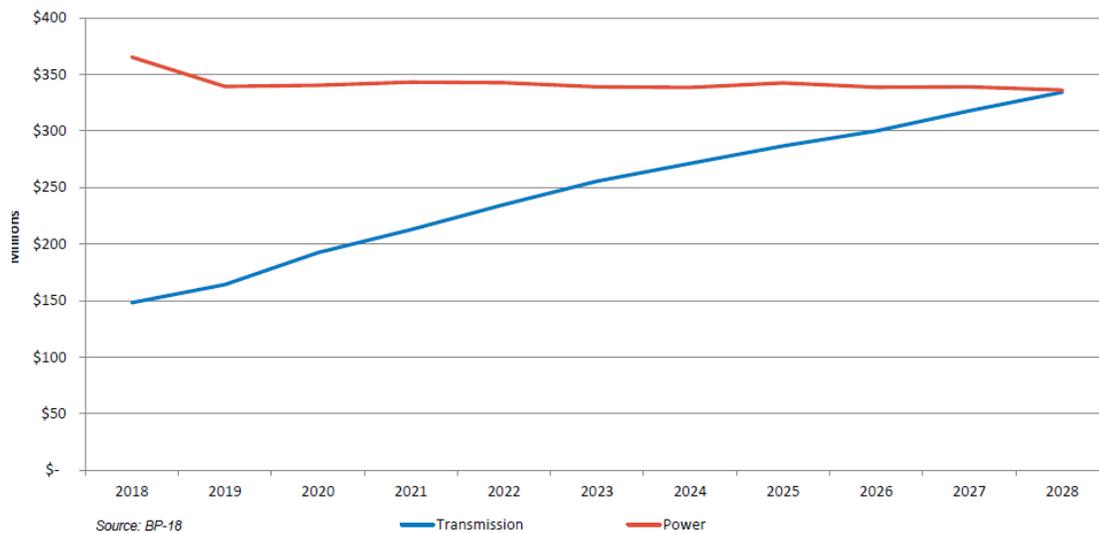
**Figure 3 – Credit Rating Agency View - Bonneville's Leverage Compared to Other Utilities**

*High Leverage Affects Interest Expense and Financial Flexibility*

Increased interest expense – whether because of a downgrade or because of an increase in the amount of debt service – is also a key consideration in a highly leveraged business. A

<sup>45</sup> *Id.*

highly leveraged business has less financial flexibility because it must use more of its current revenue to pay for interest and principal on outstanding debt. This is the case with Bonneville. As a consequence of Bonneville’s current debt payment practices, 40 percent of all costs charged in transmission rates and 32 percent of all costs charged in power rates are for capital-related costs, including debt service.<sup>46</sup> As shown in Figure 4 below, the amount of interest expense will increase in transmission rates as Transmission Services’ leverage position rises.<sup>47</sup>



**Figure 4 - Projected Interest Expense in Power and Transmission Rates**

*Need for Additional Policy Guidance*

As described above, leverage is an important indicator of Bonneville’s long-term financial health and should be monitored and actively managed. However, neither the agency’s nor the business lines’ leverage are addressed by Bonneville’s existing policies or practices. Bonneville does not consider leverage when it determines the amount of debt to repay in the repayment methodology or its debt repayment practices used to establish power and transmission rates. Similarly, Bonneville has not consistently evaluated leverage when deciding its projection of capital spending. In addition, Bonneville’s practice of accelerating repayment of debt or reducing its capital spending has been largely done on an *ad hoc*, rate-period-by-rate-period basis, with little to no guidance from a long-term strategic objective. Developing additional policy guidance that includes a coherent and consistent strategy that manages the agency’s and business lines’ leverage in the context of Bonneville’s overall financial health is both needed and appropriate.

<sup>46</sup> Bonneville March 2 Leverage Presentation at 11.

<sup>47</sup> *Id.* at 12.

## 2.6. 2018 Strategic Plan and Financial Plan

The framework for the current proposal was laid out in January 2018, when Bonneville released its Strategic Plan. The Strategic Plan describes the actions Bonneville will take over the next five years (2018–2023) to “become more competitive and responsive to customer needs, to leverage and enable industry change through modernized assets and system operations, and to deliver on [Bonneville’s] public responsibilities through a commercially successful business.”<sup>48</sup>

The centerpiece of the Strategic Plan is a set of four strategic goals that will guide Bonneville’s actions and policy development.<sup>49</sup> The first of the strategic goals, and the one most relevant to this record of decision, is Strategic Goal 1: Strengthening Financial Health.<sup>50</sup>

One way financial health can be strengthened is by building financial resiliency. In the Strategic Plan, Bonneville defined financial resiliency as the ability of an organization to withstand disruptive events that impact revenues or expenses while continuing to deliver on its mission.<sup>51</sup> To build financial resiliency, Bonneville identified three general areas where additional policy development would be appropriate: Debt Utilization, Debt Capacity, and Liquidity.<sup>52</sup> In the context of Debt Utilization, Bonneville identified the financial objective of reducing the agency’s overall leverage to a range of 75 to 85 percent.<sup>53</sup>

Bonneville provided further policy context for these areas in its Financial Plan, which was issued in February 2018. The 2018 Financial Plan established a “guiding framework for decision-making by defining the financial constraints within which Bonneville operates, and outlines objectives Bonneville has established to strengthen its financial health.”<sup>54</sup> In the Financial Plan, Bonneville again identified managing leverage as a key component of building the agency’s financial resiliency and suggested that a policy be developed that reduced the agency’s leverage position to a range of 75 to 85 percent.<sup>55</sup>

The Strategic Plan and the Financial Plan did not determine whether or how Bonneville should develop a policy on leverage. Rather, both plans identified specific goals Bonneville should consider with regional partners through a “debt-management public process” in the spring of 2018.<sup>56</sup>

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<sup>48</sup> 2018-2023 Strategic Plan at 3.

<sup>49</sup> *Id.* at 9.

<sup>50</sup> *Id.* at 11.

<sup>51</sup> *Id.* at 16.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> 2018 Financial Plan at 3.

<sup>55</sup> *Id.* at 11-13.

<sup>56</sup> 2018-2023 Strategic Plan, at 18; 2018 Financial Plan at 11, 14.

## 2.7. Leverage Policy Development Public Process

On February 2, 2018, Bonneville notified regional stakeholders of the commencement of a public process to discuss the development of a new policy on the agency's leverage. Following that notice, on February 27, 2018, Bonneville published materials that described the importance of leverage, the need to develop strategic objectives to preserve Bonneville's financial health, and the parameters for a proposed Leverage Policy. Those parameters included:

- The agency and its power and transmission services will achieve a debt-to-asset ratio in the range of 75 to 85 percent within 10 years, with a long-term goal of 60 to 70 percent.
- The debt-to-asset ratios will not worsen from rate period to rate period.
- Bonneville will consider capital spending levels and/or additional rate case measures to ensure achievement of debt-to-asset ratio goals.<sup>57</sup>

The February 27th materials also described the potential tools for achieving these goals, including:

- Additional repayment of debt: Revenue from rates is used to repay additional debt above what the repayment methodology schedules.
- Revenue financing: Revenue from rates is used to directly fund capital investments. Avoids increasing outstanding debt.
- Reducing capital investments: Reduces the need for debt or revenue financing.
- Discontinuing regulatory treatment of certain investments: A class of investments would be expensed and funded through current rates rather than capitalized and borrowed for—as was done with Energy Efficiency investments—reducing outstanding debt over time.<sup>58</sup>

A public workshop was held on March 2, 2018 to discuss the materials and to receive initial public comment on the proposals. Parties were invited to submit informal comments, additional alternatives, and requests for additional information by March 8, 2018. Seven comments and requests for information were received. The comments requested, among other things, that Bonneville extend the timeline for making a decision on the Leverage Policy to ensure that parties have an opportunity to request additional analysis. Bonneville posted its responses to the comments and requests for information on March 19, 2018. In its response to the parties' comments, Bonneville agreed to extend the timeline for the Leverage Policy process by delaying the final workshop to April 20, 2018, and extending

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<sup>57</sup> Bonneville March 2 Leverage Presentation at 20.

<sup>58</sup> Bonneville March 2 Leverage Presentation at 21.

the date for final comments on the policy to May 11, 2018. Bonneville also committed to post additional modeling, which it did on April 2, 2018.

A second workshop was held on March 20, 2018. In this workshop Bonneville described the implementation of the Leverage Policy, including which features would be decided in the Leverage Policy process, the rate case, and the Integrated Program Review (Bonneville's cost review process).<sup>59</sup> Bonneville also responded to questions concerning the leverage calculation and presented examples of how the Leverage Policy would have affected power and transmission rates in Bonneville's previous rate case (BP-18). In response to customer concerns over the cost of the Leverage Policy, Bonneville presented projected impacts of the Leverage Policy on current and projected future revenue requirements for both power and transmission rates using various scenarios of deleveraging.<sup>60</sup> Stakeholders were again invited to submit comments, alternatives, and questions for Bonneville's consideration. Seven comments or requests for information were received. Bonneville posted its responses to these comments on April 11, 2018.

On April 20, 2018, Bonneville posted its proposed Leverage Policy. On that same day, Bonneville held a public workshop where it presented the proposed Leverage Policy along with additional analysis in response to customer comments.<sup>61</sup> In that scenario analysis, Bonneville described the effects of the proposed Leverage Policy on power and transmission services and the agency's leverage positions. Bonneville also presented a "preferred" scenario for deleveraging Transmission Services. This scenario put Transmission Services on a parallel path with Power Services for deleveraging the agency.<sup>62</sup> The preferred alternative was not made a component of the Leverage Policy. Instead, Bonneville would establish specific ratio targets for the rate period in accordance with the policy in each rate case.<sup>63</sup>

The formal comment period on the Leverage Policy commenced with the issuance of the policy and closed on May 11, 2018. Stakeholders submitted eleven comments.

### **3. LEVERAGE POLICY**

The Leverage Policy, attached to this Record of Decision as Appendix 1, is comprised of five primary sections.

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<sup>59</sup> Leverage Policy Presentation, at 3 (March 20, 2018), available at <https://www.bpa.gov/Finance/FinancialPublicProcesses/Financial-Reserves-Leverage/frpdocs/Leverage%20Policy%20Public%20Workshop%203.20.2018%20Final.pdf>. ("Bonneville March 20 Leverage Presentation.")

<sup>60</sup> Bonneville March 20 Leverage Presentation at 9-18.

<sup>61</sup> Leverage Policy Presentation, at 8-20 (April 20, 2018), available at <https://www.bpa.gov/Finance/FinancialPublicProcesses/Financial-Reserves-Leverage/frpdocs/Leverage%20Policy%20Public%20Workshop%204.20.2018%20Final.pdf>. ("Bonneville April 20 Leverage Presentation.")

<sup>62</sup> Bonneville April 20 Leverage Presentation at 10 - 11.

<sup>63</sup> *Id.* at 4.

Section 1 provides a broad overview of the Leverage Policy, its stated purpose, and the context for the policy.

Section 2 describes the scope of the Leverage Policy. This section establishes that leverage will be evaluated at the agency level and the business line level. Section 2 also makes clear that the Leverage Policy is intended to guide agency action over multiple rate periods. Therefore, the Leverage Policy, will establish precedent that Bonneville will follow, absent a determination by the Administrator to modify the policy to meet a “changing operating environment.”<sup>64</sup>

Section 3 establishes near-term, mid-term, and long-term leverage targets for Bonneville and its individual business lines (Power Services and Transmission Services). These targets are as follows:

- Near-term: Bonneville will not allow an agency or individual business line debt-to-asset ratio to increase from rate period to rate period.
- Mid-term: Bonneville as an agency and each individual business line will achieve a debt-to-asset ratio between 75 and 85 percent by 2028.
- Long-term: Bonneville aspires to achieve agency and business line debt-to-asset ratios of 60 to 70 percent.<sup>65</sup>

Section 4 describes the implementation features of the Leverage Policy. Included in this section are instructions on how often the leverage ratio will be calculated. In addition, this section describes some of the tools Bonneville may use to reduce the business lines’ leverage, such as “reduced planned capital spending . . . discontinuing regulatory treatment of certain investments . . . additional debt repayment, and revenue-financing capital investments.”<sup>66</sup> Section 4 also describes the forums where Bonneville intends to discuss with regional partners which tools to use.<sup>67</sup>

Section 5 describes an initial phase-in of the Leverage Policy for Transmission Services’ rates. The initial phase-in permits Transmission Services’ “debt-to-asset ratio to rise from the end of BP-18 to the end of BP-20[.]”<sup>68</sup> However, the Leverage Policy will require Transmission Services’ ratio “to be equal to or below the end of BP-18 ratio by the end of

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<sup>64</sup> Leverage Policy at § 2.

<sup>65</sup> *Id.* at §§ 3.1-3.3..

<sup>66</sup> *Id.* at §§ 4.3-4.3.4. Reducing capital spending reduces the magnitude of the ratio’s increase due to additional 100 percent financed assets. For example, assume a business line started with \$80 million of debt and \$100 million of assets. Its debt-to-asset ratio would be 80 percent (80/100). Assume the business line planned to add \$10 million of debt to build \$10 million of assets, resulting in \$90 million in debt and \$110 million in assets. The business line’s new ratio would be 81.82 percent (90/110). However, if the planned spending were reduced to \$5 million of debt and \$5 million of asset, this would result in \$85 million in debt and \$105 million in assets. The business line’s ratio would then be 80.95 percent (85/105).

<sup>67</sup> *Id.* at §§ 4.4-4.6.

<sup>68</sup> Final Leverage Policy, Appendix 1, § 5, (“Leverage Policy”).

the next rate period, BP-22.”<sup>69</sup> This language has been clarified to allow the Administrator to propose some revenue financing in the BP-20 rate case to mitigate the increase in Transmission Services’ debt-to-asset ratio. Bonneville uses the phrase “revenue financing” broadly to include deliberately increasing rates to generate cash either to pay for a capital investment or to repay existing debt.

Section 6 describes in detail how Bonneville intends to calculate its debt-to-asset ratio (*i.e.*, the leverage ratio) for the agency and for each business line.<sup>70</sup>

## **4. RESPONSE TO COMMENTS**

### **4.1. Bonneville’s Decisions to Delay Issuing the Record of Decision and to Provide an Additional Opportunity for Comment**

Bonneville received 11 comments on its proposed Leverage Policy. The comments present a diverse set of views, with some supporting the Leverage Policy, and others opposing it. Almost all commenters requested that Bonneville delay issuing its final decisions on the Leverage Policy (and the related Financial Reserves Policy)<sup>71</sup> to allow Bonneville and commenters additional time to consider the total impact of the Leverage Policy on rates and other related processes.

On June 13, 2018, Bonneville issued a notice delaying issuing this Record of Decision until the end of summer. Bonneville also informed commenters that another opportunity to provide comments on the proposed Leverage Policy would be provided following the close of the IPR process. This additional opportunity for public comment would allow stakeholders to comment on the Leverage Policy in the context of rates and other related processes. Final comments on the Leverage Policy were due on August 2, 2018.

On August 2, 2018, Bonneville received an additional eight comments on the proposed Leverage Policy.

### **4.2. Supportive Comments**

Several stakeholders support Bonneville’s decision to adopt the Leverage Policy. Mason County PUD agrees with Bonneville’s decision to build its financial resiliency and to address its long-term debt service through the Leverage Policy.<sup>72</sup> Mason contends that

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<sup>69</sup> *Id.* at § 5.

<sup>70</sup> *Id.* at §§ 6.1-6.3.

<sup>71</sup> See, e.g., Comments of Mason County PUD No. 3 (Mason County) on BPA’s Financial Reserves and Leverage Policies, FRLP180006, at 3 (May 11, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=335> (“Mason County May 11 Comments”); Comments of Powerex Corp on BPA’s Financial Leverage Policy, FRLP180015, at 3 (May 11, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=335> (“Powerex May 11 Comments.”)

<sup>72</sup> Mason County May 11 Comments at 2.

“action is needed,” and it supports the leverage policy “as proposed.”<sup>73</sup> The Alliance of Western Energy Consumers (AWEC) similarly supports the development of a leverage policy, and agrees such a policy will “improve [Bonneville’s] overall leverage position.”<sup>74</sup> While AWEC submits specific concerns with Bonneville’s calculation of leverage, AWEC “believes it is proper for BPA to manage its business by focusing on overall leverage . . .”<sup>75</sup>

The Eugene Water & Electric Board (EWEB) provides similar supportive comments. EWEB agrees that reducing Bonneville’s power and transmission debt-to-asset ratios “is key to improving [Bonneville’s] overall financial health.”<sup>76</sup> EWEB acknowledges that the Leverage Policy may require Bonneville to reduce capital spending or increase revenue financing in rates, but EWEB states that Bonneville’s “long-term financial viability is important to EWEB and the region,” and the utility “supports [Bonneville] taking these steps.”<sup>77</sup>

Several commenters also agree with Bonneville’s assessment that developing a policy on leverage now is the correct action to address the problems threatening the agency’s overall financial health. Northwest Requirements Utilities (NRU) agrees that Transmission Services is in a capital-intensive phase, which will require additional debt to maintain the current system.<sup>78</sup> Transmission Services’ increased need for capital is coming at a time when Bonneville’s borrowing capacity is projected to run out by 2023, making reliance on non-Federal sources of debt all the more important. Accessing sources of non-Federal debt, in turn, requires Bonneville to rely on its credit rating, which the Leverage Policy will support.<sup>79</sup> NRU also agrees that heavy reliance on debt financing is unsustainable for Transmission Services. Already, 40 percent of Transmission Services’ rates are used to recover debt service. Carrying such a high percentage of fixed costs, coupled with uncertain future revenues, creates “significant and imprudent risk” for Transmission Services.<sup>80</sup> NRU expresses support for the near-term and mid-term targets. NRU also supports the phase-in of the Leverage Policy for BP-20.<sup>81</sup>

The Public Power Council (PPC) agrees that Power Services has been deleveraging the agency through existing actions, such as using Anticipated Accumulation of Cash (AAC) to

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<sup>73</sup> *Id.* at 3.

<sup>74</sup> Comments of Alliance of Western Energy Consumers (AWEC) on BPA’s Proposed Leverage Policy and Financial Reserves Policy, FRLP180010, at 1 (May 11, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=335> (“AWEC May 11 Comments”).

<sup>75</sup> *Id.*

<sup>76</sup> Comments of Eugene Water & Electric Board Regarding on BPA’s Proposed Leverage Policy and Financial Reserves Policy, FRLP180009, at 1, (May 11, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=335> (“EWEB May 11 Comments”).

<sup>77</sup> *Id.*

<sup>78</sup> Comments of Northwest Requirements Utilities (NRU) on BPA’s Proposed Leverage Policy and Financial Reserves Policy (FRP) Phase-in, FRLP180011, at 1-2 (May 11, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=335> (“NRU May 11 Comments.”)

<sup>79</sup> *Id.* at 2.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

pay down debt and by expensing Energy Efficiency costs.<sup>82</sup> PPC also notes that the need for borrowing authority is being driven primarily by Transmission Services' capital program. Power Services, in contrast, has already taken steps to reduce the agency's leverage. PPC contends that requiring Power Services to do more, such as through revenue financing, would not be consistent with cost causation or the agency's goal of maintaining competitive rates.<sup>83</sup> PPC also requests that Bonneville pay close attention to the planned capital levels for both Power Services and Transmission Services and to monitor the likelihood of executing the proposed plans.<sup>84</sup>

Western Public Agencies Group (WPAG) also supports Bonneville's Leverage Policy. Like NRU and PPC, WPAG agrees that Power Services is deleveraging the agency through existing actions, while Transmission Services should be doing more to "arrest" the upward trajectory of its leverage position.<sup>85</sup> WPAG supports the targets in the Leverage Policy and the one-rate-period phase-in of the policy for Transmission Services' rates.<sup>86</sup>

### **4.3. Objections and Concerns**

#### **4.3.1. Overview**

Stakeholders also raise a number of objections and concerns with the proposed Leverage Policy. These comments generally fall into seven broad categories:

- Concerns with the leverage calculation Bonneville proposes to use in the Leverage Policy.
- Concerns that the Leverage Policy will result in an "inequity" between customers of Power Services and Transmission Services.
- Comments claiming that Bonneville has insufficient data to adopt the Leverage Policy.
- Claims that the Leverage Policy violates statutory ratemaking provisions and generally accepted ratemaking principles.
- Arguments that Bonneville has not sufficiently justified the need for adopting the Leverage Policy.

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<sup>82</sup> Comments of the Public Power Council on Implementation Proposals for BPA's 2018 Financial Plan, FRLP180014, at 3 (May 11, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=335> ("PPC May 11 Comments").

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> Comments of the Western Public Agencies Group (WPAG) on Proposed Leverage Policy and Revisions to Reserve Policy, FRLP180012, at 3 (May 11, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=335> ("WPAG May 11 Comments").

<sup>86</sup> *Id.*

- Comments that Bonneville should not adopt a long-term target, but revisit that target post-2028.
- Comments related to the proposed phase-in of the Leverage Policy for Transmission Services in the BP-20 rate case.

Bonneville responds to these comments below.

### **4.3.2. Leverage Calculation**

#### **Issue 4.3.2.1.**

*Whether Fish and Wildlife costs and assets are properly accounted for in Power Services' leverage ratio.*

#### **Public Comments**

AWEC requests that Bonneville include Fish and Wildlife (F&W) costs and assets in the calculation of Power Services' leverage.<sup>87</sup> AWEC contends Power Services' debt-to-asset ratio of 99 percent is likely overstated because not all F&W assets that Bonneville funds are included in Power Services' leverage calculation. AWEC requests that Bonneville explain the magnitude of changing this treatment of F&W costs and assets. AWEC recognizes, though, that this change is unlikely to affect Power Services' deleveraging.<sup>88</sup>

MSR argues that Bonneville should include in Power Services' debt calculation all of its debt associated with F&W programs. MSR argues this debt is in excess of \$500 million and is expected to grow an additional \$200 million in coming years. MSR contends it is inequitable to exclude this from Power Services' debt.<sup>89</sup>

#### **Evaluation**

There are multiple possible variations in calculating an entity's debt-to-asset ratio. The most basic definition of a debt-to-asset ratio is to divide total liabilities by total assets as found on a company's balance sheet in its financial statements.<sup>90</sup> Companies and credit analysts make slight modifications to this basic formula in order to focus on either the asset or debt side of the equation. These modifications continue to provide an accurate picture of leverage to track a company's leverage movements. As an example, Moody's, a rating agency that tracks and uses a company's debt-to-asset ratio to evaluate financial health and credit-worthiness, employs a modified debt-to-asset ratio. Moody's debt-to-asset ratio formula is as follows: Net funded Debt divided by Net Fixed Assets + Net Working

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<sup>87</sup> AWEC May 11 Comments at 2; Comments of AWEC on BPA's Leverage and Financial Reserves Policies, XFRPL180004, at 2 (August 2, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=343> ("AWEC August 2 Comments").

<sup>88</sup> *Id.*

<sup>89</sup> Comments of MSR Regarding Proposed Leverage Policy and Financial Reserves Phase-in, XFRPL180006, at 11 (August 2, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=343> ("MSR August 2 Comments").

<sup>90</sup> D. Hillier, S. Ross, R. Westerfield, J. Jaffe, & B. Jordan, *Corporate Finance: European Edition*, (1st ed. 2010).

Capital.<sup>91</sup> Applying this calculation to Bonneville removes some of Bonneville's current assets such as "Cash and cash equivalents," "short-term investments in U.S. treasury securities," "materials and supplies," "prepaid expenses," and all of Bonneville's listed "Other Assets" from the asset side of the equation. Moody's adds in Bonneville's "Reserves for Risk" as an asset. From the liabilities side of the equation, Moody's removes items under Bonneville's "Other liabilities" category.

Bonneville intends to use a debt-to-asset ratio that compares its debt to its revenue-producing assets.<sup>92</sup> This is a reasonable method for calculating a business's leverage. The term "revenue-producing assets" is used broadly to describe assets, such as those that are identified as "Utility plant" and "Nonfederal generation" in Bonneville's financial statements.<sup>93</sup> These assets generate a product or service that is sold to generate revenue, or are in direct support of revenue generating functions. For Bonneville, revenue producing assets produce and transmit energy products and services. These products and services have future economic value that is captured in the form of revenue to Bonneville.<sup>94</sup>

Furthermore, certain F&W expenditures are included in net utility plant and thus are included in the leverage calculation. Bonneville includes the value of any improvements that are made to the hydro projects or related facilities. Thus, for instance, fish passage improvements at Corps of Engineers and Bureau of Reclamation hydro facilities and Federally-owned fish hatcheries are included in Power Services' net utility plant. Similarly, certain investments made in the Corps of Engineers' Columbia River Fish Mitigation (CRFM) program and the Lower Snake Compensation Plan hatcheries are also included.<sup>95</sup>

AWEC contends that Bonneville should include all direct F&W investments in the debt-to-asset ratio for Power Services.<sup>96</sup> Thus, any spending Bonneville conducts for F&W investments should be included as an asset. AWEC comments that whether an asset is revenue-producing is not consequential to whether that asset should be included in the calculation of leverage.<sup>97</sup> AWEC notes that there are many types of utility investments that do not produce revenue but are still considered assets. For example, a franchise agreement of an investor-owned utility does not produce revenues, but it is still included as an asset on the utility's balance sheet. AWEC argues that Bonneville has a statutory obligation to

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<sup>91</sup> Moody's Investors Service, Public Power Electric Utilities – US, Sector In-Depth report titled: "*Finances Hold Steady with Transition to Lower Carbon Environment*," September 15, 2016.

<sup>92</sup> Bonneville March 2 Leverage Presentation at 6.

<sup>93</sup> *Id.* at 6-7.

<sup>94</sup> Bonneville Power Administration 2017 Annual Report, at 50 (November 2017), available at <https://www.bpa.gov/Finance/FinancialInformation/AnnualReports/Documents/AR2017.pdf>.

<sup>95</sup> Leverage & Financial Reserve Policy Questions and Responses, at 7 (April 18, 2018), available at <https://www.bpa.gov/Finance/FinancialPublicProcesses/Financial-Reserves-Leverage/frpdocs/March%202020%20Workshop%20Customer%20Comments/March%202020%20questions%20and%20responses%20Final.pdf> ("Bonneville April 18 Response to Comments").

<sup>96</sup> AWEC May 11 Comments at 2; AWEC August 2 Comments at 2.

<sup>97</sup> AWEC May 11 Comments at 3.

make direct F&W investments, and if it does not, it cannot continue to provide services and cannot continue to receive revenues from customers.<sup>98</sup>

Bonneville disagrees that all of its F&W program costs should be included in the debt-to-asset calculation. Bonneville excludes all regulatory assets, including those relating to Bonneville's direct F&W program, from this calculation because such spending does not result in an asset (or the product of an asset) owned or operated by Bonneville or its Federal partners and that generates revenue or directly supports a revenue generating asset. Bonneville provides funds in its F&W program to support third parties who then acquire assets, such as land, conservation easements, habitat improvements, and screens on irrigation canals. The investments that these third parties acquire do not result in assets attributable to the FCRPS. Because this funding does not result in an asset (or the product of an asset) that is owned or operated by the Federal government, nor does the asset directly generate revenue or support a revenue generating function for the Federal government, it is appropriate to exclude this funding from Bonneville's debt-to-asset calculation.<sup>99</sup> This treatment is consistent with Bonneville's treatment of energy efficiency (EE) capital investments. Until 2016, Bonneville capitalized certain EE spending. Like the F&W program, this spending does not result in an asset that generates or supports a revenue generating function for the Federal government; it is considered a regulatory asset and is not included in the asset side of the leverage calculation.

AWEC's concerns appear to be related to the manner in which Bonneville chose to finance its F&W projects. AWEC argues that if the Administrator chose to capitalize these projects, and include them on Bonneville's balance sheet as an asset, then it would also be appropriate to include these investments as an asset in Power Services' leverage calculation.<sup>100</sup> AWEC, however, conflates the accounting treatment of Bonneville's F&W costs with the separate issue of whether the costs resulted in an identifiable asset (or product of an asset) that is Federally-owned. This treatment is similar for regulated utilities. For example, assume a utility provides funds to a third party to acquire land in order to mitigate the utility's environmental impacts. That cost could be treated as an expense (and recovered in current rates) or recovered over time as a regulatory asset (with regulatory approval). Whatever the choice, the utility's asset base would not change because a third party (not the utility) acquired the land.

Bonneville has a similar choice with its annual F&W expenses. It could pay a third party for an F&W project and include the full cost of that project in its current rates. Alternatively, Bonneville could pay the third party for the project and then defer recovery of those costs over multiple rate periods. In either case, no additional revenue-producing assets would be added to Bonneville's balance sheet because the one-time costs would not result in any Federally-owned products or services that would produce revenue for the Federal government. Further, in the latter choice, Bonneville would incur debt that would have to

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<sup>98</sup> *Id.*

<sup>99</sup> Bonneville March 20 Leverage Presentation at 7.

<sup>100</sup> AWEC May 11 Comments at 2.

be paid back. That debt would appear in Bonneville's debt-to-asset calculation, even though there would be no corresponding revenue-producing asset.

Moreover, even if Bonneville were to agree with AWEC's comment, it would not change Bonneville's need for the Leverage Policy. As AWEC acknowledged in its comment, including direct F&W investments would be unlikely to affect Power Services' deleveraging.<sup>101</sup>

MSR contends the Leverage Policy irrationally ignores debt incurred by Power Services for F&W investments. MSR argues that the fact that F&W investments are treated as a regulatory asset is immaterial. MSR argues that Bonneville has \$506 million in F&W investments from 2000–2017, and another \$188 million projected for 2018–2021. MSR contends this debt should be included to determine Power Services' leverage and cannot be ignored.<sup>102</sup>

Bonneville is not ignoring F&W debt for Power Services. Bonneville includes debt associated with F&W investments in Power Services' leverage ratio. As discussed above, to the extent that Bonneville borrowed for its F&W investments, that debt is included in Power's debt-to-asset ratio. All categories of debt listed in the FCRPS balance sheet are included as debt in the debt-to-asset ratio calculation, but not all assets listed in the FCRPS balance sheet are included as assets. Assets such as regulatory assets, and other non-revenue-generating assets, are not included.

### **Decision**

*F&W debt and assets are properly treated in Power Services' leverage ratio.*

### **Issue 4.3.2.2.**

*Whether calculating a business line's leverage ratio based on forecast capital spending is reasonable.*

### **Public Comments**

MSR argues that the Leverage Policy is flawed because it relies on a forecast of capital spending. MSR contends that Bonneville has historically underspent its capital budget. MSR argues that basing a Leverage Policy on forecasts would be unreasonable.<sup>103</sup>

MSR also argues that basing the leverage calculation on a forecast is unreasonable because it does not allow for changes in leverage that may be due to unanticipated outages or events.<sup>104</sup>

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<sup>101</sup> *Id.*

<sup>102</sup> MSR August 2 Comments at 3, 11.

<sup>103</sup> Comments of M-S-R Public Power Agency (MSR) Regarding BPA's Proposed Leverage Policy, FRLP180002, at 4 (May 11, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=343> ("MSR May 11 Leverage Policy Comments"); MSR August 2 Comments at 9.

Avangrid Renewables, LLC, Avista Corporation, Idaho Power Company, PacifiCorp, Portland General Electric Company, and Puget Sound Energy, Inc. (“Commenting Parties”) raise a similar argument in their comments.<sup>105</sup>

### **Evaluation**

MSR argues that Bonneville’s decision to use forecast capital spending as the basis for the Leverage Policy is “problematic.”<sup>106</sup> MSR contends that Bonneville has “persistent[ly]” underspent its projected capital spending levels by as much as 30 percent. Because of this disparity, MSR objects to Bonneville’s use of the BP-18 capital figures as the basis for calculating the business lines’ leverage under the Leverage Policy. MSR argues that the BP-18 numbers are stale in light of new capital decisions to use non-wire solutions (thus avoiding transmission capital costs) and have not been “scrubbed” to address the consistent over-forecasting issues reflected in data submitted by Bonneville.<sup>107</sup> MSR also argues that using the forecast change in a business line’s leverage position skews the policy such that Transmission customers bear 100 percent of the burden of the policy, while Power customers have no implementation costs.<sup>108</sup>

Bonneville agrees that actual capital spending is often different from forecast capital spending. However, Bonneville does not view these differences as problematic, because these variances affect both sides of the debt-to-asset ratio. If, for example, actual spending were lower than forecast, Bonneville would borrow less, incurring less debt than forecast. Both the debt and the asset sides of the leverage calculation would be affected by the same amount, resulting in very slight impacts on the ratio. As forecasts are updated throughout the rate case process, the ratio calculations will also be updated so that the most current information is used in the final proposal when the target ratios are set for the rate period.

Furthermore, actual results are used to inform the forecasts of the ratio. Actual results are used to adjust the starting point for the forecasts, which will always start with the last complete fiscal year. Thus, if capital spending levels come in under projections, those reductions will be reflected in the next forecast. Bonneville will always base its forecast capital spending on the best and most recent information.

MSR and Commenting Parties also raise concerns with the flexibility of the capital spending forecast. MSR notes that Bonneville’s system is aging and subject to unanticipated forced outages. MSR is concerned that the Leverage Policy makes no allowance for such occurrences, and, in MSR’s view, this calls into question the use of capital spending

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<sup>104</sup> MSR May 11 Leverage Policy Comments at 5; MSR August 2 Comments at 9-10.

<sup>105</sup> Comments of Commenting Parties on (i) 2018 Integrated Program Review; (ii) Extended: Financial Reserves and Leverage Policies; and (iii) BPA Capital Financing, XFRPL180003, at 15-16(Aug 2, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=343> (“Commenting Parties August 2 Comments”).

<sup>106</sup> MSR May 11 Leverage Policy Comments at 4.

<sup>107</sup> *Id.*

<sup>108</sup> MSR August 2 Comments at 7.

forecasts to justify the Leverage Policy.<sup>109</sup> Commenting Parties argue that the Leverage Policy would require revenue financing for unexpected capital projects.<sup>110</sup>

MSR and Commenting Parties' concerns are misplaced. Any unanticipated outage that causes a change to the capital forecast will be incorporated in the following ratio calculation. Moreover, unanticipated outage repairs are often treated as an annual expense, not capitalized, which does not affect the debt-to-asset ratio calculation. Furthermore, the Leverage Policy retains the Administrator's discretion to address major changes to Bonneville's capital needs. Section 2 of the Leverage Policy states:

The Policy is intended to provide a consistent framework within which BPA can manage its leverage position. To that end, the Policy will constitute precedent that BPA will adhere to in future rate cases absent a determination by the Administrator that the Policy must be modified to meet BPA's changing operating environment.<sup>111</sup>

This language permits the Administrator to revise the Leverage Policy if, for example, a catastrophic event caused significant damage to Bonneville's assets. The Administrator could choose to suspend the implementation of the Leverage Policy for the rate period in which Bonneville was incurring substantial capital costs to repair its system.

MSR claims it is inequitable to utilize capital forecasts to determine the leverage ratios and impose revenue financing.<sup>112</sup> MSR's proposed alternative is to apply a 15 percent downward adjustment to the capital forecast for both business lines, which would eliminate about \$2 billion of projected capital spending overall, and \$1 billion from Transmission. That adjustment would enable Transmission Services to meet the actual proposed Leverage Policy.<sup>113</sup>

Bonneville disagrees that reducing its capital forecast by 15 percent for purpose of the Leverage Policy would be reasonable. While capital spending at the agency level has generally been under projections, business line capital spending has not followed the same pattern. During the 2012 to 2017 time period, Transmission Services' spending has been below, above, and close to the rate case forecasts.<sup>114</sup> These capital forecasts were based on the best information available and determined through the IPR process. If adjustments to Bonneville's capital projections are needed, they should be addressed during the IPR process. Once vetted, these spending forecasts are used in Bonneville's ratemaking process and become Bonneville's expected level of spending. To apply a "downward adjustment" to

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<sup>109</sup> MSR May 11 Leverage Policy Comments at 5; MSR August 2 Comments at 9-10.

<sup>110</sup> Commenting Parties August 2 Comments at 15-16.

<sup>111</sup> Leverage Policy at § 2.

<sup>112</sup> MSR August 2 Comments at 12-13.

<sup>113</sup> *Id.* at 13.

<sup>114</sup> See April 20 Workshop Info Requests Spreadsheet, at Question 7 (May 1, 2018), available at <https://www.bpa.gov/Finance/FinancialPublicProcesses/Financial-Reserves-Leverage/frpdocs/April%2020%20workshop%20info%20requests.xlsx> ("Bonneville April 20 Workshop Info Requests Spreadsheet").

these thoroughly vetted assumptions just for purposes of the Leverage Policy would undermine the process used to develop these projections and result in inconsistent forecasts of Bonneville's capital spending. For these reasons, Bonneville declines to use two different capital projection forecasts. Nonetheless, Bonneville remains committed to developing capital spending forecasts that avoid as much as possible a delta between actuals and rate case forecasts.

### **Decision**

*It is reasonable to calculate a business line's leverage ratio based on forecast capital spending.*

### **Issue 4.3.2.3.**

*Whether the agency's leverage calculation should include only non-Federal debt.*

### **Public Comments**

MSR argues that Bonneville should modify its calculation of leverage by including only non-Federal debt.<sup>115</sup>

### **Evaluation**

MSR argues that Bonneville's calculation of leverage is just one of "several possible calculations."<sup>116</sup> MSR suggests that Bonneville revise the leverage calculation to include only non-Federal debt. MSR argues this is reasonable because (1) Federal debt is subordinated; (2) Federal debt acts more like preferred stock; and (3) the rating agencies rate only BPA's non-Federal debt. MSR also argues that using only non-Federal debt in the calculation would result in both business lines being well within the acceptable debt-to-asset ratio ranges of the credit rating agencies.<sup>117</sup>

Bonneville disagrees that the Leverage Policy should be limited to non-Federal debt. Debt in any form affects Bonneville's business. Higher debt means higher fixed interest and principal costs and lower overall financial flexibility. These constraints arise regardless of whether the debt is Federal or non-Federal. Managing the accumulation and extinguishment of debt is vitally important to Bonneville's long-term financial and competitive interests. To date, Bonneville has had no formal policy by which to gauge the agency's overall financial health in terms of leverage. The Leverage Policy supplies that guidance by providing a metric by which Bonneville can measure its financial health. For this metric to be most useful, it should be comprehensive and include all relevant debt. Removing Federal debt from the calculation would remove over \$7 billion of Bonneville's \$15.3 billion in outstanding debt, or roughly half of Bonneville's overall debt. The resulting ratio would provide an entirely incomplete picture of Bonneville's leverage situation.

MSR's reasoning for excluding Federal debt is also misguided. First, Bonneville is unaware of any financial or accounting practice that would permit Bonneville to exclude its Federal

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<sup>115</sup> MSR May 11 Leverage Policy Comments at 5; MSR August 2 Comments at 10.

<sup>116</sup> MSR May 11 Leverage Policy Comments at 5.

<sup>117</sup> *Id.*; MSR August 2 Comments at 10.

debt from its financial statements. While Federal debt is subordinated to other non-Federal debt, it is still debt that Bonneville must repay. Consistent with generally accepted accounting principles (GAAP), Federal debt is classified as debt on Bonneville's balance sheet. It would not make financial or business sense to have debt on Bonneville's balance sheet, but then exclude that same debt when assessing the agency's leverage.

Second, Federal debt is not preferred stock. Bonneville does not pay dividends to the Treasury; it pays principal and interest as scheduled in rate cases. Further, paying a dividend to a shareholder is not required, and failing to pay a dividend would not necessarily indicate poor financial health for a business. Failing to pay the Treasury, however, would be an important indicator of Bonneville's health. Though subordinate to other non-Federal debt, money borrowed from the Treasury must be repaid pursuant to the terms and conditions agreed to between the agencies. There can be little question that this is how Congress intended Bonneville to view its obligations with the Treasury. In the Transmission System Act, Bonneville's authorization to borrow from the Treasury is described as debt:

The Administrator is authorized to issue and sell to the Secretary of the Treasury from time to time in the name and for and on behalf of the Bonneville Power Administration bonds, notes, and other evidences of indebtedness (in this chapter collectively referred to as "bonds") to assist in . . . [construction and other matters]

Such bonds shall be in such forms and denominations, bear such maturities, and be subject to such terms and conditions as may be prescribed by the Secretary of the Treasury taking into account terms and conditions prevailing in the market for similar bonds, the useful life of the facilities for which the bonds are issued, and financing practices of the utility industry.<sup>118</sup>

Treating this Federal debt as debt in the Leverage Policy is consistent with Bonneville's statutes and properly reflects the character of the repayment obligation between Bonneville and the Treasury.

Third, rating agencies assess Bonneville's overall financial condition based on its ability to repay all obligations, including both Federal and non-Federal. Rating agencies view Bonneville's ability to support its Federal debt as an important indicator of Bonneville's ability to support its non-Federal debt obligations. Further, the calculations used by ratings agencies to assess Bonneville's leverage include both Federal and non-Federal debt.

### **Decision**

*The leverage calculation will include both Federal and non-Federal debt.*

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<sup>118</sup> 16 U.S.C. § 838k(a) (2011).

#### **Issue 4.3.2.4.**

*Whether the Leverage Policy's calculation of leverage properly accounts for (1) financial reserves; (2) Power Services' reliance on the Treasury facility; and (3) depreciation.*

#### **Public Comments**

MSR requests that the leverage calculation in the Leverage Policy be modified. Specifically, MSR comments that (1) Bonneville should reduce the debt by the amount of financial reserves held for risk; (2) the debt for Power Services should include the portion of the \$750 million line of credit relied on in the rate case to support liquidity for Power rates; and (3) the asset value should not be reduced by depreciation because that understates the value of the operating asset.<sup>119</sup>

#### **Evaluation**

##### *Financial Reserves for Risk*

Bonneville disagrees that the calculation of leverage as proposed in the Leverage Policy should be modified. Bonneville's financial reserves for risk (from here on referred to simply as financial reserves) are categorized in two broad categories: cash and cash equivalents (*e.g.*, short-term investments), and deferred borrowing. Deferred borrowing refers to cash used by Bonneville to pay for capital investments for which Bonneville will eventually borrow. Most of Bonneville's financial reserves are in deferred borrowing because it avoids interest expense. Deferred borrowing is accounted for in the ratio by lowering outstanding debt, thereby reducing the debt component of the ratio. In this way, the debt-to-asset ratio calculation indirectly includes most of Bonneville's financial reserves and thus improves the debt-to-asset ratio. Cash and cash equivalents, the smaller portion of financial reserves, along with other current assets, are not included in the leverage calculation because they are not revenue-generating assets.

MSR's suggestion that outstanding debt be reduced by the amount of financial reserves would not be proper. Financial reserves are generally classified as an asset but are not included in the leverage calculation as they are not revenue producing assets. By using financial reserves to reduce debt, Bonneville would be mixing assets with debt, corrupting the calculation. Furthermore, classifying financial reserves as a revenue producing asset would mean that Bonneville should also consider deferred borrowing as a debt since Bonneville intends ultimately to borrow for the spending. As a result, both the asset and debt sides of the ratio would grow with little to no net effect on the leverage calculation.

##### *Treasury Facility*

Bonneville also disagrees that the \$750 million line of credit from the Treasury (Treasury facility) is not properly reflected in Power Services' leverage calculation. By way of background, the \$750 million Treasury facility is a line of credit with the Treasury that Bonneville may use to meet expenses incurred under the Northwest Power Act. In ratemaking, Bonneville assumes the Treasury facility would be available to meet the

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<sup>119</sup> MSR May 11 Leverage Policy Comments at 5-6. MSR August 2 Comments at 10-11.

liquidity needs of the Power business unit (*i.e.*, unexpected costs and to address fluctuations in cash flow). In making this assumption, no actual debt is incurred; it is potential debt. If Bonneville actually draws on the Treasury facility, a debt would be created, and that debt would be included in Power Services' leverage calculation.

MSR argues that, because Power Services is relying on the availability of the Treasury facility for its liquidity needs, the entire Treasury facility should be treated as a debt in Power Services' debt-to-asset ratio. This treatment would not be reasonable. The Treasury facility is not projected debt. Bonneville does not plan on using the Treasury facility to meet any forecast costs when setting rates. No debt obligations are created when Bonneville assumes the Treasury facility is available for Power Services' liquidity needs.

The Treasury facility is thus very different from Power Services' projected capital spending. "Potential" debt is very different from projected debt. Projected capital spending assumes Power Services will incur debt to support the projects. This debt will have to be repaid by both current and future power rates, and Bonneville sets its rates to recover these projected costs. Because projected capital spending is expected to result in a debt that will be reflected in Bonneville's rates, it is properly included in Power Services' leverage calculation. The availability of the Treasury facility, in contrast, has no effect on rates unless drawn upon, and is therefore properly excluded from Power Services' leverage calculation.

Furthermore, while there are various ways leverage and debt-to-asset ratios can be calculated, in none of them is "potential" debt deemed to be an appropriate basis for calculating leverage. Significantly, MSR cites no support for this approach. Generally accepted accounting principles do not treat an undrawn line of credit as a liability or debt. It is a source of liquidity, a source of potential debt, but not actual debt.

MSR's method would also improperly skew the calculation of Power Services' debt-to-asset ratio. The leverage ratio is an indicator of a business's financial health. The higher the ratio, the less healthy a business is because it must use more of its current revenue to service its outstanding debt. Assigning the Treasury facility as debt would skew the leverage ratio for Power Services. Power Services' leverage ratio would appear, on paper, dramatically worse because the \$750 million Treasury facility would be added to Power Services' leverage ratio without an associated asset. This same \$750 million would be additive to Power Services' projected capital spending (approximately \$500 million), making it appear as if Power Services intended to incur \$1.2 billion in new debt. In reality, only the \$500 million in projected capital spending would be "real" projected debt.

Finally, if MSR's logic for including the Treasury facility were adopted, Bonneville would need to count the entire amount of Treasury *borrowing authority* as debt for the purposes of the ratio calculation, regardless of whether it had been used. Unused borrowing authority is, just like the Treasury facility, potential debt. Indeed, the Treasury facility is simply unused borrowing authority. Some of the unused borrowing authority would have to be allocated to Transmission Services, which would worsen its ratio. This extreme measure—which is a logical outgrowth of MSR's proposal—demonstrates the unreasonableness of counting the Treasury facility as debt. Including potential debt

defeats the purpose of the leverage calculation and offers no insight into the financial health of Bonneville's business lines.

### *Depreciation*

MSR suggests that the calculation of leverage in the Leverage Policy be modified so that the asset value is not reduced by depreciation. MSR argues that this treatment is appropriate because depreciation understates the value of the operating asset.<sup>120</sup> MSR also contends that the capital projections for Transmission Services (but not Power Services) reflect a new depreciation study that raises composite depreciation from 2.77 percent to 3.29 percent. This change, according to MSR, raises Transmission rates for non-cash expenses and is another way Bonneville is raising Transmission rates to effectively revenue finance capital improvements.<sup>121</sup> MSR argues this accelerated depreciation also decreases the asset base for purposes of measuring leverage under Bonneville's proposed Leverage Policy. MSR notes that, unlike a private utility, there is no offsetting benefit for reducing the return on rate base. MSR contends that the proposed Leverage Policy turns the higher depreciation rates into a justification for requiring revenue financing of capital assets.<sup>122</sup>

Bonneville does not agree that removing depreciation is appropriate. Depreciation reflects the diminution of an asset's value over its life. It recognizes that an asset is worth less due to the normal wear and tear of its use. Like a personal automobile, power equipment is worth less over time. In a sense, the debt-to-asset ratio looks at the issue of how much an entity is worth compared to what it owes. If the entity were to go out of business, its assets would be sold and used to pay off outstanding debts. The assets would not be sold at the original book value, that is, the original price paid. Instead, they would be sold at a diminished value that factors in their remaining useful life, the original value net of depreciation is an approximation of that. Bonneville performs depreciation studies based in large amounts of industry data, to make sure that the depreciation assumptions of its assets are reflecting the actual diminishing value and cost to replace an aging asset. Regularly updating the depreciation studies should correct for MSR's concern that the depreciated amounts do not reflect the true value of the assets. Recognizing depreciation in the calculation of leverage appropriately accounts for the diminished value of Bonneville's assets and provides an accurate picture of the financial health of the agency.

MSR's concerns with the new depreciation study are also misguided. A new depreciation study and resulting higher depreciation expense is not a pretext for higher revenue financing of capital investments. The new depreciation study reflects the best estimates of how to depreciate Bonneville's assets. To the extent Transmission rates pay down additional debt as a result of this new study, it is a result of Bonneville's repayment practices, not the Leverage Policy. Bonneville is a cost-based entity. Like other utilities, it includes depreciation in its cost structure. Higher depreciation expense increases costs. Depreciation, however, is a non-cash expense, and as such, it produces cash flow for the

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<sup>120</sup> MSR May 11 Leverage Policy Comments at 5-6.

<sup>121</sup> MSR August 2 Comments at 4.

<sup>122</sup> *Id.*

utility. Private utilities have a range of options for the use of this cash flow, including building financial reserves, paying for capital investments, repaying debt, and paying dividends to shareholders. Bonneville can exercise only the first three options since it has no shareholders. Bonneville has chosen, as it has for many years for both business lines, to dedicate the amount of depreciation to the repayment of debt. Bonneville's choice of how to deploy the cash flow resulting from higher depreciation expense has no bearing on Bonneville's customers or the development of the Leverage Policy. Bonneville's customers will still bear the cost of depreciation in rates even if Bonneville chooses to let it accumulate as financial reserves. MSR's claim that Bonneville is using the new depreciation study to require Transmission rates to engage in additional revenue financing is unsupported.

### **Decision**

*The Leverage Policy's calculation of leverage properly accounts for (1) financial reserves; (2) Power Services' reliance on the Treasury facility; and (3) depreciation.*

### **4.3.3. Equity Concerns**

#### **Issue 4.3.3.1.**

*Whether the Leverage Policy results in inequities between Power Service and Transmission Service customers.*

### **Public Comments**

Commenting Parties argue that the Leverage Policy is inequitable to Transmission customers. Leverage for Transmission Services is currently within the mid-term range. Power Services' leverage, however, is above the mid-term range. Nonetheless, the Leverage Policy would require Transmission Services to revenue finance and take other rate action to maintain Transmission Services' leverage position. Power Services will not be required to take any additional rate action because its forecast leverage position is expected to decline.<sup>123</sup> Commenting Parties argue that the Leverage Policy would allow Power Services' leverage ratio to remain "indefinitely" at its current rate (98 percent), while at the same time ratcheting Transmission Services' leverage down.<sup>124</sup> The Commenting Parties argue that adopting a policy that requires Transmission Services—but not Power Services—to take rate action is inequitable.<sup>125</sup>

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<sup>123</sup> Comments of Avangrid Renewables, LLC, Avista Corporation, Idaho Power Company, PacifiCorp, Portland General Electric Company, and Puget Sound Energy, Inc. on BPA's Proposed Leverage Policy and Financial Reserves Policy Phase-in Implementation, at 4 (May 11, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=335> ("Commenting Parties May 11 Comments").

<sup>124</sup> Commenting Parties May 11 Comments at 5, 7; MSR May 11 Leverage Policy Comments at 4.

<sup>125</sup> See Commenting Parties May 11 Comments at 2-5, 7, 9; MSR May 11 Leverage Policy Comments at 2-4; Comments of the Northwest & Intermountain Power Producers Coalition (NIPPC) on Leverage Policy, *Pro Forma* Gap Analysis, South of Alston, and Grid Modernization, FRLP180013, at 2 (May 11, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=335> ("NIPPC May 11 Comments").

MSR raises similar comments. MSR argues that Power Services' leverage is above the Leverage Policy targets, and Transmission Services' is within them. Furthermore, Power Services has had leverage well above the targets for many years, but Bonneville took no rate action to address Power Services' leverage. MSR contends it is inequitable to place the burden of managing the agency's leverage on Transmission customers.<sup>126</sup>

NIPPC also argues that Power Services is not paying its fair share to support the agency's leverage.<sup>127</sup>

### **Evaluation**

The Leverage Policy sets near-term, mid-term, and long-term leverage goals for the agency and each of Bonneville's business lines (Power Services and Transmission Services). The near-term goal prohibits the debt-to-asset ratio of either Power Services or Transmission Services – and therefore the agency - from increasing (when compared to rate case forecasts).<sup>128</sup> This goal halts the increase in leverage for the business lines and the agency. The mid-term goal requires the agency's and business lines' leverage to be within 75 to 85 percent by 2028.<sup>129</sup> This goal provides a range for Bonneville to manage towards as it makes capital and debt financing decisions in each rate case. The long-term goal establishes an aspirational leverage range of between 60 to 70 percent for each business line and the agency for the post-2028 period.<sup>130</sup>

The Leverage Policy includes a number of tools Bonneville may use to ensure that each business line's leverage reaches the near-term and mid-term goals.<sup>131</sup> These tools include reducing capital spending, discontinuing regulatory treatment of certain investments, paying off additional debt, and revenue financing capital projects.<sup>132</sup>

Several commenters oppose the Leverage Policy because they view it as having a disproportionate impact on Transmission customers. The Commenting Parties argue that Power Services is highly leveraged—at 98 percent—and therefore significantly above the mid-term range. Commenting Parties argue that Power Services is not projected to experience any incremental rate impacts from the Leverage Policy because Power Services' leverage is projected to decline (and is expected to continue to decline over the next 10 years), based on meeting the repayment study requirements alone. Commenting Parties note that Power Services' is expected to be within the mid-term range by 2028, under the normal operation of the repayment methodology and practices of its non-Federal debt.<sup>133</sup>

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<sup>126</sup> MSR August 2 Comments at 6.

<sup>127</sup> NIPPC May 11 Comments at 2.

<sup>128</sup> Leverage Policy at § 3.1.

<sup>129</sup> *Id.* at § 3.2.

<sup>130</sup> *Id.* at § 3.3.

<sup>131</sup> *Id.* at § 4.3.

<sup>132</sup> *Id.* at §§ 4.3.1-4.

<sup>133</sup> Commenting Parties May 11 Comments at 2-3; Commenting Parties August 2 Comments at 11, 13.

The Commenting Parties contrast Power Services' position with that of Transmission Services, which is currently within the mid-term leverage range, with a debt-to-asset ratio of 79 percent.<sup>134</sup> However, they note that the Leverage Policy will likely have a direct impact on Transmission customers, because over the next 10 years Transmission Services' leverage is expected to increase if only the repayment methodology and practices are followed. To meet the near-term goal to hold leverage flat, Bonneville will likely have to employ the mechanisms identified in the Leverage Policy. Revenue financing and paying off additional debt are expected to be the primary mechanisms used to maintain Transmission Services' leverage. The Commenting Parties note that simply holding Transmission Services' leverage flat over the next 10 years, as required by the Leverage Policy, will result in a net increase to the Transmission revenue requirement of approximately \$150 million.<sup>135</sup>

MSR raises similar concerns. MSR argues that using the forecast change in leverage skews the policy so that Transmission customers bear 100 percent of the burden of the policy, with "no implementation costs imposed on power customers, despite Power's leverage position being considerably higher . . . and despite the fact that Power's leverage is forecasted to continue to be higher than Transmission's leverage for at least seven or eight more years."<sup>136</sup> MSR similarly argues that the practical consequence of the policy is to "freeze the respective leverage ratios for the business lines."<sup>137</sup> This, according to MSR, could result in Power having a leverage ratio significantly higher than Transmission indefinitely.<sup>138</sup> MSR argues that if leverage is a concern, then Bonneville's focus should be on accelerating the reduction of the business line with the highest leverage (Power Services), not containing the one with the lowest leverage (Transmission Services).<sup>139</sup>

Bonneville does not agree that the Leverage Policy results in an inequity between Power and Transmission customers, either in its design or its application. To begin with, Bonneville disagrees that the Leverage Policy excuses Power Services from taking active steps to meet the mid-term target. The Leverage Policy requires both business lines to achieve the mid-term goal within 10 years. The Leverage Policy states: "Mid-term: BPA as an agency and each individual business line will achieve a debt-to-asset ratio between 75-85% by 2028."<sup>140</sup> This language is mandatory, not permissive. It also applies to both business lines. Power Services, like Transmission Services, will be required to meet the 75 to 85 percent range by 2028.

The Leverage Policy also requires Bonneville to track the performance of both business lines in meeting these objectives. Section 4.1 of the Leverage Policy states: "BPA will

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<sup>134</sup> Commenting Parties May 11 Comments at 2-3, 4; MSR May 11 Leverage Policy Comments at 2-3.

<sup>135</sup> Commenting Parties May 11 Comments at 4.

<sup>136</sup> MSR May 11 Leverage Policy Comments at 2-3.

<sup>137</sup> *Id.* at 4.

<sup>138</sup> MSR August 2 Comments at 9.

<sup>139</sup> MSR May 11 Leverage Policy Comments at 4; MSR August 2 Comments at 9.

<sup>140</sup> Leverage Policy at § 3.2 (emphasis added).

monitor and annually report out its progress toward meeting the Policy's targets." If Power Services' leverage is expected to be outside of the limits of the Leverage Policy, action must be taken. Section 4.6 of the Leverage Policy makes this clear: "BPA also plans to take additional action if it is necessary in order to achieve the mid- and long-term targets. These actions will be determined on a rate case by rate case basis." Thus, for instance, if Power Services' leverage is not forecast to be within the mid-term target range by 2028, Bonneville would need to take steps (including revenue financing) to reach that objective.

MSR and the Commenting Parties also claim the Leverage Policy is inequitable because it requires action on the part of Transmission Services (which is currently within the range of the leverage targets), but requires no additional action be taken by Power Services (which is outside of the leverage targets).<sup>141</sup> The Commenting Parties note that this disparity could last for 10 years.<sup>142</sup> MSR raises a related concern, noting that Transmission Services' leverage remains at 82 percent for several years while Power Services' leverage declines from 94 percent to 84 percent over the same eight-year period.<sup>143</sup> MSR further contends that Power Services' debts are nearly triple those of Transmission Services' (\$15.3 billion versus \$ 5.6 billion), so any change in Transmission Services' leverage will have a relatively small impact on the agency's leverage.<sup>144</sup> NIPPC similarly argues that Power Services is not paying its fair share.<sup>145</sup>

Bonneville disagrees with these commenters' views. First, MSR misstates the facts. Power Services' debts are *not* \$15.3 billion. Bonneville's total debt is \$15.3 billion. Of this amount, Power Services accounts for about \$9.7 billion and Transmission Services accounts for \$5.6 billion.<sup>146</sup>

Second, Bonneville also does not agree that the Leverage Policy is inequitable simply because the near-term effect of the policy on Power Services and Transmission Services is different. The Leverage Policy provides needed policy guidance on managing the agency's and business lines' leverage. Historically, Bonneville has not managed its leverage with any set guidelines or objectives. Because the Leverage Policy is introducing discipline in an area that Bonneville has not previously emphasized, it will naturally have a greater impact on the business line that will be increasing its leverage.

Third, commenters improperly focus on the *incremental* impact of the Leverage Policy. This ignores the fact that, in the absence of policy guidance, Bonneville has made rate-case-by-rate-case decisions that have impacted business line leverage and rates. Power Services' declining leverage is not natural or without cost; it is the result of prior decisions.

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<sup>141</sup> Commenting Parties May 11 Comments at 4; MSR May 11 Leverage Policy Comments at 2-3.

<sup>142</sup> Commenting Parties May 11 Comments at 5.

<sup>143</sup> MSR May 11 Leverage Policy Comments at 3-4.

<sup>144</sup> MSR August 2 Comments at 9.

<sup>145</sup> NIPPC May 11 Comments at 2.

<sup>146</sup> Bonneville March 2 Leverage Presentation at 4-5.

Transmission Services' leverage is within the targets (79 percent), but cannot be maintained at the same level without immediate action. Since 2012, Transmission Services has incurred \$1.8 billion more in debt than it has repaid.<sup>147</sup> This trend is expected to continue, with Bonneville borrowing for Transmission Services more than \$1.9 billion in additional debt above what transmission customers will repay over the next six years.<sup>148</sup> Another related factor contributing to the expected increase in Transmission Services' leverage is that depreciation is outpacing debt repayment. This means the asset value is decreasing faster than the reduction of the asset's related debt, causing the debt ratio to increase. If Bonneville does nothing, Transmission Services' leverage will increase to over 90 percent by 2028—an increase of over 9 percent—which is outside of the Leverage Policy's targets.<sup>149</sup> Concerted action is needed to achieve the agency's leverage objectives with Transmission Services. This action is not discriminatory or inequitable: the Leverage Policy requires both business lines to maintain or reduce their respective leverage ratios. Bonneville must take steps now to ensure that Transmission Services does not become more leveraged, whether through revenue financing, reducing capital spending, paying off additional debt, or changing the regulatory treatment of assets.<sup>150</sup>

Power Services, in contrast, is not within the mid-term target range, but is projected to significantly deleverage over the same time period and be within the mid-term target range by 2028. This decline is due primarily to the fact that Power Services is repaying (and will continue to repay) more debt each year than its assets are depreciated. Additionally, Bonneville has taken a host of rate-case-by-rate-case actions to reduce Power Services' debt over the years. For example, Bonneville has held Power Services' capital program generally flat and chosen to expense the energy efficiency program.<sup>151</sup> These (and other) financial decisions have enabled Power Services to pay off \$100 million more in debt than it has incurred, making it a net debt payer.<sup>152</sup> This trend is expected to continue. Bonneville projects paying off more than \$300 million more in debt than Power Services takes out over the next six years.<sup>153</sup> While Power Services' leverage is expected to be high at 94 percent at the end of FY 2019, it is expected to be 82 percent by 2028, a decline of 12 percent.<sup>154</sup>

The Commenting Parties argue that the “rate impacts” to Power Services of the Leverage Policy are “nonexistent or negligible.”<sup>155</sup> This is only true from an incremental standpoint. Power Services customers are already achieving a significant reduction in the debt-to-asset ratio through the status quo. Power Services is already taking rate action that results in

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<sup>147</sup> *Id.* at 8.

<sup>148</sup> *Id.*

<sup>149</sup> *Id.* at 10.

<sup>150</sup> Leverage Policy at § 4.3.

<sup>151</sup> See Bonneville March 2 Leverage Presentation at 21; see also PPC May 11 Comments at 3.

<sup>152</sup> Bonneville March 2 Leverage Presentation at 8.

<sup>153</sup> *Id.*

<sup>154</sup> Bonneville March 20 Leverage Presentation at 11.

<sup>155</sup> Commenting Parties May 11 Comments at 10.

Power Services' leverage declining year over year. Power Services will not need to take new, incremental, rate action as a result of the Leverage Policy for this decline to occur, and Bonneville expects Power Services' to be within the mid-term range by 2028 based on meeting the repayment study requirements alone.

Furthermore, that repayment comes at a great cost to Power customers. Each year for the next 10 years, Power customers will pay between \$500 million and \$600 million in principal payments.<sup>156</sup> The principal payments go directly to deleveraging the agency, replenishing borrowing authority, and improving the agency's overall financial health. Indeed, without these large payments, the agency's leverage position would substantially increase over the next decade. Requiring that more be done simply because Transmission Services will be required to take steps to maintain its leverage ratio ignores the actions and costs Bonneville has required Power Services to take already.

The Commenting Parties do not dispute that Power Services is repaying more debt than it is incurring.<sup>157</sup> However, they claim that this fact should not "absolve" Power Services from revenue financing under the Leverage Policy.<sup>158</sup> Bonneville agrees. Forecasts of reductions in leverage will not absolve Power Services from revenue financing (or other actions) if it appears that the objectives of the Leverage Policy will not be met. At this point, based on the current implementation of the repayment study and the schedule of non-Federal debt, Power Services is on track to reach the mid-term goals by 2028. If this were to change in the future, the Leverage Policy would require Power Services to take action.<sup>159</sup>

The Commenting Parties argue that Bonneville's proposal requires substantial revenue financing on Transmission Services to meet the agency's mid-term target.<sup>160</sup> NIPPC raises a similar argument, contending that, to achieve the agency's mid-term goal of a debt-to-asset ratio of 79 percent, Bonneville proposes to burden Transmission customers to make up the difference. NIPPC contends that each business line should be responsible to meet Bonneville's financial policies. NIPPC argues that Transmission Services should not be saddled with over-achieving the leverage policy to compensate for Power Services.<sup>161</sup>

Arguments that Transmission Services is bearing the burden of achieving the agency mid-term target are incorrect. Under the Policy, Bonneville reaches the agency mid-term target of 75 to 85 percent only when both business lines meet the requirements of the Leverage Policy. That is, Power Services' leverage must continue to decline as projected (and Transmission Services' leverage must stay flat) to reach the agency target of 75 to

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<sup>156</sup> Bonneville March 20 Leverage Presentation at 9.

<sup>157</sup> Commenting Parties May 11 Comments at 2-3.

<sup>158</sup> *Id.* at 9; Commenting Parties August 2 Comments at 15.

<sup>159</sup> *See* Leverage Policy at § 3.2.

<sup>160</sup> Commenting Parties May 11 Comments at 4.

<sup>161</sup> NIPPC May 11 Comments at 2.

85 percent.<sup>162</sup> There is no scenario wherein the agency leverage target is met solely through revenue financing by Transmission Services.

The Commenting Parties also contend that Bonneville has not adequately supported the Leverage Policy's "imposition of revenue-financing only on the Transmission Business Line for the foreseeable future."<sup>163</sup> They characterize the Leverage Policy as inequitably "imposing" revenue financing on Transmission customers only.<sup>164</sup> The Commenting Parties misunderstand the Leverage Policy. The Leverage Policy does not "impose" revenue financing. Section 4.3 of the Leverage Policy identifies a number of actions Bonneville may take to reduce the debt-to-asset ratio of the business lines. One of these actions is "revenue-financing capital investments."<sup>165</sup> Bonneville, however, has other actions it can take, including reducing capital spending, discontinuing regulatory treatment of certain investments, and paying down additional debt.<sup>166</sup> Bonneville could also take other actions.<sup>167</sup> These actions, as explained in Bonneville's workshop material, are the primary mechanisms that affect the agency's and business lines' leverage.<sup>168</sup>

Further, the Leverage Policy does not impose this obligation "only" on Transmission Services. As discussed above, Power Services is subject to the terms of the Leverage Policy, including the features of Section 4.3 (*e.g.*, revenue financing). If Power Services is forecast not to satisfy either the near-term or mid-term targets, Bonneville would implement the features of Section 4.3 (including revenue financing) to bring Power Services in line with the requirements of the Leverage Policy.

The Commenting Parties also object to the near-term target's ratchet feature of the Leverage Policy.<sup>169</sup> They argue that, even though Transmission Services is within the mid-term target range, if its leverage ratio declines, the Leverage Policy would ratchet Transmission Services' leverage down even further. Bonneville agrees that this is how the Leverage Policy is intended to work. The same ratchet feature will also be applicable to Power Services. The point of the near-term target is to prevent either business line or the agency from losing the ground it gains as the agency deleverages to ranges within the mid-term and long-term targets. Allowing the leverage ratios of both business lines to float up and down, from rate case to rate case, will not provide the long-term certainty or discipline necessary to improve the agency's overall financial health and meet Bonneville's financial objectives. As Bonneville noted in the workshops: "Leverage is a slow moving metric that takes years to influence in a specific direction and therefore is better to manage through a long-term policy as opposed to one rate case at a time."<sup>170</sup> Managing leverage through a

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<sup>162</sup> See Bonneville March 20 Leverage Presentation at 11.

<sup>163</sup> Commenting Parties May 11 Comments at 10-11.

<sup>164</sup> *Id.* at 7-8.

<sup>165</sup> Leverage Policy at § 4.3.4.

<sup>166</sup> *Id.* at §§ 4.3.1-3.

<sup>167</sup> *Id.* at § 4.3 ("These actions may include, but are not limited to, one or more of the following:")

<sup>168</sup> Bonneville March 20 Leverage Presentation at 9-10.

<sup>169</sup> Commenting Parties May 11 Comments at 7; Commenting Parties August 2 Comments at 12-13.

<sup>170</sup> Bonneville March 2 Leverage Presentation at 11.

ratchet feature, which locks in existing leverage gains and prevents a regression back to higher leverage, is both an important aspect of the Leverage Policy and a reasonable means of preserving the value of the Federal power and transmission systems.

Commenters' concerns with the equity of the Leverage Policy also fail to acknowledge that deleveraging a business line has benefits that go beyond additional Treasury borrowing capacity and support for Bonneville's credit rating (benefits that are shared by both business lines). Lower leverage for Transmission Services means lower principal and interest payment for future Transmission ratepayers. As more fully discussed in Issue 4.3.6.2, 40 percent of Transmission Services' revenue requirement is committed to principal and interest payments.<sup>171</sup> This percentage is expected to significantly increase over the next decade in the absence of the Leverage Policy.<sup>172</sup> Maintaining Transmission Services' leverage position preserves the value of the Federal transmission system for future ratepayers by prudently managing the amount of fixed debt expenses that must be recovered in future transmission rates.

### **Decision**

*The Leverage Policy does not create inequities between Power and Transmission customers.*

### **Issue 4.3.3.2.**

*Whether the Leverage Policy is inequitable because of staff's Preferred Plan, which proposes to achieve a 75 percent leverage ratio for Transmission Services by 2028.*

### **Public Comments**

The Commenting Parties, MSR, Powerex, and NIPPC object to the preferred implementation plan for Transmission Services under the Leverage Policy. They claim that implementing this plan would require substantial cost increases to Transmission customers and result in a lower leverage ratio than Power Services in 2028, which is inequitable.<sup>173</sup>

### **Evaluation**

The preferred alternative was a staff proposal presented during the workshops.<sup>174</sup> Under this proposal, Bonneville would manage Transmission Services' leverage to the lower range of the mid-term target, *i.e.*, 75 percent. Staff explained the various benefits of why Bonneville preferred this approach to implement the Leverage Policy.<sup>175</sup>

The preferred alternative was not made part of the Leverage Policy. Instead, it reflects one way the Leverage Policy could be implemented to reach the lower range of the mid-term target for Transmission Services. The near-term, mid-term, and long-term targets do not

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<sup>171</sup> *Id.*

<sup>172</sup> *Id.* at 12.

<sup>173</sup> Commenting Parties May 11 Comments at 2-3; Commenting Parties August 2 Comments at 10-11; Powerex May 11 Comments; NIPPC May 11 Comments at 1.

<sup>174</sup> Bonneville March 20 Leverage Presentation at 12-13; Bonneville April 20 Leverage Presentation at 10.

<sup>175</sup> *Id.*

require this result. Whether Bonneville actually manages to this target is within the discretion of the Administrator:

4.5. Actions related to additional debt repayment above the minimum levels established by the repayment methodology and revenue-financing capital investments will be addressed in the applicable Power and Transmission rate proceeding.<sup>176</sup>

Several comments suggest that this discretionary aspect of the plan makes the Leverage Policy inequitable. The Commenting Parties argue that Bonneville is “forcing” Transmission Services to achieve a debt-to-asset ratio of 75 percent by 2028, without requiring the same action for Power Services. Commenting Parties claim Power Services is expected to achieve only a debt-to-asset ratio of 81 percent by 2028.<sup>177</sup> They note that this proposal would increase the revenue requirement of transmission services by \$578 million by 2028, and claim the interest savings from paying off debt (\$210 million) would be insufficient to offset the increase in the revenue requirement.<sup>178</sup> Powerex raises a similar concern in its comments and argues that this approach “does not appear to accord with equitable treatment of the respective business lines.”<sup>179</sup> MSR also argues that the preferred alternative would require Transmission Services to reduce its leverage by 6 percent, adding about \$1.35 billion in costs to Transmission customers.<sup>180</sup> NIPPC echoes this argument in its comment, arguing that staff’s preferred alternative would have Transmission customers facing significant rate increases to bring Transmission’s debt-to-asset ratio to 75 percent in 10 years.<sup>181</sup>

Bonneville clarifies here that the preferred alternative was a staff-level example of how the Leverage Policy could be implemented. The Leverage Policy does not require Bonneville to achieve the preferred alternative. Bonneville stated in its response to public comments that “[t]he scenarios that provided a 10 year look at expected debt-to-asset ratios will not be included in the Leverage Policy . . . ” and did acknowledge that the preferred scenario would be a goal subject to the Administrator’s discretion.<sup>182</sup> Whether the Administrator would choose to manage either Power Services or Transmission Services to a 75 percent leverage ratio will be based on the facts and circumstances of each rate case.<sup>183</sup>

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<sup>176</sup> Leverage Policy at § 4.5.

<sup>177</sup> Commenting Parties May 11 Comments at 2.

<sup>178</sup> *Id.* at 3; Commenting Parties August 2 Comments at 10-11.

<sup>179</sup> Powerex May 11 Comments at 2.

<sup>180</sup> MSR May 11 Leverage Policy Comments at 3; MSR August 2 Comments at 8.

<sup>181</sup> NIPPC May 11 Comments at 1.

<sup>182</sup> Information Requests & Corrections, at 2, posted May 1, 2018, *available at* <https://www.bpa.gov/Finance/FinancialPublicProcesses/Financial-Reserves-Leverage/frpdocs/Information%20Request%20responses%20Final.pdf>.

<sup>183</sup> *See* Leverage Policy at § 4.5.

## **Decision**

*Staff's Preferred Plan is not part of the Leverage Policy and is not a required approach to implementing the Leverage Policy. The Leverage Policy retains the Administrator's discretion to manage Power Services' and Transmission Services' leverage to achieve the mid-term goal of 75 to 85 percent by 2028 and to position both business lines to achieve the long-term target range of 60 to 70 percent.*

### **Issue 4.3.3.3.**

*Whether the cumulative effect of the Financial Reserves Policy, the Leverage Policy, and other financial processes Bonneville is considering is inequitable to Transmission customers.*

## **Public Comments**

Commenting Parties, MSR, and NIPPC contend that the Leverage Policy, in conjunction with the Financial Reserves Policy and other financial processes (such as access to capital), result in additional costs and burdens on Transmission customers.<sup>184</sup> These parties contend that the cumulative application of these policies is inequitable to Transmission customers.

## **Evaluation**

Commenters express concern over the equity of the Leverage Policy in light of its cumulative effect on other policies Bonneville is considering. For instance, the Commenting Parties argue that it is inequitable to impose financing discipline through the Leverage Policy on Transmission Services while Power Services is allowed to carry low levels of financial reserves despite its greater net revenue volatility.<sup>185</sup> They note that the "cumulative effect" of low financial reserves with the Leverage Policy will "inequitably burden" Transmission customers<sup>186</sup> and urge Bonneville to avoid "undue transmission rate increases" as a result of its policy choices in the Leverage Policy and Financial Reserves Policy.<sup>187</sup>

MSR raises a similar theme in its comments.<sup>188</sup> MSR argues that Bonneville will impose additional costs on Transmission customers but will not allow those costs to be mitigated through financial reserves because Power Services does not have sufficient financial reserves to meet its targets under the Financial Reserves Policy. While Bonneville is proposing to increase Power Services' costs by \$40 million a year to build reserves, MSR argues that growth will not be sufficient to reach the level of agency financial reserves necessary to permit Transmission Services to use its excess financial reserves to offset the

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<sup>184</sup> Commenting Parties May 11 Comments at 5; Commenting Parties August 2 Comments at 2-3; MSR May 11 Leverage Policy Comments at 3; NIPPC May 11 Comments at 1.

<sup>185</sup> Commenting Parties May 11 Comments at 5.

<sup>186</sup> *Id.* at 5, FN 20.

<sup>187</sup> Commenting Parties May 11 Comments at 14-15.

<sup>188</sup> MSR May 11 Leverage Policy Comments at 3; MSR August 2 Comments at 2.

costs of the proposed Leverage Policy until after the 10-year period under study is completed.<sup>189</sup>

NIPPC argues that Transmission customers are already bearing the “full burden of BPA’s Financial Reserves Policy related to cash reserves” and now staff appears poised to recommend that Transmission customers again bear the burden of the Leverage Policy.<sup>190</sup> NIPPC contends that this “fundamental unfairness” is exacerbated by the Financial Reserves Policy, which does not permit Transmission Services to use cash accumulated above its needs to reduce Transmission Services’ debt consistent with the Leverage Policy.<sup>191</sup> NIPPC argues that Bonneville should provide customers with a comprehensive understanding of what Bonneville hopes to accomplish through its proposed financial policies.<sup>192</sup> NIPPC comments that providing this analysis will allow customers to advise Bonneville on the most effective use of Transmission Services’ financial reserves for the near-term and long-term impact on rates. NIPPC gives the example of revising the FRP to permit Bonneville to use financial reserves for reducing Transmission Services’ leverage. NIPPC recognizes that this would require an increase in the amount of reserves collected from Power customers, but NIPPC argues that Transmission customers should not be required to support the majority of the agency’s liquidity targets while facing double-digit rate increases.<sup>193</sup>

Bonneville appreciates the concerns raised in comments that its financial policies can have cumulative effects on its customers. However, Bonneville does not agree that there is a cumulative “cost” to transmission customers occurring under Bonneville’s financial policies. The Financial Reserves Policy (FRP), noted in many comments, serves a separate purpose to the Leverage Policy. As described in detail in the BP-18 Record of Decision<sup>194</sup> and the FRP Phase-In Implementation Record of Decision,<sup>195</sup> the FRP establishes lower and upper thresholds for business line and agency financial reserves. These reserves are needed to ensure that the agency’s and business lines’ overall financial health, provide rate stability and liquidity, and support the agency’s high credit rating. Importantly for Transmission Service customers, the FRP results in no net increase or cumulative cost to Transmission rates. Transmission Services’ financial reserves have met the FRP’s minimum requirements, and as such, Transmission Services is not required to increase its rates to meet any of the FRP’s goals or objectives.<sup>196</sup>

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<sup>189</sup> MSR May 11 Leverage Policy Comments at 3. MSR August 2 Comments at 6.

<sup>190</sup> NIPPC May 11 Comments at 1.

<sup>191</sup> *Id.* at 2.

<sup>192</sup> NIPPC August 2 Comments at 2.

<sup>193</sup> *Id.* at 2.

<sup>194</sup> Administrator’s Final Record of Decision, BP-18-A-04, at 282.

<sup>195</sup> See Administrator’s Record of Decision, Financial Reserves Policy Phase-In Implementation, September 2018, available at <https://www.bpa.gov/news/pubs/Pages/RODs.aspx>.

<sup>196</sup> Power Services, in contrast, has not met the minimum requirements of the FRP (because its financial reserves are below the lower threshold), and therefore, must increase its rates to build financial reserves. As

Several commenters claim that Bonneville's financial policies are inequitable to Transmission customers because they do not permit Bonneville to use financial reserves to mitigate the effects of the Leverage Policy. Bonneville disagrees. Under the FRP, there is a two-part test to determine whether reserves are at a sufficient level to be repurposed. Reserves must be above (1) a business line upper threshold (120 days cash on hand) and (2) the agency's upper threshold (90 days cash on hand).<sup>197</sup> If a business line and the agency financial reserves both exceed the respective upper thresholds, then Bonneville may repurpose those financial reserves for other uses, including repaying debt (or reserve financing). Financial reserves attributable to Transmission Services are currently above Transmission Services' upper threshold, but agency financial reserves are not above the agency upper threshold. Therefore, the reason why Bonneville cannot repurpose financial reserves under the FRP to mitigate the Leverage Policy's effects on Transmission rates is that the conditions needed to allow that repurposing have not occurred. To the extent the commenters disagree with the parameters Bonneville adopted for repurposing financial reserves, their concerns should have been directed to the FRP in the BP-18 rate case, not the Leverage Policy.

Commenters also frame the cumulative effects of the FRP and Leverage Policy as creating an undue "cost" on Transmission customers. That is incorrect. Whether financial reserves are used for other purposes, such as reducing debt, is a discretionary action even under the FRP.<sup>198</sup> Failing to receive a discretionary benefit under the FRP is not a "cost" to Transmission rates. Significantly, prior to adopting the FRP, there was no guidance on when reserves were sufficient to be repurposed. Reserves attributable to Transmission Services could have simply been allowed to continue to accumulate. One reason for adopting the FRP was to provide a pathway for repurposing financial reserves. The FRP established criteria for determining when financial reserves can be used for other purposes. Bonneville explained, in detail, its rationale for setting the upper threshold in this manner in the BP-18 ROD and will not revisit those decisions here.<sup>199</sup>

More generally, even if the FRP and Leverage Policy resulted in cumulative costs to Transmission Services, Bonneville does not see how these policies could be viewed as being inequitable to Transmission customers. These policies apply to both business lines. Power Services (which is incurring incremental costs as a result of the FRP) could be affected by both policies. Thus, there is no unequal application of these policies between the business lines.

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explained in the Financial Reserves Policy Implementation Record of Decision, Bonneville is taking steps to increase Power Services' financial reserves.

<sup>197</sup> See BP-18 Wholes Power and Transmission Rate Proceeding, Administrator's Final Record of Decision, BP-18-A-04, ("BP-18 ROD"), Appendix A, Financial Reserves Policy, at §§ 3.4 (July 26, 2017). ("Financial Reserve Policy").

<sup>198</sup> Financial Reserves Policy at § 3.4.1; See also BP-18 ROD at 326-328.

<sup>199</sup> See BP-18 ROD at 320-331.

The Commenting Parties also claim that the Leverage Policy is inequitable because Power Services has lower financial reserves and greater net revenue risk.<sup>200</sup> These arguments, however, apply to the equity of the FRP, not the Leverage Policy. Bonneville previously addressed the equities of Power Services' lower financial reserves and greater net revenues in justifying the FRP in the BP-18 ROD. There, Bonneville concluded that the FRP properly balanced the equities of Power's lower financial reserves and greater financial risk, with the need to ensure that both business lines were contributing to the agency's financial reserves.<sup>201</sup> Because Bonneville previously found that the FRP is equitable in both its design and application to Transmission customers, there can be no cumulative inequity to Transmission customers created by the Leverage Policy. The Leverage Policy must be viewed on its own merits and in light of the facts presented herein. As described above in Issue 4.3.3.1, the Leverage Policy is equitable to the customers of both business lines.

MSR contends that Power Services' current reserves are so low because Power Services utilized Anticipated Accumulation of Cash (AAC) to pay down debt rather than fund reserves.<sup>202</sup> MSR argues that the Leverage Policy ignores (1) the relationship between the business lines' current leverage positions and the overall financial position of the business lines, (2) the relationship between their relative leverage positions, and (3) the relationship between the leverage position and financial reserves positions.<sup>203</sup>

MSR conflates actions taken in a rate case with actual operations. MSR is correct that Bonneville chose to use the AAC to pay down Power Services' debt. The AAC was expected to occur in 2014–2018 because the repayment model was scheduling less Federal repayment than the amount of cash being generated. During this period, non-Federal debt payments were increasing. The model produced level debt service over the repayment period by reducing Federal repayment in that period. Bonneville was not obligated to use the potential cash flow for debt repayment; it could have allowed reserves to accumulate as it did under similar circumstances in the late 1990s. However, Bonneville chose to increase Federal repayment and avoid building reserves because it would have created inequities between Slice and non-Slice customers.<sup>204</sup> Increased payment of Federal debt also restored borrowing authority available to both business lines. The AAC decision did not cause Power Services' reserves to decline. In each rate case, Power rates were set to ensure reserves remained stable through the rate period. Power Services' reserves declined because the actual results were worse than the rate case forecasts. Therefore, MSR is incorrect to assert that the use of the AAC caused a reduction in Power Services' reserves.

Several commenters also argue that Bonneville is placing an undue burden on Transmission customers as a result of the initial work done in the access to capital workshops. Contrary to these parties' comments, Bonneville has not made any proposed

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<sup>200</sup> Commenting Parties May 11 Comments at 5.

<sup>201</sup> See BP-18 ROD at §§ 6.4.4, 6.5.3.

<sup>202</sup> MSR May 11 Leverage Policy Comments at 5.

<sup>203</sup> *Id.* at 5; MSR August 2 Comments at 10.

<sup>204</sup> Lennox *et al.*, BP-16-E-BPA-13 at 9.

decisions on the appropriate steps to be taken to address Bonneville's access to capital issues. The materials presented in the workshops were intended for discussion and for regional input. The solution addressing Bonneville's access to capital needs will take additional time and will likely involve other parties. Waiting to address the agency's leverage concerns until these other processes are complete would delay the important steps Bonneville can and should be taking now to deleverage. As noted in the introduction to this Record of Decision, and more fully explained in Issue 4.3.6.1 below, regardless of whether Bonneville's access to capital situation improves, Bonneville would continue to have legitimate business reasons to manage its leverage as proposed in the Leverage Policy.

MSR also argues that the FRP creates an extensive period for Power Services to build reserves that it used for rate relief over the last 10 years. Transmission, however, receives no similar structured phase-in. MSR contends that Power Services benefits during the phase-in of the FRP from an "interest free loan" in the form of deferred borrowing. MSR argues that Power Services can fund capital projects during the rate period using Transmission's funds, interest-free. MSR contends that the financial health process ignores this substantial benefit provided by Transmission.<sup>205</sup>

MSR is incorrect. The Leverage Policy includes a limited phase-in for Transmission Services of the Leverage Policy.<sup>206</sup> Further, Power does not benefit from an "interest free loan" in the form of deferred borrowing for the FRP. Bonneville has never planned to have Power Services use Transmission Services reserves to finance capital projects. If Power Services (or Transmission Services) ever relies on the other business line's reserves for any purpose, the borrowing business line replenishes those reserves with interest.

MSR also contends that the Leverage Policy fails to take into account several important factors. MSR claims that the Leverage Policy imposes costs based on each business line's forecast change in leverage, without regard to several factors, including: (1) Power is tying up \$750 million in borrowing authority for liquidity; (2) Transmission rates "continually over-collect[ ] costs" resulting in continued growth of Transmission's reserves; (3) Power rates under-collect, resulting in continued degradation of Power's reserves; and (4) Transmission cannot access its reserves to offset the impacts of the Leverage Policy because of Power's diminishing reserves. MSR argues that these reasons demonstrate that the Leverage Policy places an inequitable burden on Transmission customers to resolve the Agency's limited access to Federal borrowing.<sup>207</sup>

Each of the factors MSR identifies is outside the scope of the Leverage Policy. Bonneville's decision to use the \$750 million Treasury facility for Power Services liquidity is a ratemaking construct. As noted earlier, if Power Services borrows against the facility, that debt would be reflected against Power Services' leverage ratio. Further, MSR's concern that Transmission rates "continually over-collect costs" is not a Leverage Policy issue but a

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<sup>205</sup> MSR August 2 Comments at 4.

<sup>206</sup> Leverage Policy at § 5.

<sup>207</sup> MSR August 2 Comments at 6.

rate case issue. If MSR believes Bonneville's forecasts are faulty, it may raise that issue in the forums in which those forecasts are developed. MSR's concern that Power rates "under-collect" their cost, resulting in the degradation of Power reserves, is similarly a rate case issue, not a Leverage Policy issue. Finally, MSR's objection that Transmission is unable to access its financial reserves because of the level of Power's financial reserves is not a Leverage Policy issue but an FRP issue. As described above, the FRP has been fully vetted and found to be reasonable on its own terms. The Leverage Policy is a separate policy addressing a different aspect of Bonneville's financial health.

### **Decision**

*The cumulative effect of the Financial Reserves Policy, the Leverage Policy, and other financial processes is not inequitable to Transmission customers.*

### **Issue 4.3.3.4.**

*Whether the Leverage Policy should allocate responsibility for revenue financing based on use of Bonneville's borrowing authority.*

### **Public Comments**

The Commenting Parties argue that the Leverage Policy fails to take into account each business line's use of outstanding Federal debt when "allocating" responsibility for revenue financing.<sup>208</sup> They contend that this methodology ignores the "actual leverage and the amount of the outstanding Federal debt of the business line."<sup>209</sup> The Commenting Parties note that both business lines rely on Federal borrowing and each business line has roughly equal amounts of outstanding Federal debt.<sup>210</sup> Thus, they claim it is inequitable, unreasonable, and arbitrary and capricious to adopt the Leverage Policy, which would impose responsibility for revenue financing on one business line without recognizing the outstanding Federal debt of each business line.<sup>211</sup> The Commenting Parties suggest that a more "equitable" approach would be to allocate revenue financing between the business lines "in proportion to its outstanding Treasury borrowing."<sup>212</sup> They argue that Transmission Services should "not solely [be] responsible for the constraints on BPA's Treasury borrowing."<sup>213</sup>

MSR argues that Power Services should be required to revenue finance because it is taking out more Federal borrowing than it is paying off, and thus is a net Federal borrower.<sup>214</sup> MSR contends that Power Services is not a net re-payer of debt when it comes to "critically

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<sup>208</sup> Commenting Parties May 11 Comments at 6-7.

<sup>209</sup> *Id.* at 7.

<sup>210</sup> Commenting Parties May 11 Comments at 7.

<sup>211</sup> *Id.*

<sup>212</sup> *Id.* at 8.

<sup>213</sup> *Id.* at 15.

<sup>214</sup> MSR May 11 Leverage Policy Comments at 4.

scarce” Federal debt.<sup>215</sup> To address declining Federal borrowing authority, MSR argues that the Leverage Policy should mitigate both business lines’ Federal borrowing, not just “force” Transmission Services to revenue finance over \$1.0 billion in capital.<sup>216</sup>

NIPPC raises similar concerns in its comments.<sup>217</sup>

### **Evaluation**

Several commenters claim that the Leverage Policy is intended to solve Bonneville’s access to capital issues. Framed in this manner, commenters argue that the Leverage Policy inequitably allocates the responsibility of resolving the access to capital issue between the business lines. For instance, Commenting Parties contend that Bonneville should revise the Leverage Policy by assigning responsibility for revenue financing based on borrowing authority usage.<sup>218</sup> MSR suggests that Power Services be required to revenue finance because it is taking out more Federal borrowing authority than it is paying off.<sup>219</sup> MSR asserts that the real purpose of the Leverage Policy is to solve Bonneville’s access to capital concerns, and that Bonneville is imposing 100 percent of the first \$1.3 billion of responsibility on Transmission. MSR argues that this result is inequitable and “bad business policy.”<sup>220</sup>

Bonneville disagrees with these characterizations of the Leverage Policy. The Leverage Policy is not designed to solve Bonneville’s borrowing authority concerns or allocate responsibility for preserving borrowing authority. Rather, the Leverage Policy is designed to look at the business lines’ and the agency’s leverage position. To that end, the amount of revenue financing required by either business line under the Leverage Policy is not determined by available Federal borrowing authority. Bonneville recognizes that revenue financing will preserve available borrowing authority relative to a decision to incur Federal debt, but that is not the variable solved for by the Leverage Policy. Instead, the amount of revenue financing (or other action) is determined by what is required for each business line to meet the Leverage Policy targets: (1) the business line ratio will not worsen from rate period to rate period; and (2) the agency and each business line will achieve a ratio between 75 to 85 percent by 2028.

MSR argues that the primary beneficiary of the access to capital target of retaining \$1.5 billion in borrowing authority is Power Services, but Transmission Services is being required to shoulder the burden of supporting access to capital through the Leverage Policy and “possibly” through the Access to Capital policy. MSR claims that Power is the primary beneficiary of the \$1.5 billion in borrowing authority that Bonneville seeks to retain because Power relies on the \$750 million Treasury note for liquidity, and the

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<sup>215</sup> *Id.* at 2; MSR August 2 Comments at 3.

<sup>216</sup> *Id.* at 7.

<sup>217</sup> NIPPC August 2 Comments at 2-3.

<sup>218</sup> Commenting Parties May 11 Comments at 8, 15; Commenting Parties August 2 Comments at 7-8.

<sup>219</sup> MSR August 2 Comments at 4.

<sup>220</sup> *Id.* at 6.

remaining \$750 million is needed to meet urgent capital needs due to Power not having insurance for catastrophic events. MSR argues that Transmission customers do not have a similar need as they “fund insurance premiums for Transmission.”<sup>221</sup> NIPPC raises a similar argument in its comments, noting that Bonneville’s proposal in the Access to Capital process to maintain \$1.5 billion in Treasury borrowing authority places the bulk of maintaining the agency borrowing authority on Transmission customers.<sup>222</sup>

MSR’s and NIPPC’s arguments attempt to frame the Leverage Policy as an access to capital policy. It is not. The Leverage Policy supports Bonneville’s need for capital, but does not solve that specific issue. The criteria Bonneville has developed to measure leverage and guide the agency’s actions go beyond simply preserving the agency’s borrowing authority. As discussed below, managing leverage has multiple benefits to both current and future rate payers. Moreover, Bonneville believes that adopting a policy on leverage is a reasonable business decision. The Leverage Policy will provide important guidance on when Bonneville will take active steps to manage the agency’s leverage, which promotes the agency’s overall financial health.

Commenting Parties also argue that allocating revenue financing under the Leverage Policy based on outstanding Federal debt is consistent with cost causation.<sup>223</sup> Bonneville disagrees. Federal debt is not the only basis for maintaining a healthy leverage position. Bonneville’s credit rating and future flexibility in rate setting are also supported by deleveraging the agency. Further, assigning the responsibility to deleverage based on which business line is using Federal debt is not reasonable because it only takes into account part of the debt picture. Each business line has both Federal and non-Federal debt. Assigning a business line the responsibility to revenue finance simply because it is using Federal borrowing authority does not take into account other forms of issuing debt as well as whether the business line is repaying debt.

### **Decision**

*Leverage Policy will not be revised to allocate responsibility for revenue financing based on use of Bonneville’s borrowing authority.*

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<sup>221</sup> *Id.* at 4.

<sup>222</sup> NIPPC August 2 Comments at 2-3.

<sup>223</sup> Commenting Parties August 2 Comments at 7.

#### 4.3.4. Sufficiency of Data

##### Issue 4.3.4.1.

*Whether Bonneville's decision to adopt the Leverage Policy is supported by sufficient information.*

##### **Public Comments**

Commenting Parties argue that Bonneville should have analyzed the projected rate impacts of the Leverage Policy.<sup>224</sup> Commenting Parties also contend that Bonneville has not provided any detailed analysis supporting the need for the Leverage Policy.<sup>225</sup>

Seattle City Light also requests that Bonneville not make a decision on the Leverage Policy until Bonneville provides its customers with financial analysis of the costs and benefits of the policy.<sup>226</sup>

##### **Evaluation**

As noted earlier, Bonneville engaged in a robust public process to present its analysis and take customer input on the proposed Leverage Policy. This dialogue was not a one-way street. The public was invited to make inquiries of Bonneville, and Bonneville posted its answers to their questions.<sup>227</sup> For instance, on March 19, 2018, Bonneville published responses to informal public comments submitted by stakeholders.<sup>228</sup> Bonneville also posted detailed forecasts of its non-Federal debt issuance and interest rates, and projected sustain and expand capital forecasts.<sup>229</sup> Bonneville also supplied source materials for its depreciation studies,<sup>230</sup> responses to requests from the April 20 workshop,<sup>231</sup> and a

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<sup>224</sup> *Id.* at 12.

<sup>225</sup> *Id.* at 13.

<sup>226</sup> Comments of Seattle of City Light on 2018 Integrated Program Review (IPR), Financial Reserves, Leverage, IPR1818 0023, at 3 (August 2, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=345> ("Seattle August 2 Comments").

<sup>227</sup> <https://www.bpa.gov/Finance/FinancialPublicProcesses/Financial-Reserves-Leverage/Pages/Financial-Reserves-Leverage-Policies.aspx>.

<sup>228</sup> *See, generally*, Bonneville March 19 Response To Comments.

<sup>229</sup> 2016 Capital Investment Review Total Agency Sustain Spending Spreadsheet, posted April 2, 2018, available at <https://www.bpa.gov/Finance/FinancialPublicProcesses/Financial-Reserves-Leverage/frpdocs/2016%20CIR%20Sustain%20vs%20Expand.xlsx>.

<sup>230</sup> Bonneville Power Administration, 2016 Depreciation Study, September 30, 2016, available at <https://www.bpa.gov/Finance/FinancialPublicProcesses/Financial-Reserves-Leverage/frpdocs/Depreciation%20Study%20implemented%20in%202018.pdf>; Bonneville Power Administration, 2010 Depreciation Study, September 30, 2010, available at <https://www.bpa.gov/Finance/FinancialPublicProcesses/Financial-Reserves-Leverage/frpdocs/Depreciation%20Study%20implemented%20in%202012.PDF>.

<sup>231</sup> Information Requests & Corrections, posted May 1, 2018, available at <https://www.bpa.gov/Finance/FinancialPublicProcesses/Financial-Reserves-Leverage/frpdocs/Information%20Request%20responses%20Final.pdf>.

spreadsheet that addressed numerous questions from stakeholders' comments.<sup>232</sup> Bonneville also performed additional scenario analyses requested by commenters.<sup>233</sup>

The Commenting Parties argue that Bonneville's failure to quantify and present for discussion projected increases in rates for Transmission Services resulting from the proposed Leverage Policy (1) prevented the commenters from providing informed comment on the Leverage Policy, and (2) deprived Bonneville of rate information that is essential in evaluating the impacts of the Leverage Policy.<sup>234</sup> Commenting Parties acknowledge that Bonneville provided projections of revenue financing and projected interest savings, but note that the agency has not analyzed projected rate impacts to its Transmission customers, even after customers asked for such analyses.<sup>235</sup> The Commenting Parties contend that it would be arbitrary and capricious for Bonneville to adopt the Leverage Policy without considering the future rate impacts of the policy.<sup>236</sup>

Bonneville recognizes that stakeholders want to understand the potential impact of the Leverage Policy on rates. However, Bonneville was concerned that providing commenters with future projections of transmission rates with the Leverage Policy would be neither practical nor useful for evaluating the policy.

First, it is unclear what additional value these projections would have on evaluating the Leverage Policy. The forecasts would have been based on projections and speculation about what future transmission costs and sales could be. Each of these projections, on its own, would have had a significant margin for error. If Bonneville were to add the Leverage Policy's effects into an already uncertain picture of the future, the effect of the Leverage Policy could easily have been either overstated (having a large impact on rates) or completely muted (not reflecting any impact on rates at all). The multiplicity of variables that can affect rate levels makes projecting future rates an imprecise and difficult endeavor. These projections would be even less certain when adding a variable like the effects of the Leverage Policy. As an example of the difficulty in projecting future rates, in the BP-18 rate case, Bonneville projected a transmission rate increase of 1.1 percent at the beginning of the rate case in November 2016. Eleven months later, at the end of the proceeding in September 2017, that number turned into a net *decrease* of 0.7 percent, largely due to changes in repayment results. Similarly, in the BP-18 rate case, Bonneville projected a power rate increase of 3.5 percent, but ended with an increase of 5.4 percent. The administrative burden of producing these rate projections outweighs any slight incremental value they may have provided to Bonneville's evaluation of the Leverage Policy.

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<sup>232</sup> April 20 Workshop Info Requests Spreadsheet, posted May 1, 2018, available at <https://www.bpa.gov/Finance/FinancialPublicProcesses/Financial-Reserves-Leverage/frpdocs/April%2020%20workshop%20info%20requests.xlsx>.

<sup>233</sup> Bonneville April 20 Leverage Presentation at 17-18.

<sup>234</sup> Commenting Parties May 11 Comments at 4.

<sup>235</sup> *Id.*; Commenting Parties August 2 Comments at 12.

<sup>236</sup> Commenting Parties May 11 Comments at 5.

Second, while Bonneville chose not to develop future rate projections for the reasons noted above, Bonneville did consider the relative impact of the Leverage Policy on its costs. This information, which Bonneville provided to stakeholders, demonstrated the projected change to the revenue requirement with the effects of the Leverage Policy included.<sup>237</sup> This approach allowed Bonneville to isolate the effects of the Leverage Policy on Bonneville's projected costs, which is the area most impacted by the Leverage Policy. From this analysis, Bonneville and commenters could see the relative effects of the Leverage Policy on Bonneville's revenue requirement over time. Although it did not provide a total picture of future rate impacts (because projected sale and revenue forecasts were not included), this analysis provided ample data to Bonneville and stakeholders about the impacts of the Leverage Policy on costs over the 10-year horizon Bonneville evaluated. Bonneville also prepared multiple scenarios showing how the Leverage Policy would have impacted current costs<sup>238</sup> and future revenue requirement projections under various conditions.<sup>239</sup> Bonneville also made available its source data for these projections, and provided subsidiary responses to questions regarding this data.<sup>240</sup>

Commenting Parties claim that they could not provide informed comments without projected rate information.<sup>241</sup> Bonneville disagrees. They did offer informed comments. These parties submitted over 30 pages of detailed comments on the Leverage Policy, notwithstanding the lack of projected rate information.

Moreover, it is unclear whether such rate projections would have added to their comments. Commenting Parties have argued that "it is apparent that the rate impacts of the Proposed Leverage Policy to the Transmission Business Line will be substantial, whereas the rate impacts of the Proposed Leverage Policy to the Power Business Line will be nonexistent or negligible."<sup>242</sup> The Commenting Parties also make numerous references to the cost impacts of the Leverage Policy on transmission customer rates, even without specific projections of those rates.<sup>243</sup>

The Commenting Parties also contend that Bonneville must have projected rate information to adopt the Leverage Policy.<sup>244</sup> Bonneville disagrees that this is necessary. The projected cost information described above provides ample information on the future impacts of the Leverage Policy on Transmission Services' costs. This analysis demonstrates that the Leverage Policy would impact Transmission Services' costs. Bonneville has taken that outcome into consideration in formulating the Leverage Policy. In light of that impact,

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<sup>237</sup> Bonneville March 20 Leverage Presentation at 9-10; Bonneville April 20 Leverage Presentation at 8-9,17-18.

<sup>238</sup> Bonneville March 20 Leverage Presentation at 6-7; Bonneville April 20 Leverage Presentation at 5.

<sup>239</sup> Bonneville March 20 Leverage Presentation at 9-10, 11-13, 16-18; Bonneville April 20 Leverage Presentation at 17-18.

<sup>240</sup> See April Workshop Info Request Excel Spreadsheet.

<sup>241</sup> Commenting Parties May 11 Comments at 4.

<sup>242</sup> *Id.* at 10.

<sup>243</sup> See, e.g., Commenting Parties May 11 Comments at 10, 13, 14.

<sup>244</sup> *Id.* at 4.

Bonneville has proposed to include in the Leverage Policy a phase-in period, which will allow Transmission Services' leverage ratio to increase for up to a rate period before the near-term target feature of the Leverage Policy becomes applicable.<sup>245</sup>

The Commenting Parties acknowledge that Bonneville has taken steps to mitigate the cost impact of the Leverage Policy on Transmission customers, but then argue that this phase-in does not "adequately mitigate" the impacts on transmission rates.<sup>246</sup> The Commenting Parties, however, do not suggest or propose "adequate mitigation" for the Leverage Policy. The phase-in provides Transmission Services one rate period to absorb current expected increases in costs before full application of the Leverage Policy. This is a prudent means of initiating the Leverage Policy before the near-term target to hold the ratio flat is applied in the BP-22 rate proceeding. Because of Bonneville's need to sustain its financial health, a delay beyond BP-22 would not be reasonable. The BP-22 rate proceeding will begin in 2021, leaving Bonneville only seven years (effectively three rate periods) to achieve its Leverage Policy objectives by 2028.

The Commenting Parties also argue that Bonneville has failed to respond to their "detailed comments and proposals" submitted on April 6, 2018.<sup>247</sup> They contend that while Bonneville states that it addressed public comments in its workshop materials and responses to comments, these documents contain "no analyses of, and do not even address . . ." their detailed comments.<sup>248</sup>

This criticism is unwarranted. Contrary to the Commenting Parties' complaint, Bonneville responded with analyses to the Commenting Parties' questions in workshop materials and subsequent responses. For instance, in Bonneville's response to comments, Bonneville answered six questions posed by the Commenting Parties.<sup>249</sup> In those responses, Bonneville responded to the question about the treatment of the \$750 million line of credit in the Power Services' liquidity calculation.<sup>250</sup> Bonneville also addressed questions about "flat capital" and provided supporting analysis.<sup>251</sup> Bonneville also explained why it did not perform a separate rate projection for the Leverage Policy.<sup>252</sup> To the extent that the Commenting Parties posed a question or proposal, Bonneville responded to it. However, most of the April 6, 2018, comments submitted by Commenting Parties are not a request for analysis or a suggested proposal, but legal and policy arguments against adopting the Leverage Policy.<sup>253</sup> Bonneville did not believe it would be prudent or useful to address

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<sup>245</sup>Bonneville April 20 Leverage Presentation at 10; Leverage Policy at § 5.

<sup>246</sup> Commenting Parties May 11 Comments at 10.

<sup>247</sup> Commenting Parties May 11 Comments at 10; Commenting Parties August 2 Comments, at 16.

<sup>248</sup> Commenting Parties May 11 Comments at 10.

<sup>249</sup> See Bonneville May 1 Information Request & Correction at 2-3.

<sup>250</sup> *Id.* at 3.

<sup>251</sup> *Id.* at 2.

<sup>252</sup> *Id.* at 3.

<sup>253</sup> See Commenting Parties Comment, April 6, at 1 ("To the extent that BPA adopts a leverage policy, BPA must do so pursuant to a reasoned decision and comply with the applicable requirements of the Administrative Procedure Act and BPA's governing statutes."), at 2 ("The result of BPA's proposed leverage

policy and legal arguments in response to the Commenting Parties' comment in workshop materials or in a response for information. Instead, Bonneville reserved its responses for this Record of Decision, which is addressing Commenting Parties' legal and policy arguments.

The Commenting Parties also assert that Bonneville has not presented "any analysis of the costs and benefits of adopting the Proposed Leverage Policy, has not demonstrated that the Proposed Leverage Policy is the appropriate approach to the limited Treasury borrowing authority, and has not justified adoption of the Proposed Leverage Policy."<sup>254</sup> Seattle City Light similarly argues that Bonneville should not make a decision on the Leverage Policy until it provides customers a financial analysis of the costs and benefits of the policy.<sup>255</sup>

Bonneville has provided analysis on the costs and benefits of the Leverage Policy. As described in detail above, Bonneville provided extensive analysis demonstrating the cost of the Leverage Policy, including analysis of the Leverage Policy on existing rates,<sup>256</sup> as well as projections of future costs in the revenue requirement.<sup>257</sup> Bonneville also explained the benefits of managing the agency's and business lines' leverage. These benefits include lowering the agency's debt-to-asset ratio (which supports the agency's long-term financial health)<sup>258</sup> improving financial flexibility, reducing the interest expense in future rates,<sup>259</sup> preserving the agency borrowing authority,<sup>260</sup> and supporting the agency credit rating.<sup>261</sup> The Commenting Parties' and Seattle City Light's claims that Bonneville provided no "analyses of the costs and benefits" of the Leverage Policy are unsupported. Furthermore, Bonneville did not demonstrate that the proposed Leverage Policy is the appropriate method to limited Treasury borrowing authority because that is not the purpose of the policy. The analysis and approach regarding Treasury borrowing authority was discussed, and will continue to be addressed, in capital financing workshops and plans.

## **Decision**

*Sufficient information has been provided to discuss and make a decision on establishing a leverage policy. Bonneville's decision to adopt the Leverage Policy is supported by sufficient information.*

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policy would be to force the Transmission Business Line to bear all of the responsibility for revenue financing for the foreseeable future to meet the Agency's leverage goal. As discussed below, this would be inequitable and would result in undue transmission rate increases."); and at 3 ("There has been no showing that BPA needs to adopt a leverage policy.")

<sup>254</sup> Commenting Parties May 11 Comments at 5.

<sup>255</sup> Seattle August 2 Comments at 3.

<sup>256</sup> Bonneville March 20 Leverage Presentation at 6-7; Bonneville April 20 Leverage Presentation at 5.

<sup>257</sup> Bonneville March 20 Leverage Presentation at 9-10, 11-13, 16-18; Bonneville April 20 Leverage Presentation at 17-18.

<sup>258</sup> Bonneville April 20 Leverage Presentation at 11.

<sup>259</sup> *Id.* at 12.

<sup>260</sup> *Id.* at 13.

<sup>261</sup> Bonneville March 2 Leverage Presentation at 16-17, 18.

### 4.3.5. Statutory and Ratemaking Comments

#### Issue 4.3.5.1.

*Whether the Leverage Policy violates Bonneville's statutory ratemaking requirements.*

#### **Public Comments**

Commenting Parties contend that Bonneville's statutes require it to recover the costs of its Federal assets over a "reasonable period of years."<sup>262</sup> Commenting Parties argue that the Leverage Policy would violate this provision because it would require revenue financing of Federal assets, which would result in paying off the assets before the end of the assets' useful life. Commenting Parties assert that revenue financing would increase Transmission rates and violate Bonneville's statutory obligation to recover Federal assets over a reasonable period of years.

Commenting Parties and MSR also argue that Bonneville is not applying the "reasonable period of years" statutory standard consistently between Power and Transmission rates.<sup>263</sup>

#### **Evaluation**

Section 7(a)(1) of the Northwest Power Act requires that Bonneville set its power and transmission rates as follows:

to recover, in accordance with sound business principles, the cost associated with the acquisition, conservation, and transmission of electric power, including the amortization of the Federal investment in the Federal Columbia River Power System (including irrigation costs required to be repaid out of power revenues) over a reasonable period of years and the other costs and expenses incurred by the Administrator pursuant to this chapter and other provisions of law. Such rates shall be established in accordance with sections 9 and 10 of the Federal Columbia River Transmission System Act (16 U.S.C. 838) [16 U.S.C. 838g and 838h], section 5 of the Flood Control Act of 1944 [16 U.S.C. 825s], and the provisions of this chapter.

The Commenting Parties argue that section 7(a)(1) of the Northwest Power Act requires Bonneville to recover the costs of Federal assets over a "reasonable period of years."<sup>264</sup> They note that the Leverage Policy would require revenue financing over the next decade in amounts ranging from \$150 million to \$368 million. They claim that the transmission assets revenue financed, however, will have useful lives extending to 50 years or more. The Commenting Parties assert that requiring substantial rate increases to recover this

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<sup>262</sup> Commenting Parties May 11 Comments at 6; Commenting Parties August 2 Comments at 7.

<sup>263</sup> Commenting Parties May 11 Comments at 6; Commenting Parties August 2 Comments at 7; MSR May 11 Leverage Policy Comments at 4.

<sup>264</sup> Commenting Parties May 11 Comments at 6.

amount of revenue financing would violate the statutory requirement to recover the costs of such assets over a “reasonable period of years.”<sup>265</sup>

In effect, Commenting Parties argue that the phrase “reasonable period of years” is a statutory directive requiring Bonneville to finance its assets over the “useful li[f]e” of the transmission asset. This is not the meaning of the statutory language. The statutory language (“reasonable period of years”) has been interpreted by Bonneville and the Department of Energy for many years to mean establishing the maximum time frame over which Bonneville must repay Federal investment in Federal assets (typically a maximum of 50 years or less).<sup>266</sup> Significantly, the statutory language does not dictate how Bonneville must finance its capital programs. It only states that Federal money appropriated by Congress or borrowed from the Treasury to fund Bonneville programs must be repaid over a “reasonable period of years.” If Bonneville decides to fund its capital programs with something other than borrowing money from the Treasury, then there is no “Federal investment” that must be paid back over a “reasonable period of years.”

The following hypothetical helps to explain. If Bonneville proposes to incur \$100 million in cost for a new transmission line, Bonneville has the discretion to partially fund \$25 million with cash raised through rates and incur debt for the remaining \$75 million. That decision is entirely permissible under Section 7(a)(1) of the Northwest Power Act.<sup>267</sup> The portion paid up front (\$25 million) would be a present cost, recovered in current rates as part of Bonneville’s “total system costs.”<sup>268</sup> The portion paid by debt (\$75 million) would be a “Federal investment” that would have to be recovered over a “reasonable period of years” (typically 35 years for transmission assets).

Revenue financing capital investments is not a new concept. Bonneville has revenue financed capital investments many times in prior rate cases.<sup>269</sup> FERC, which is required to

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<sup>265</sup> *Id.* at 6; Commenting Parties August 2 Comments at 7.

<sup>266</sup> See RA 6120.2, § 10d(1).

<sup>267</sup> 16 U.S.C. §839e(a)(1).

<sup>268</sup> 16 U.S.C. § 839e(a)(2)(B).

<sup>269</sup> See, e.g., 1983 Wholesale Power Rate and Transmission Rate Adjustment Proceeding, Administrator’s Final Record of Decision, WP-83-A-02, at 74-75 (September 29, 1983) (Bonneville decides to revenue finance 5 percent of construction and conservation program); 1985 Wholesale Power Rate and Transmission Rate Adjustment Proceeding, Administrator’s Final Record of Decision, WP-85-A-02, at 59-67 (April 26, 1985) (Bonneville decides to revenue finance 7.5 percent of new construction and conservation plant in service to ensure a reasonable “investment service coverage”); 1987 Wholesale Power Rate and Transmission Rate Adjustment Proceeding, Administrator’s Final Record of Decision, WP-87-A-02, at 41-47, (July 29, 1987) (Bonneville decides to revenue finances \$39.3 million in FY 1988 and \$49.8 million in FY 1989); 1993 Wholesale Power Rate and Transmission Rate Adjustment Proceeding, Administrator’s Final Record of Decision, WP-93-A-02, at 87-88 (July 22, 1993) (Bonneville decides to revenue finance WNP-2 capital expenditures with a service life of 10 years or less); 1996 Wholesale Power Rate and Transmission Rate Adjustment Proceeding, Administrator’s Final Record of Decision, WP-96-A-02, at 74-78, (June 14, 1996) (Bonneville decides to revenue finance \$22 million per year for WNP-2 investments and \$15 million per year for transmission investments).

review Bonneville's rates for compliance with repaying the Federal investment over a "reasonable period of years," has approved Bonneville's rates in each instance.<sup>270</sup>

The Commenting Parties also argue that the "reasonable period of years" language applies to both Power Services' and Transmission Services' rates.<sup>271</sup> They claim that if Bonneville interprets this statutory language as requiring it to recover the costs of power assets over their useful life (without revenue financing), then Bonneville should similarly interpret this language as requiring it to recover the costs of transmission assets over their useful life (without revenue financing).<sup>272</sup>

The Commenting Parties conflate Bonneville ratemaking obligations with Bonneville's capital finance decisions. These are two different decisions. No Federal law requires Bonneville to borrow to fund all its capital projects. Additionally, no Federal law prohibits Bonneville from using revenues generated by rates to pay for all or some portion of a capital asset. Bonneville has discretion to determine the best and most effective means of financing its capital program. As described throughout this Record of Decision, Bonneville's decision to maintain its business lines' leverage through revenue financing a portion of its capital programs, among other actions, is entirely reasonable.

The Commenting Parties also insinuate that Bonneville intends to apply its statutory standards inconsistently between Bonneville's business lines.<sup>273</sup> That is incorrect. The repayment methodologies for both business lines will continue to model the minimum payment of Federal debt over a reasonable period of years. Parity between the business lines in this regard will continue no matter the actions Bonneville takes as a consequence of the Leverage Policy.

MSR argues that revenue financing violates Bonneville's obligation to set rates at the lowest levels possible consistent with sound business principles because it increases Transmission rates above the level necessary to meet its costs if the same financing mechanism used for Power Services were applied to Transmission Services.<sup>274</sup>

Bonneville disagrees. Bonneville will set both Power and Transmission rates at the lowest levels possible "consistent with sound business principles."<sup>275</sup> The Leverage Policy

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<sup>270</sup> See *U.S. Dept. of Energy – Bonneville Power Admin.*, 32 FERC ¶ 61,014 (July 2, 1985) (approving Bonneville's 1983 power and transmission rates); *U.S. Dept. of Energy – Bonneville Power Admin.*, 39 FERC ¶ 61,078, at P 61,207-208 (April 29, 1987) (approving Bonneville's 1985 power and transmission rates and finding Bonneville's decision to include 7.5 percent of revenue financing for an investment service coverage was "appropriate"); *U.S. Dept. of Energy – Bonneville Power Admin.*, 54 FERC ¶ 61,235 (March 5, 1991) (approving Bonneville's 1987 power and rates and investment service charge); *U.S. Dept. of Energy – Bonneville Power Admin.*, 67 FERC ¶ 61,351 (June 20, 1994) (approving the Bonneville's 1993 power and transmission rates); *U.S. Dept. of Energy – Bonneville Power Admin.*, 80 FERC ¶ 61,118 (July 30, 1997) (approving Bonneville's 1996 power and transmission rates).

<sup>271</sup> Commenting Parties May 11 Comments at 6; Commenting Parties August 2 Comments at 7.

<sup>272</sup> Commenting Parties May 11 Comments at 6.

<sup>273</sup> *Id.* at 6.

<sup>274</sup> MSR May 11 Leverage Policy Comments at 4; MSR August 2 Comments at 15.

<sup>275</sup> 16 U.S.C. §838g (2011).

supports this statutory requirement because managing the agency's and business lines' leverage ratios strengthens the agency's financial health, improves financial flexibility, lowers future interest and principal costs, supports the agency's credit rating, and helps manage the agency's borrowing authority.<sup>276</sup>

Finally, commenters' general statements that revenue financing is inconsistent with Bonneville's ratemaking statutes or sound business principles are foundationally misplaced. The logical conclusion from such a view is that Bonneville must use debt for all of its capital investments and that such debt cannot be repaid earlier than the useful life of the underlying assets. In other words, Bonneville must have a debt-to-asset ratio of 100 percent in perpetuity. No sound business would willingly operate in such a state. As noted in the workshops, the average debt-to-asset ratio for public utilities with generating assets is 54 percent.<sup>277</sup> Bonneville is an outlier with a ratio that is nearly double the average (90 percent). Bonneville is unaware of any utility that strives for high leverage. Two of MSR's own members have debt-to-asset ratios that are well below Bonneville's, with one well under 50 percent.<sup>278</sup> A third member has seen a significant decline in leverage, from 109 percent to 91 percent in just over two years.<sup>279</sup> Clearly, these entities do not believe it makes good business sense to be highly leveraged. In a similar way, Bonneville finds no statutory impediment to taking prudent steps (such as revenue financing) to preserving its own long-term financial health by managing its leverage to a reasonable level.

### **Decision**

*The Leverage Policy does not violate Bonneville's statutory ratemaking requirements.*

### **Issue 4.3.5.2.**

*Whether the Leverage Policy inequitably allocates costs on current ratepayers versus future ratepayers.*

### **Public Comments**

MSR argues that revenue financing is an "extreme measure" that raises considerable fairness issues even if it is applied equally between the business lines.<sup>280</sup> MSR claims that revenue financing is broadly recognized as resulting in generational inequity because it forces current ratepayers to pay the costs of assets that will be used by future generations without paying a fair share of the costs of those assets. MSR claims that adopting a policy that imposes revenue financing is neither equitable nor a sound business policy.<sup>281</sup>

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<sup>276</sup> 2018 Financial Plan at 13.

<sup>277</sup> Bonneville March 2 Leverage Presentation at 16.

<sup>278</sup> Lennox *et al.*, BP-18-E-BPA-31, at 31.

<sup>279</sup> *Id.* at 31.

<sup>280</sup> MSR May 11 Leverage Policy Comments at 3-4.

<sup>281</sup> *Id.*

Powerex and the Commenting Parties raise similar intergenerational equity arguments in their comments.<sup>282</sup>

### **Evaluation**

Bonneville recognizes that one effect of the Leverage Policy may be additional revenue financing of capital projects in rates, resulting in current ratepayers paying for assets that will benefit future ratepayers. If Bonneville were to continue to debt finance all assets (as has generally been the case), then the benefit of those assets would flow to those paying current rates. The choice between debt financing and revenue financing involves tradeoffs between the goals of intergenerational equity, and Bonneville's goals of financial flexibility and health. Bonneville agrees that intergenerational equity is an important consideration when considering its policies. However, on balance, Bonneville finds that it is reasonable at this time to pursue financial flexibility and health through the Leverage Policy.

MSR claims revenue financing is an "extreme measure."<sup>283</sup> MSR also calls revenue financing a form of "tax."<sup>284</sup> Bonneville disagrees. As noted in the workshops, it is common practice for utilities to raise cash through rates to finance capital investments.<sup>285</sup> Bonneville has adopted revenue financing several times in past rate cases.<sup>286</sup> Furthermore, it is not uncommon for utilities to propose to pay for capital assets through current rates. For instance, one of MSR's members, Silicon Valley Power, is in the process of expanding its Fiber Optic system. This project, which will likely have a long useful life, is being funded by an "Electric Customer Service Charge" which is essentially revenue financing.<sup>287</sup> Additionally, as MSR and Commenting Parties have noted, Bonneville is unlike a private utility. Bonneville cannot issue equity to raise funds for its capital projects. Because Bonneville's sources of capital are limited, revenue financing has always been an available alternative that Bonneville could use to support the agency's financial objectives. The Leverage Policy simply provides additional policy context and guidance on when that tool would be used.

MSR and Commenting Parties argue that it is inequitable to have current ratepayers pay for assets that will have a long useful life. Bonneville disagrees. Even without the Leverage Policy, some revenue financing would always be needed in Bonneville rates. Due to the unique circumstances in which Bonneville is placed by the limits on its ability to issue debt to the Treasury, it is impossible for Bonneville to issue debt for its capital programs that matches the useful life of the assets funded. As Bonneville continues to increase its asset base, it will be forced to either pay off debt faster or revenue finance some debt unless non-

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<sup>282</sup> Powerex May 11 Comments at 2; Powerex August 2 Comments at 1; Commenting Parties May 11 Comments at 6.

<sup>283</sup> MSR May 11 Leverage Policy Comments at 3-4; MSR August 2 Comments at 14-15.

<sup>284</sup> *Id.* at 7.

<sup>285</sup> Bonneville March 2 Leverage Presentation at 14.

<sup>286</sup> *See, supra* FN 269-270.

<sup>287</sup> City of Santa Clara, 2018-2019 Through 2022-23 Five Year Financial Plan, at 43-19, (June 27, 2017), available at <http://santaclaraca.gov/home/showdocument?id=53168>.

Federal debt financing is used. By improving its leverage position, Bonneville will be better positioned to finance planned capital spending over a rolling 10-year period, which is an objective in Bonneville's Financial Plan.<sup>288</sup>

MSR also contends that if Bonneville decides to revenue finance a capital asset, it should revenue finance assets with a shorter life than assets with a 40 to 50-year useful life.<sup>289</sup> MSR's suggestion, however, would result in no practical difference in costs or rates. Even if Bonneville were to track each asset it acquires and associate it with a specific form of financing (which it does not do) Bonneville would still include in its rates the cost of revenue financing as well as depreciation of the asset. Depreciation expense will be no higher or lower if current revenues or debt is used to finance an asset. The amount of revenue financing will be no higher or lower if it is used to pay for computer software, with a five-year life (FERC Account 391.3), or towers and fixtures, with a service life of 75 years (FERC Account 354).

For example, assume Bonneville's capital program included \$5 million for computer software and a \$75 million transmission tower. Assume that the useful life of the computer software is five years, and that of the transmission tower is 75 years, and both assets will be depreciated using straight-line depreciation. In rates, Bonneville would include the yearly depreciation of both assets (\$1 million for the transmission tower, and \$1 million for the computer software), plus associated interest costs. Assume now that Bonneville also decided to revenue finance \$1 million to maintain Transmission Services' leverage ratio. The total costs in Transmission Services' revenue requirement would be \$3 million, regardless of whether the revenue financing is applied to the computer software or the transmission tower. Here, associating the form of financing with the asset has no effect on the costs that are embedded in rates.

Powerex also argues that instead of revenue financing as directed by the Leverage Policy, Bonneville should be adding assets to its revenue requirement when they go into service, and then adjusting rates accordingly based on ratemaking principles. Powerex recommends that Bonneville identify necessary "sustain" investments to maintain current assets, which would be approved through the IPR, and then build these assets into rates for current customers when they go into service.<sup>290</sup> For new assets, Powerex suggests that Bonneville match depreciation and the borrowing expenses together to the appropriate revenue stream. Powerex contends that this approach should be conducted through the Integrated Program Review process, rather than automatically added to rates based on the debt-to-asset ratio.<sup>291</sup>

Powerex misunderstands how Bonneville develops its revenue requirement. Bonneville adds assets to its revenue requirement as they are placed into service or are forecasted to be placed into service. Actual results are always the starting point for revenue requirement

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<sup>288</sup> 2018 Financial Plan at 12.

<sup>289</sup> MSR August 2 Comments at 15-16.

<sup>290</sup> Powerex May 11 Comments at 2.

<sup>291</sup> *Id.* at 2.

forecasts. Plant in-service forecasts are incorporated for the forecast period. As Bonneville moves from rate case to rate case, actual results and forecasts are updated.

Powerex seems to suggest that Bonneville’s sustain investment program should be financed through current rates. This approach, however, would result in significantly larger Transmission rate increases. Bonneville’s “sustain” program is large—in the hundreds of millions of dollars a year.<sup>292</sup> If Bonneville revenue financed these sustain investments, transmission rates would rise dramatically, resulting in the very “rate-shock” Powerex encourages Bonneville to avoid.<sup>293</sup>

The proposed Leverage Policy provides a far more measured approach to addressing the agency’s leverage. Bonneville has taken steps to mitigate the first-rate-period implementation costs of the Leverage Policy, as discussed in Section 4.3.8. While these steps do not completely eliminate the cost increases, this is an acceptable result because the Leverage Policy provides other benefits to Transmission customers. One such benefit is increased rate stability and certainty. Today, Bonneville has no specific policy guidance on how it would manage Transmission Services’ leverage. Bonneville could propose in each rate case that certain projects are revenue financed while other projects are financed by debt (as suggested by Powerex). That approach, which is entirely possible under the status quo, provides less certainty to Transmission customers because the amount of capital financed versus revenue financed would be dependent upon Bonneville’s rate-case-by-rate-case determinations. With no stated criteria or objective guiding the agency’s decisions on leverage, Bonneville could choose in one rate period to revenue finance its entire capital project list and then turn around and debt finance the same in the next rate period. While such an extreme example is unlikely to occur, it demonstrates the value of having the Leverage Policy, which provides a series of goals and objectives that guide Bonneville’s long-term financing decisions. This approach provides near-term rate stability (because Bonneville’s leverage objectives are known) and meets the agency’s long-term financial objectives.

### **Decision**

*The Leverage Policy is equitable in its consideration of current and future ratepayers.*

### **Issue 4.3.5.3.**

*Whether Bonneville should defer deciding the Leverage Policy until the BP-20 rate case or later.*

### **Public Comments**

MSR requests that the Leverage Policy be vetted through the BP-20 rate case. MSR argues that Bonneville has consistently underspent its capital projects. MSR contends that additional time is needed to fully explore the data on which Bonneville is making its decision. Additional time would also allow for a decision on whether to expand the

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<sup>292</sup> Bonneville March 2 Leverage Presentation at 14.

<sup>293</sup> Powerex May 11 Comments at 2.

Regional Cooperation Debt (RCD) program. MSR contends that since the Leverage Policy will not be implemented in BP-20, this delay would have no practical effect on Bonneville's finances.<sup>294</sup>

Commenting Parties argue that it would be arbitrary and capricious for Bonneville to decide to include in rates revenue financing without also considering in the applicable rate case the cumulative effects on rates of capital spending levels, the FRP, the proposed Leverage Policy, and the financial plan.<sup>295</sup> Commenting Parties note that Bonneville has made revenue financing decisions in past rate cases and should continue to do so going forward.<sup>296</sup>

Powerex requests that the Leverage Policy be further considered in the BP-20 rate case.<sup>297</sup>

### **Evaluation**

MSR and Commenting Parties request that Bonneville delay making a decision on the Leverage Policy. MSR requests that the Leverage Policy be further vetted in the BP-20 rate case.<sup>298</sup> Commenting Parties contend that Bonneville should not decide to revenue finance until it is able to see the cumulative effects of capital spending levels, the FRP, the Leverage Policy, and the financial plan.<sup>299</sup> Powerex argues that including the Leverage Policy in the rate case would ensure a full record on the facts and issues at hand and allow Bonneville and parties to the proceeding to establish an appropriate and complete record prior to the issuance of a Draft Record of Decision. As proposed, Powerex argues that Bonneville's current process which includes a single comment period prior to issuing a Final Record of Decision is not sufficient for a policy that will have a significant impact on Transmission rates in BP-20 and many rate periods to come.<sup>300</sup>

Bonneville disagrees that it must delay this decision.

First, Bonneville disagrees that additional vetting of the Leverage Policy in the BP-20 rate case would be either useful or warranted. Bonneville has already delayed issuing this Record of Decision and lengthened the public process to further develop the record for the Leverage Policy. The Leverage Policy process has now spanned five months and included two formal comment periods. Stakeholders have filed 19 comments related to the Leverage Policy. The record developed through this process provided the Administrator with the information needed to make a decision. Additional development of the record in the BP-20 rate case is unnecessary.

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<sup>294</sup> MSR August 2 Comments, at 2.

<sup>295</sup> Commenting Parties August 2 Comments at 6.

<sup>296</sup> *Id.*

<sup>297</sup> Comments of Powerex on BPA's Financial Leverage and Capital Financing Plan Proposals, XFRPL180010, at 3 (August 2, 2018), available at <https://www.bpa.gov/applications/publiccomments/CommentList.aspx?ID=343>. ("Powerex August 2 Comments").

<sup>298</sup> MSR August 2 Comments at 2.

<sup>299</sup> Commenting Parties August 2 Comments at 6.

<sup>300</sup> Powerex August 2 Comments at 3-4.

Second, Bonneville disagrees with Commenting Parties' assertion that Bonneville must decide in its rate case the cumulative effects of its financial policies before proposing revenue financing in a rate period. As noted before, prior to this Leverage Policy, there was no overarching policy guiding Bonneville's rate-case-by-rate-case decision to address the agency's leverage. Bonneville could choose in one rate case to revenue finance significant portions of its assets and then debt-finance all of its assets in the next. With no policy guidance, Bonneville must make *ad hoc* decisions in each rate case. The result of this *ad hoc* policy approach is where Bonneville finds itself today: Power Services is projected to improve its leverage over time, while Transmission Services' leverage is projected to get progressively worse. The Leverage Policy fills this policy gap by providing guidelines that will, over time, lower the agency's overall leverage.

Commenting Parties note that Bonneville has in the past decided revenue financing in its rate cases. This is correct and, going forward, if revenue financing is the chosen tool for addressing either business line's leverage, it will also be included in the appropriate rate case. The only difference now is that the Leverage Policy provides clear criteria for when Bonneville will include revenue financing in Power and Transmission rates. Developing a policy that provides clear guidance in an area where there was previously none is not arbitrary and capricious.

Finally, if Bonneville adopts commenters' view that the impacts of the Leverage Policy must be re-evaluated in each rate case, along with other factors impacting rates, then the basis for having a policy on leverage largely goes away. The purpose of developing the Leverage Policy is to provide overarching guidance that transcends the specific events in each rate case. If Bonneville must revisit whether to implement the Leverage Policy in every rate case, then Bonneville is simply back in the place it is today: it must choose whether to address business line leverage in each rate case. Although such an approach may satisfy short-term rate goals, the long-term financial health of the agency will suffer. To preserve the long-term business interest of Bonneville, more strategic action and direction is necessary. The Leverage Policy provides that direction and introduces needed discipline to the agency's finances.

### **Decision**

*Bonneville will not defer making a decision on the Leverage Policy.*

#### 4.3.6. Justification of Need for Leverage Policy

##### Issue 4.3.6.1.

*Whether Bonneville should not adopt the Leverage Policy and address, instead, its issues with access to capital.*

##### **Public Comments**

Several commenters contend that the issue that Bonneville intends to solve with the Leverage Policy is its diminishing access to capital.<sup>301</sup> Those comments generally claim that the only real financial issue Bonneville is facing is access to capital, and the Leverage Policy is not the appropriate response to solving that issue.

##### **Evaluation**

As part of the benefits of adopting a policy on leverage, Bonneville staff described the effects that managing the agency's leverage would have on Bonneville's ability to borrow from the Treasury. Bonneville's Federal borrowing authority is limited.<sup>302</sup> As of September 30, 2017, Bonneville had \$2.7 billion in remaining Federal borrowing authority to meet its capital needs of both of its business lines.<sup>303</sup> Without additional action, Bonneville's Federal borrowing authority is projected to be exhausted by FY 2023.<sup>304</sup>

The Leverage Policy supports Bonneville's Federal borrowing authority because it requires the business lines to maintain or reduce their leverage ratios. Managing business line leverage ratios means Bonneville may need to reduce its capital expenditures (*i.e.*, reducing the need for debt), pay off additional debt, revenue finance capital assets, or discontinue regulatory treatment of certain investments (*i.e.*, avoiding debt). All of these actions preserve Federal borrowing authority for future use.<sup>305</sup>

The Commenting Parties argue that Bonneville has a fundamental financial problem—lack of access to capital—which is exemplified by the constraints on its Treasury borrowing authority.<sup>306</sup> The Commenting Parties note that in developing the Financial Reserves Policy and the Leverage Policy, Bonneville has not provided or evaluated alternative solutions to Bonneville's lack of access to capital problem. The Leverage Policy, in their view, does not directly address the constraints on Treasury borrowing authority.<sup>307</sup> They also argue that Bonneville has not demonstrated that the Leverage Policy is the appropriate approach to addressing Bonneville's borrowing authority limitations.<sup>308</sup>

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<sup>301</sup> Commenting Parties May 11 Comments at 8; MSR May 11 Leverage Policy Comments at 10; Powerex May 11 Comments at 2-3; Powerex August 2 Comments at 2.

<sup>302</sup> Bonneville March 2 Leverage Presentation at 13.

<sup>303</sup> *Id.* at 13.

<sup>304</sup> *Id.* at 15-16.

<sup>305</sup> *Id.* 19.

<sup>306</sup> Commenting Parties May 11 Comments at 8; Commenting Parties August 2 Comments, at 13-14.

<sup>307</sup> Commenting Parties May 11 Comments at 8-9.

<sup>308</sup> *Id.* at 9.

MSR raises a similar concern, noting that leverage is neither a substantive nor an urgent issue. Bonneville has had high leverage in the past, upwards of 150 percent, and today is at 90 percent, which is a 40 percent decline. MSR claims that leverage was “not raised as an issue when it was 150 percent” so it is unclear why it is now an issue at 90 percent.<sup>309</sup> MSR comments that access to capital is both substantive and urgent, and it encourages Bonneville to focus on that issue. MSR argues that the Leverage Policy is not an equitable mechanism to address access to capital.<sup>310</sup>

Powerex argues that leverage and access to capital are related but distinct issues and should be treated as such. The solution to one may not be the most appropriate, or cost-effective, solution to the other. If Bonneville’s concern is access to capital, there are likely more appropriate and effective solutions to that issue than subjecting Transmission Services to significant increase in its revenue requirement to finance future capital programs.<sup>311</sup> To that end, Powerex believes that Bonneville should focus on access to debt instruments to fund its capital plan. That would focus Bonneville’s financial policy, rather than taking a fragmented approach to developing a financial policy.<sup>312</sup>

Bonneville generally agrees with commenters that the agency’s leverage position and access to capital are distinct issues. Bonneville also agrees with commenters that the Leverage Policy is not intended to solve Bonneville’s access to capital concerns. However, commenters are incorrect to claim that the only problem that Bonneville should solve for is its access to capital or that the Leverage Policy is inequitable because it does not solve that problem entirely. Bonneville’s limitation with accessing capital is a specific financial issue that Bonneville intends to address through a broader capital financing discussion with its customers.

In addition, solving Bonneville’s access to capital problems would not solve Bonneville’s concerns with leverage. For example, Bonneville’s access to capital issues could be solved in the near term if Congress authorized an additional \$20 billion in borrowing authority. With no stated policy guidance and increased borrowing authority, Bonneville could continue to debt finance all of its capital projects, thereby burdening the agency with chronically high leverage, interest expense, fixed costs, and, potentially, a reduced credit rating. In that scenario, Bonneville’s long-term health and financial flexibility would not improve even with its access to capital issue resolved.

The Leverage Policy focuses on an aspect of Bonneville’s financial health that helps achieve a variety of financial objectives. While it may not completely solve any one financial issue, it introduces discipline that will benefit many aspects of Bonneville’s business.

A health analogy is useful to explain Bonneville’s rationale. Assume a person is trying to decide what actions to take to improve their overall health. One solution is to focus on a

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<sup>309</sup> MSR May 11 Leverage Policy Comments at 10.

<sup>310</sup> *Id.*

<sup>311</sup> Powerex May 11 Comments at 2-3.

<sup>312</sup> Powerex August 2 Comments at 2.

specific health issue, such as high cholesterol. An effective means of managing that specific health issue is to take medication, like a statin. A statin generally will reduce dangerously high cholesterol, and consequently, will address the immediate health issue. However, taking a statin would not otherwise improve the individual's overall health. Addressing only Bonneville's access to capital issue is akin to addressing only high cholesterol by taking a statin to improve overall health.

Bonneville's approach is to address the health of the agency more holistically. In the case of our hypothetical person, a holistic approach would include improving their diet. Those changes would have broad-reaching health benefits. Will improving diet alone solve all health issues? It may not entirely, but changing a person's diet will unquestionably improve overall health, reducing, if not eliminating, the need for outside intervention, such as medication.

In the same way, the Leverage Policy introduces financial discipline that benefits many aspects of Bonneville's business, even though it may not totally solve any specific financial issue. The Leverage Policy will provide guidance regarding when Bonneville must take steps to reduce its leverage through, among other means, revenue financing. Revenue financing, in turn, reduces Bonneville's need to access its Treasury borrowing authority, which has the additional benefit of retaining Treasury borrowing authority for future projects. It also reduces the agency's leverage, which protects Bonneville's credit rating, and reduces future fixed expenses in rates such as principal and interest payments, which supports Bonneville's long-term competitiveness and financial flexibility. Is the Leverage Policy the sole solution to any one of those problems? No, but it is not intended to be. Does it improve all of these financial areas, making the need to address them through other specific actions less likely or less severe? Certainly. Bonneville views the more holistic approach as the better means of managing the agency's overall financial health.

MSR contends that it is unclear why Bonneville is concerned with its leverage ratio, since Bonneville has had high leverage in the past (upwards of 150 percent) and took no action.<sup>313</sup> MSR is mistaken. Throughout the last 38 years, Bonneville took multiple *ad hoc* steps to address its high debt-to-asset ratio. For instance, in the 1993 rate case, Bonneville adopted a 10-year financial plan wherein Bonneville decided to revenue finance in Power rates all capital projects with a useful life of under 10 years.<sup>314</sup> At other times, in response to concerns expressed by Congress regarding Bonneville's debt, Bonneville proposed to revenue finance capital projects in both Power and Transmission rates.<sup>315</sup> Bonneville lowered its leverage position through those decisions. The Leverage Policy is designed to solidify the progress that Bonneville has made in deleveraging and prevent a return to a highly leveraged business.

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<sup>313</sup> MSR May 11 Leverage Policy Comments at 10.

<sup>314</sup> See Revenue Requirement Study, WP-93-FS-BPA-02, Appendix C, 10-Year Financial Plan, at C-28 (July 1993).

<sup>315</sup> See 1996 Wholesale Power and Transmission Rate Proposal, Administrator's Record of Decision, at 76-78, June 1996 (proposing revenue financing of \$22 million for WNP-2 investments and \$15 million of transmission investments).

Commenting Parties argue that Bonneville failed to consider other alternatives for addressing its access to capital problem, apart from the FRP and Leverage Policy. Commenting Parties claim that the Leverage Policy does not directly address the constraints on Bonneville's Treasury borrowing authority.<sup>316</sup>

As noted above, Commenting Parties misstate the purpose of the Leverage Policy. The Leverage Policy supports Bonneville's access to Treasury borrowing authority, but is not designed to resolve it. Although Commenting Parties may believe that Bonneville should focus its policy efforts elsewhere, such as on access to capital, Bonneville disagrees that such an approach is reasonable or required. Bonneville's access to capital will be addressed in the broader context of Bonneville's long-term financial plan. Those efforts should not preclude Bonneville from taking concrete steps now to improve the agency's financial health through sensible business decisions, like establishing reasonable parameters for the agency's leverage.

MSR also claims that Bonneville has understated the nature of the access to capital shortfall. MSR claims that the shortfall is \$3 billion, not \$1.6 billion as stated in the Access to Capital workshop materials. That shortfall must be viewed as a whole when making reasoned decisions about allocation of responsibility for addressing the capital needs of Bonneville. MSR argues that Bonneville has staged a piecemeal approach that attempts to predetermine that between \$725 million and \$1.35 billion of the capital shortfall rest on the shoulders of Transmission, based on projections of the two business lines' leverage.<sup>317</sup> MSR contends that those policies will saddle Transmission Services with between \$1.3 billion and \$3 billion of the agency's access to capital problem, depending on how Bonneville addresses cost responsibility for the access to capital segment of the financial health program.<sup>318</sup>

Bonneville agrees that the access to capital shortfall may be larger than shown in the access to capital workshops. The material prepared for the workshop assumed implementation of the "preferred alternative" for the Leverage Policy which, as described above, is not part of the policy and will be subject to a rate-case-by-rate-case review. But even assuming that the shortfall is \$3 billion does not make the Leverage Policy unreasonable. Because the Leverage Policy is not intended to solve for Bonneville's Treasury borrowing authority limitations, the size of the borrowing shortfall should not be a factor in deciding whether Bonneville should adopt the Leverage Policy. Nor does Bonneville propose through the Leverage Policy (or any other policy) to allocate responsibility for the shortfall between the business lines. The actions Bonneville may take to address the access to capital shortfall (whatever its size) are outside of the scope of this process.

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<sup>316</sup> Commenting Parties August 2 Comments at 14-15.

<sup>317</sup> MSR August 2 Comments At 3, 5.

<sup>318</sup> *Id.* at 4-5.

## **Decision**

*The Leverage Policy is beneficial to Bonneville's overall financial health, and although it is not intended to solve access to capital issues, it helps preserve borrowing authority and is a prudent policy.*

### **Issue 4.3.6.2.**

*Whether interest savings support adopting the Leverage Policy.*

## **Public Comments**

The Commenting Parties dispute that the future interest savings from the Leverage Policy justify adopting the policy.<sup>319</sup> MSR argues that while it is true that less borrowing will result in less interest cost in Bonneville's rates, this reason does not recognize that the revenue financing results in capital costs to ratepayers.<sup>320</sup>

## **Evaluation**

The Leverage Policy will stabilize interest and principal expenses in future rates. Interest and principal payments makeup a significant portion of both Power Services' and Transmission Services' rates. In BP-18, \$890 million of Power Services' \$2.8 billion revenue requirement—roughly 32 percent—was dedicated to debt service.<sup>321</sup> For Transmission Services, \$400 million of a \$1 billion revenue requirement was dedicated to debt service—or roughly 40 percent of the costs recovered.<sup>322</sup>

Bonneville projects that without the Leverage Policy, the interest expense recovered in rates will grow, particularly for Transmission Services. Bonneville forecasts that Transmission Services' interest payments will more than double over the next 10 years, from roughly \$156 million per year in the 2018–19 rate period to over \$317 million per year by the 2026–28 rate period.<sup>323</sup> If no action is taken, Transmission Services will need to collect, *each year*, over \$317 million in rates simply to pay the interest on its outstanding debt in 2028. During this same period, Transmission Services will become significantly more leveraged, with its leverage ratio increasing from around 81 percent to over 88 percent.<sup>324</sup> With the Leverage Policy in place, and with only the provision requiring that the leverage ratio not increase, Transmission Services' interest expense will drop to \$247 million by 2028, while its leverage ratio will remain within the mid-term range of 82 percent.<sup>325</sup>

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<sup>319</sup> Commenting Parties May 11 Comments at 9-10.

<sup>320</sup> MSR May 11 Leverage Policy Comments at 6.

<sup>321</sup> Bonneville March 2 Leverage Presentation at 11.

<sup>322</sup> *Id.*

<sup>323</sup> Bonneville March 20 Leverage Presentation at 10; Bonneville April 20 Leverage Presentation at 18.

<sup>324</sup> Bonneville March 20 Leverage Presentation at 10.

<sup>325</sup> Bonneville April 20 Leverage Presentation at 18.

The Commenting Parties disagree that the future interest savings from the Leverage Policy justifies adopting the policy. The Commenting Parties claim Bonneville fails to recognize that the rate impacts of revenue financing are far larger than any interest savings. Further, the Commenting Parties argue that if interest savings are a benefit of the Leverage Policy, then revenue financing would also be appropriate for Power Services' rates.<sup>326</sup>

MSR raises a similar argument in its comment. MSR argues that, while it is true that less borrowing will result in less interest cost in Bonneville's rates, this reason does not recognize that the revenue financing results in capital costs to ratepayers. MSR contends that Bonneville assumes that the cost of equity capital is \$0. MSR argues that the reduced interest expense will come at a cost to Bonneville's Transmission customers, who will be forced to contribute equity on which they will earn no return. That equity contribution has a cost that is likely higher than Bonneville's cost of capital. MSR argues that modern finance assigns a higher cost of capital to equity over debt because of the higher risk of not receiving a return.<sup>327</sup>

Commenting Parties' and MSR's arguments are not persuasive. Essentially, MSR contends that Bonneville should consider its customers' cost of money in adopting the Leverage Policy. Bonneville disagrees. Bonneville is not a private business, nor does it have shareholders. It is a Power Marketing Administration of the Federal government. Further, Bonneville is statutorily tasked to sell services from these Federal assets and obligated to recover its total system costs. In this regard, Bonneville's customers are exactly that—customers. They receive monthly bills for services and products they purchased. From the Bonneville-customer perspective, these bills are annual operating expenses that would be recovered through their own rates. Bonneville's efforts to revenue finance may increase customers' costs, but it should not increase their capital costs.

More generally, Commenting Parties' and MSR's comments raise the issue of balancing competing interests. For these customers, interest savings in prospective rates have little value because such savings require immediate rate increases. These customers would prefer that Bonneville finance its capital costs, delaying as long as possible the payment of debt for the assets, so that later customers also bear a significant responsibility to pay the interest expenses. That approach generally describes Bonneville's mode of operation prior to the Leverage Policy. The consequence of that business model placed Bonneville in its current position: Transmission Services' interest expenses are increasing, consuming an increasing share of its revenue requirement.<sup>328</sup>

Bonneville, however, is now revising its long-term objectives. Those objectives, as described in the Strategic Plan and Financial Plan, include ensuring long-term financial flexibility and building financial resiliency.<sup>329</sup> To preserve the agency's long-lasting financial health, Bonneville must reconsider its previous business practices. To that end,

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<sup>326</sup> Commenting Parties May 11 Comments at 9-10; Commenting Parties August 2 Comments, at 15.

<sup>327</sup> MSR May 11 Leverage Policy Comments at 6; MSR August 2 Comments at 11.

<sup>328</sup> Bonneville March 2 Leverage Presentation at 12.

<sup>329</sup> 2018-2023 Strategic Plan at 16; 2018 Financial Plan at 10-11.

Bonneville believes that it is prudent to, at a minimum, maintain Transmission Services' leverage and not allow it to get any worse. This action reduces the interest expense Bonneville must collect in rates and benefits ratepayers by reducing fixed costs in Transmission rates. The interest rate savings Bonneville's transmission customers would experience are not insignificant. The cumulative total interest savings that Bonneville could save under the base application of the Leverage Policy (assuming that Transmission Services' leverage stays flat) is \$422 million over the next nine years.<sup>330</sup> This is a conservative estimate of savings because the debt avoided or repaid early would most likely have been in place longer than nine years, costing more than nine years' worth of interest. With these interest savings, Bonneville's future Transmission rates will have flexibility to address uncertainty in Bonneville's ongoing costs.

MSR and the Commenting Parties question whether the cost of achieving flexibility is worth the benefit of reducing interest expense. From a short-term, single-customer perspective, it may not appear so. As MSR notes, customers likely have uses for their money other than supporting the long-term viability of the Federal transmission system. However, Bonneville is statutorily responsible for "operat[ing] and maintain[ing] the Federal transmission system within the Pacific Northwest . . ."<sup>331</sup> That statutory objective requires Bonneville to consider actions that preserve its Federal assets for the long term. The Leverage Policy, which will preserve the financial flexibility of Bonneville's future rates, supports that statutory objective. Furthermore, customers that remain with Bonneville will reap the benefits of these decisions when Bonneville's future Transmission rates are lower than they would otherwise be because of the Leverage Policy. Paying off debt sooner means less interest is paid over time and lower total costs to customers. These benefits will come in the form of a healthy business, with a strong credit rating, sufficient Treasury borrowing authority, and lower fixed interest expenses in rates.

### **Decision**

*Interest savings support adopting the Leverage Policy, but are not the only determining factor.*

### **Issue 4.3.6.3.**

*Whether the Leverage Policy will support Bonneville's credit rating.*

### **Public Comments**

Commenting Parties contend that the Leverage Policy will not support Bonneville's credit rating. Commenting Parties assert that Bonneville is unique and it is incorrect to compare Bonneville to other utilities rated by the credit rating agencies.<sup>332</sup>

Powerex argues that if Bonneville is concerned with its credit rating, it should pursue other means of supporting its credit rating.<sup>333</sup>

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<sup>330</sup> Bonneville April 20 Leverage Presentation at 18 (comparing scenario 1 with 4).

<sup>331</sup> 16 U.S.C. § 838b.

<sup>332</sup> Commenting Parties May 11 Comments at 11; Commenting Parties August 2 Comment at 17.

## **Evaluation**

As discussed previously, Bonneville relies on non-Federal borrowing to finance a significant portion of its capital program. Of Bonneville's \$15.3 billion in outstanding debt, over half (\$8.3 billion) is held by non-Federal entities.<sup>334</sup> Accessing non-Federal capital markets and receiving favorable interest rates are essential for Bonneville to meet its various statutory obligations, including supporting the Federal Power and Transmission systems<sup>335</sup> and keeping rates as low as possible, consistent with sound business principles.<sup>336</sup>

Bonneville is able to access non-Federal sources of debt and receive favorable interest rates because it receives a favorable credit rating from each of the major credit rating agencies (Moody's, Fitch, and Standard & Poor's). A credit rating is an independent assessment of financial health that aids investors in making investment decisions.<sup>337</sup> Because most utilities, including Bonneville, have financial obligations that extend over 20 years, a credit rating is a long-term measure of financial health and ultimately reflects the likelihood that a borrower will be able to meet all of its financial obligations over time. Credit ratings have real cost implications in that they help determine the interest rate levels at which investors will purchase debt. Bonneville's credit rating is high by industry standards. As of January 2018, Bonneville held an Aa1 (stable outlook) from Moody's, AA (negative outlook) from Fitch, and AA- (stable outlook) from Standard & Poor's.<sup>338</sup> Maintaining these investment-grade credit ratings from all three rating agencies is one of the key action items under Bonneville's financial health strategic objective.<sup>339</sup>

The Leverage Policy supports Bonneville's credit rating by putting the agency on a path to reduce overall leverage to industry standard levels. Compared to its sector, Bonneville has a high leverage ratio of nearly 90 percent.<sup>340</sup> The average leverage ratio of companies with credit ratings similar to Bonneville's is 54 percent.<sup>341</sup> One credit rating agency has recently noted that Bonneville's leverage position is high by industry standards.<sup>342</sup> All three credit rating agencies have expressed concern with Bonneville's accumulation of debt.<sup>343</sup>

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<sup>333</sup> Powerex May 11 Comments at 2; Powerex August 2 Comments at 1.

<sup>334</sup> Bonneville March 2 Leverage Presentation at 4.

<sup>335</sup> See 16 U.S.C. § 838b (2011); 16 U.S.C. § 839d-1 (2011).

<sup>336</sup> 16 U.S.C. § 839e(a)(1) (2011).

<sup>337</sup> 2018-2023 Strategic Plan at 21.

<sup>338</sup> *Id.*

<sup>339</sup> *Id.*; 2018 Financial Plan at 14.

<sup>340</sup> Bonneville March 2 Leverage Presentation at 17.

<sup>341</sup> *Id.* at 16-17.

<sup>342</sup> *Id.* at 17.

<sup>343</sup> See Standard & Poor's, Energy Northwest, Washington, Bonneville Power Administration, Oregon; Wholesale Electric, at 5, (February 8, 2018) available at <https://www.bpa.gov/Finance/FinancialInformation/Debt/Pages/Rating-Agency-Reports.aspx> ("If, during our two-year outlook horizon, BPA does not shore up its competitiveness, liquidity, and revenue stream, including surplus sales revenues, we could lower the stand-alone credit profile. Also, if the utility adds

The Leverage Policy sets near-term, mid-term, and long-term targets for agency and business line leverage.<sup>344</sup> The near-term target reduces the pressure on Bonneville's credit rating by preventing an increase in agency and business line leverage. The mid-term target continues the process of aligning Bonneville's leverage with other sector-rated utilities. The long-term target poises Bonneville to achieve a leverage ratio comparable to other utilities in the industry. All three Leverage Policy targets support Bonneville's credit rating.

The Commenting Parties object to Bonneville's references to the credit-related benefits of the Leverage Policy. They note that Bonneville's comparison of its leverage to other utilities in its sector is inapposite because most of the 50 publicly owned utilities are municipal utilities with "business models and financial backing that are not comparable to" Bonneville.<sup>345</sup> In particular, the Commenting Parties argue that Bonneville's Federal debt is subordinate to non-Federal debt, meaning that the Federal debt can be deferred if necessary. This, the Commenting Parties contend, makes Bonneville's comparison to other utilities misplaced.<sup>346</sup> The Commenting Parties also note that there are other utilities that have lower credit ratings than Bonneville, and that Bonneville's rating is below only the Tennessee Valley Authority's credit rating in its sector.<sup>347</sup>

Bonneville disagrees that its reliance on the credit rating agencies' assessments is misplaced. Bonneville recognizes that its financial situation is unique, not only because of the deferrable nature of its Federal debt, but also because of its unique position as a Federal entity. These special aspects of Bonneville's business are taken into account by the credit rating agencies, and it is likely because of these special attributes that credit rating agencies have rated Bonneville-backed non-Federal debt at investment grade even though they would rate an otherwise comparable, non-Federal utility below-investment-grade level. Moody's, in its report, notes that Bonneville's leverage ratio corresponds to a much lower rating:

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significant non-Federal leverage obligations because of its statutory debt ceiling, there could be negative implications for the stand-alone credit profile and the 'AA-' rating.");

Moody's Credit Opinion, Report Final, at 5, (February 9, 2018) *available at* <https://www.bpa.gov/Finance/FinancialInformation/Debt/Pages/Rating-Agency-Reports.aspx> ("On a fully consolidated basis including Federal debt, BPA's financial metrics are commensurate with B to A category scoring on a historic basis. Total DSCR has averaged below 1.0x over the last three years, which is commensurate with a 'B' scoring, while BPA's debt ratio is high at an average of 91%, which is commensurate with a 'Ba' scoring.");

Fitch Rates Energy Northwest, WA's Electric Rev Bonds 'AA'; Outlook Negative, at 2, (May 1, 2018) *available at* <https://www.bpa.gov/Finance/FinancialInformation/Debt/Pages/Rating-Agency-Reports.aspx> ("Leverage is high with debt/FADS (funds available for debt service) of 11.0x in fiscal 2017, as compared to the category median of 5.3x, and is expected to remain elevated. Planned capital spending is manageable but reflects the assumed debt financing of all planned capital spending, providing no financial flexibility in the form of rate-funded capital. Bonneville is initiating discussions to design a debt policy that may introduce some level of revenue funding for capital.").

<sup>344</sup> See Leverage Policy at § 3.

<sup>345</sup> Commenting Parties May 11 Comments at 11; Commenting Parties August 2 Comments at 17.

<sup>346</sup> Commenting Parties May 11 Comments at 11.

<sup>347</sup> *Id.* at 11-12.

On a fully consolidated basis including Federal debt, BPA's financial metrics are commensurate with B to A category scoring on a historic basis. . . . BPA's debt ratio is high at an average 91 percent which is commensurate with a 'Ba' scoring.<sup>348</sup>

The Commenting Parties suggest that the Leverage Policy is unnecessary because Bonneville can rely on these special attributes to maintain its credit rating. Bonneville disagrees. The credit rating agencies care about Bonneville's overall financial health in the same way they care about any other entity that they evaluate for the ability to repay long-term debt. If Bonneville's financial situation deteriorates, it is probable that Bonneville's credit rating would be adversely affected, even though Bonneville is fundamentally different from other utilities in its sector. Bonneville is already on a Negative Outlook by Fitch in part because of Bonneville's high leverage position.<sup>349</sup> Hoping that the credit rating agencies continue to grade Bonneville based on its unique characteristics, and overlook the agency's high leverage position, is not a sound business strategy. The better approach is for Bonneville to take active steps to maintain the agency's high credit rating through, among other actions, managing the factors that can have a deleterious effect on that rating. Having sustained high leverage is one such factor, and the Leverage Policy properly identifies a series of reasonable steps to address it.

The Commenting Parties also argue that credit rating agencies' concerns should not dictate adoption of the Leverage Policy.<sup>350</sup> Bonneville agrees. The concerns that the credit rating agencies raise do not dictate Bonneville's long-term policy objectives. As Powerex noted in its comments, each of the credit rating agencies described specific financial concerns with Bonneville's overall business, only one of which (Fitch) specifically pointed to leverage.<sup>351</sup> Even there, Fitch identified specific concerns with a measure of leverage (Debt/FADS) that Bonneville is not adopting.<sup>352</sup> The differences between the credit rating agencies' concerns and how Bonneville chooses to address those concerns demonstrate that Bonneville is not blindly chasing solutions to issues identified by these entities. Instead, Bonneville is using the credit rating entities' concerns as one source of guidance in formulating broader agency policies to address overall financial health.

Commenters question the effectiveness of Bonneville's policies to address the credit rating agencies' concerns without directly addressing the concerns in the reports. Bonneville views the rating agencies' concerns as providing general guidance that it can respond to in a variety of ways. The Leverage Policy is one response that Bonneville believes will provide positive credit support to the agency's credit rating, while also achieving the agency's other financial objectives. Early indications are that this assessment is accurate. The credit rating agencies did not request that Bonneville develop a policy on leverage, nor

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<sup>348</sup> Bonneville March 2 Leverage Presentation at 17.

<sup>349</sup> *Id.* at 17.

<sup>350</sup> Commenting Parties May 11 Comments at 11.

<sup>351</sup> Powerex May 11 Comments at 1-2.

<sup>352</sup> *Id.*

did they provide a range for Bonneville to achieve with such a policy. Nonetheless, the development of the strategic objective on leverage, which formed the basis for the Leverage Policy, has proven to be a benefit to the agency's credit rating. Already, Moody's has identified Bonneville's leverage objectives as a credit positive:

BPA published a new strategic plan that provides some credit positive objectives like reducing the debt ratio to a 75% to 85% range and maintaining \$1.5 billion of US treasury line availability.<sup>353</sup>

Similarly, Moody's noted that failing to address Bonneville's leverage issues could undermine the positive credit benefits of Bonneville's strategic objectives:

[T]he announced strategic goals could be insufficient to offset BPA's credit deterioration, particularly if the new strategic goals do not translate into robust actions to improve credit quality.<sup>354</sup>

The Commenting Parties and Powerex note other differences between the Leverage Policy and the credit rating agencies' most recent reports.<sup>355</sup> Both commenters note that a different measure of leverage, Debt/FADS, was considered by Fitch, and, using that methodology, Bonneville's leverage position likely would not affect the agency's credit rating.<sup>356</sup>

Bonneville recognizes that some rating agencies use modified measures for determining the leverage of a utility. Moody's uses the debt-to-asset ratio.<sup>357</sup> Fitch uses Debt/FADS and Net Debt/Net Capital Assets.<sup>358</sup> S&P uses a similar metric to Fitch's Debt/FADS and does not track an additional metric that takes into account asset values. Bonneville analyzed whether its leverage position was dramatically different under a Debt/FADS comparison, and concluded that even under that metric Bonneville was well above the category median.<sup>359</sup> Bonneville ultimately chose to use debt-to-asset ratio as the basis for its policy because it better reflects the areas of financial health in which Bonneville is most interested. Debt/FADS is a coverage ratio that measures net debt in relation to cash from operations. This ratio focuses on how quickly an entity could repay its debt obligations with cash from operations. Unlike a debt-to-asset ratio, it does not indicate how assets are funded, how solvent a company is, or the level of fixed costs incurred due to outstanding debt. Developing a policy around leverage also addresses the other broader issues for financial health that, as described above, support multiple agency objectives.

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<sup>353</sup> Moody's Credit Opinion, Report Final , at 5, February 9, 2018, *available at* <https://www.bpa.gov/Finance/FinancialInformation/Debt/Pages/Rating-Agency-Reports.aspx>.

<sup>354</sup> *Id.*

<sup>355</sup> Commenting Parties May 11 Comments at 11-12; Powerex May 11 Comments at 1-2.

<sup>356</sup> Commenting Parties May 11 Comments at 12; Commenting Parties August 2 Comments at 17-18.

<sup>357</sup> Bonneville March 20 Leverage Presentation at 4.

<sup>358</sup> *Id.*

<sup>359</sup> *Id.* at 5.

The Commenting Parties and Powerex also contend that if Bonneville is trying to solve the concerns of the rating agencies with Bonneville's credit rating, then there are other, more direct ways of addressing those concerns. The Commenting Parties argue that Bonneville adopted other policies, like the Financial Reserves Policy, that if properly implemented, should alleviate Bonneville's credit rating concerns.<sup>360</sup> Powerex notes that Moody's identified diminishing liquidity and declining availability of Treasury borrowing as primary concerns.<sup>361</sup> Powerex also argues that Standard & Poor's cites financial reserves and secondary power sales as its primary concerns.<sup>362</sup> In all cases, no rating agency specifically identified concerns regarding Transmission Services' leverage or its debt-to-asset ratio.<sup>363</sup> Powerex questions whether the prohibition on increasing a business lines' leverage will directly address the concerns that the credit rating agencies raised.<sup>364</sup>

Commenters' questions concern the objectives of the Leverage Policy. The Commenting Parties and Powerex question whether the Leverage Policy will solve all of Bonneville's credit objective concerns. Bonneville agrees that the Leverage Policy will not, but that does not make adopting the policy any less reasonable. Like the Financial Reserves Policy noted by the Commenting Parties, the Leverage Policy addresses an aspect of Bonneville's credit concerns. The Financial Reserves Policy did not solve all of Bonneville's credit-related problems, but it introduced financial discipline in an area where discipline did not previously exist. With the Financial Reserves Policy in place, Bonneville is no longer exposed to unmitigated declines in agency financial reserves.

The Leverage Policy provides a benefit to Bonneville's credit rating similar to that provided by the Financial Reserves Policy. It provides needed policy guidance in an area previously unaddressed. Leverage and debt accumulation are becoming an increasingly important aspect of Bonneville's credit rating. Addressing the agency's leverage, which results in an overall lower leverage level and less debt to repay, can only benefit Bonneville's credit rating. If there were any question as to the truth of this statement, it can be tested by positing the opposite: would a *higher* leverage level improve Bonneville's credit rating? Obviously not, and no commenter claimed otherwise.

Further, while there may be other ways of addressing the credit rating agencies' concerns, Bonneville is constrained by what it can directly impact with its policy development. Many of the concerns noted by the credit rating agencies are beyond Bonneville's control. The headwinds that Bonneville is facing in the market are well beyond Bonneville's ability to immediately address through policy development. When credit rating agencies express concerns with Bonneville's business model, Bonneville must consider not only what the concerns are, but the extent to which they are within Bonneville's control. In the case of

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<sup>360</sup> Commenting Parties May 11 Comments at 11.

<sup>361</sup> Powerex May 11 Comments at 1.

<sup>362</sup> *Id.*

<sup>363</sup> *Id.*

<sup>364</sup> *Id.* at 2.; Powerex August 2 Comments at 1.

changes to the wholesale energy market, Bonneville has little ability to develop policies directly affecting those factors.

That is not to say that Bonneville is not taking active steps to address the market headwinds identified by the credit rating agencies. As described in the Strategic and Financial Plans, Bonneville has been taking aggressive steps to manage its costs and look for new sources of revenue in the evolving wholesale markets that leverage the capabilities of the FCRPS.<sup>365</sup> Bonneville is taking steps to directly address the concerns in the rating reports as to costs.

In the case of agency leverage, Bonneville has more direct control. Bonneville can choose whether to not incur the cost or fund a project with current rates. Taking either of these actions reduces agency leverage, which is a measure of financial health and a factor in Bonneville's credit rating. Addressing this aspect of Bonneville's financial health through a defined policy is both appropriate and necessary.

The Commenting Parties also argue that Bonneville's need for a good credit rating may be diminishing because Bonneville's projection of future lease financing will change from 50 percent to 25 percent, and Bonneville indicated that WNP-1 and WNP-3 debt may not be extended.<sup>366</sup>

Bonneville agrees that if a diminished use of non-Federal financing occurs, then the negative impact of a lower rating would also be diminished. However, at this point and for the immediate future, reliance on non-Federal borrowing remains an essential component of meeting Bonneville's long-term capital financing needs. The July 25, 2018, Capital Financing workshop included a preferred scenario that included the extension of additional Energy Northwest Regional Cooperation Debt to replenish borrowing authority. As such, non-Federal financing tools continue to be a major factor in achieving Bonneville's objective of a rolling 10 years of access to capital. As also noted previously, providing support for Bonneville's credit rating is one benefit of the Leverage Policy, but other benefits—such as reduced interest expense, financial flexibility and resiliency, and increased availability of borrowing authority—also justify adoption of the Leverage Policy.

Finally, even apart from the direct credit-related benefits of the Leverage Policy, Bonneville finds that responding to the leverage-related concerns expressed by the credit rating agencies is a prudent business decision. The credit rating agencies' insights are helpful indicators of Bonneville's long-term ability to meet its non-Federal debt obligations in full and on time. Bonneville believes their concerns have merit and that steps to address the leverage ratio will improve the overall financial health of the agency. While the rating agencies do not rate Bonneville's Federal debt, their concerns with Bonneville's ability to repay non-Federal debt would be an indicator of increasing risk of repayment of Federal debt, which is subordinate to the non-Federal debt. By addressing the issues that may

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<sup>365</sup> 2018-2023 Strategic Plan at 12.

<sup>366</sup> Commenting Parties May 11 Comments at 12.

threaten the agency's ability to repay non-Federal debt (high leverage), Bonneville further ensures its long-term ability to repay the Treasury.

### **Decision**

*The Leverage Policy will support Bonneville's credit rating.*

#### **4.3.7. Long-Term Target Revision**

##### **Issue 4.3.7.1.**

*Whether Bonneville should revisit the long-term target of 60 to 70 percent in 2028.*

### **Public Comments**

NRU does not support the Leverage Policy's long-term target of 60 to 70 percent. NRU recommends that Bonneville revisit this target in a public process in 2028.<sup>367</sup>

### **Evaluation**

NRU contends that, given the number of uncertainties that will occur within the next 10 years regarding Bonneville's financial health and market conditions, Bonneville should not adopt a long-term target of 60 to 70 percent. Instead, NRU argues that Bonneville should hold a public process in 2028 to reevaluate the targets and develop a post-2028 target based on such information.<sup>368</sup>

The long-term target of achieving agency and business line debt-to-asset ratios of 60 to 70 percent is an aspirational target. Although the long-term target does not specifically require any rate action, Bonneville determined that it was important to indicate its desired long-term leverage position. Bonneville intends to implement the Leverage Policy in a manner that positions both business lines to eventually achieve this aspirational target. Any policy and plan should be reviewed periodically to ensure that it is still applicable and is leading the agency in the best direction possible. If Bonneville finds that the long-term target, and therefore the policy, needs to be changed when it is periodically reviewed, a public process will be held. However, Bonneville does not believe that it is appropriate to commit to holding a process by a specific date.

### **Decision**

*Bonneville will not commit to revisit the Leverage Policy's long-term target at a specific date.*

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<sup>367</sup> NRU May 11 Comments at 2.

<sup>368</sup> *Id.*

#### **4.3.8. Phase-in of Leverage Policy in the BP-20 Rate Case**

##### **Issue 4.3.8.1.**

*Whether Bonneville should clarify in the Leverage Policy that the Administrator may permit some revenue financing in the BP-20 rate case to mitigate an increase in Transmission's leverage.*

##### **Public Comments**

NIPPC agrees that, if Bonneville adopts the Leverage Policy, any reductions in program costs should be evaluated in terms of deriving the greatest benefit to Transmission customers as a result of either repaying debt or revenue financing.<sup>369</sup>

The Commenting Parties contend that a two-year phase-in is inadequate.<sup>370</sup> These parties also contend that if Bonneville can achieve cost reductions, the reductions should be used to mitigate the Transmission rate increase rather than to support revenue financing.<sup>371</sup>

Powerex argues that if Bonneville finds cost reductions, Bonneville should implement those cost reductions rather than assigning Transmission customers a significant rate increase for the purpose of revenue financing.<sup>372</sup>

Richard Devlin supports interpreting the Leverage Policy to permit the Administrator to propose revenue financing in the BP-20 rate case.<sup>373</sup>

##### **Evaluation**

Section 5 of the proposed Leverage Policy contained a one rate period phase-in of the policy for Transmission rates. The phase-in allowed "Transmission's debt-to-asset ratio to rise from the end of BP-18 to the end of BP-20, but will require the ratio to be equal to or below the end of BP-18 ratio by the end of the next rate period, BP-22."<sup>374</sup> Following the publication of the proposed Leverage Policy, Bonneville requested feedback from customers on whether to interpret this language as permitting the Administrator to propose to implement the Leverage Policy in the BP-20 rate case.<sup>375</sup> Specifically, Bonneville stated:

BPA is interested in feedback on whether BPA should interpret this language as permitting a limited amount of additional repayment or revenue financing in BP-20 if it can be supported by cost reductions in other program areas. This interpretation would allow BPA to mitigate the increase in Transmission Services' leverage ratio in the BP-20 rate period, resulting in a smaller

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<sup>369</sup> NIPPC August 2 Comments at 2.

<sup>370</sup> Commenting Parties August 2 Comments at 16.

<sup>371</sup> *Id.* at 19.

<sup>372</sup> Powerex August 2 Comments at 4.

<sup>373</sup> Devlin August 2 Comments at 1.

<sup>374</sup> Leverage Policy at § 5.

<sup>375</sup> *See* Notice to Customers, "BPA Seeks Comments on Leverage Policy," July 5, 2018.

required reduction in leverage for Transmission Services in BP-22. The amount of additional repayment or revenue financing would be determined in the BP-20 Rate Case.<sup>376</sup>

Bonneville will interpret the Leverage Policy to permit revenue financing in BP-20. Bonneville did not intend to restrict the Administrator's ability to mitigate Transmission Services' leverage ratio from increasing in BP-20. Furthermore, the Leverage Policy is clear that any increase in Transmission Services' leverage in BP-20 will have to be reduced in BP-22. Thus, it is reasonable to preserve the Administrator's discretion to mitigate Transmission Services' leverage increase in BP-20. Transmission's leverage will be permitted to increase in BP-20. Bonneville will determine the level of that increase, and any actions to mitigate that increase, in the BP-20 rate case. To avoid any confusion, Bonneville has added language to the Leverage Policy to make it clear that the Administrator retains this discretion.

Commenting Parties' and Powerex's argument that Bonneville should use any cost savings for rate reduction is understandable. Bonneville finds that the benefits of lowering the agency's leverage support adopting the Leverage Policy and providing the Administrator the discretion to revenue finance in BP-20. Commenting Parties and Powerex should present their arguments in the BP-20 rate case.

Powerex further requests that this discussion continue in the BP-20 rate case prior to making a final decision.<sup>377</sup> Bonneville has made a final decision on the Leverage Policy in this Record of Decision. However, Bonneville does not make a final decision on whether to revenue finance (from cost reductions) in Transmission rates for the BP-20 rate case. Whether the Administrator will use revenue financing to reduce Transmission's leverage will be decided in the BP-20 rate case.

## **Decision**

*The Leverage Policy will not preclude Bonneville from proposing to revenue finance in BP-20.*

### **4.4. Alternative Proposals**

#### **4.4.1. Overview**

Some commenters propose alternatives to Bonneville's Leverage Policy. Some of these proposals are mere modifications of the Leverage Policy, such as Commenting Parties' and Powerex's comments. MSR, in contrast, offers an entirely new proposal. For the reasons articulated below, Bonneville has decided not to adopt these alternative proposals. In each case, the commenter's proposed modification or alternative fails to achieve the objectives that Bonneville believes the Leverage Policy, as proposed, would achieve. Nonetheless, Bonneville appreciates the effort that commenters put into developing these alternatives.

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<sup>376</sup> *Id.*

<sup>377</sup> Powerex August 2 Comments at 4.

## 4.4.2. Stakeholder Alternative Proposals

### Issue 4.4.2.1.

*Whether Bonneville should modify the Leverage Policy as proposed by the Commenting Parties, MSR, Powerex, or NIPPC.*

### **Public Comments**

Commenting Parties, MSR, Powerex, and NIPPC proposed various modifications or alternatives to the proposed Leverage Policy.

### **Evaluation**

#### *Commenting Parties' Alternatives*

The Commenting Parties suggest that if a business line is within the mid-term target of 75 to 85 percent, no ratchet should be applied. The Commenting Parties contend that this revision would prevent the Leverage Policy from arbitrarily decreasing a business line's leverage when it is within the mid-term target.<sup>378</sup>

Bonneville disagrees with this proposal. Given that the long-term target is 60 to 70 percent, it would be counterproductive to allow a business line's ratio to increase, only to have to reduce it later to achieve the long-term target. The Commenting Parties assume that actual performance by a business line will cause a reduction in its leverage ratio. The example provided by the Commenting Parties is that a business line will have lower capital spending than forecast in rates, resulting in a lower ratio at the end of the rate period than was started with, thereby producing a ratcheting effect. Bonneville addressed above the need to maintain the business lines' leverage ratios within the near-term and mid-term targets.

Commenting Parties also argue that Bonneville should maximize Lease Purchasing to minimize the use of revenue financing.<sup>379</sup>

The Lease-Purchase program is a tool to debt finance Transmission capital projects through non-Federal third-party entities. Maximizing the Lease-Purchase program for Transmission Services while holding the amount of debt it expects to repay constant would increase (worsen) Transmission Services' debt-to-asset ratio. That effect is the exact opposite outcome Bonneville aims to achieve through the Leverage Policy, and it would not support the agency's Strategic and Financial Plans. The Lease-Purchase program is a tool to debt finance capital spending without using Bonneville's limited borrowing authority. While increased use of the Lease-Purchase program to finance Transmission assets may preserve Bonneville's Treasury borrowing authority, it would negatively impact Transmission Services' leverage position. As noted above, Bonneville has several reasons for managing the agency's leverage, apart from preserving borrowing authority.

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<sup>378</sup> Commenting Parties May 11 Comments at 12; Commenting Parties August 2 Comments at 18.

<sup>379</sup> Commenting Parties August 2 Comments at 10.

### *MSR's Alternatives*

MSR presents a detailed alternative to Bonneville's Leverage Policy. Under MSR's proposal, Bonneville would set a target leverage ratio of 85 percent for each business line. If a business line's leverage is below 85 percent, no action is taken. If the business line's leverage is above 85 percent, its borrowing authority would be limited so as to bring its leverage down by 1 percent. MSR proposes that by 2024–25, both business lines must be within the 85 percent range. A business line that is not within the range will be unable to utilize borrowing authority. Additionally, Bonneville would, in each rate case, re-evaluate the policy targets, making adjustments to the policy in the rate case. MSR also proposes a new phase-in in which the Leverage Policy would have no impact on Transmission Services' leverage until Power Services' leverage is within the same range as Transmission Services' leverage. MSR also proposes to use financial reserves to reduce the need to revenue finance for Transmission Services. MSR also proposes to impose a rate cap, similar to the Financial Reserves Policy phase-in. Finally, MSR provides an elaborate proposal to use excess incremental reserves to pay down additional debt when actual revenues exceed forecasts.<sup>380</sup>

Bonneville appreciates the alternative proposals that MSR provided for consideration, but Bonneville does not find that the proposals are superior to the Leverage Policy. The proposals listed above interfere with the existing Financial Reserves Policy established in BP-18. Bonneville communicated in the public workshops, and in its response to comments, that although use of reserves is a tool to implement the Leverage Policy, reserves will be available to be repurposed when Bonneville meets the Financial Reserves Policy requirements. If the Reserves Distribution Clause is triggered, for example, the Administrator can use the distributed reserves to pay down debt or fund capital improvements. Outside of a Reserves Distribution Clause, reserves attributable to Transmission Services will not be used to reduce the need to revenue finance capital investments in order to achieve the Leverage Policy requirements without a change in policy.

MSR's proposal also conditions the use of borrowing authority on a business line's leverage ratio. As stated previously, the Leverage Policy is not intended to solve the issues surrounding borrowing authority or be directly tied to the use of borrowing authority. Limiting a business line's ability to issue Treasury debt based on its leverage ratio increases the complexity of implementing and administering the policy. A target of 85 percent debt-to-asset ratio is also at the top of the mid-term target that Bonneville proposed and would allow Transmission's leverage position to worsen. This is directly contrary to the purpose of the Leverage Policy, which is designed to improve the agency's and each business line's leverage ratio. MSR's proposed alternative would weaken the targets that Bonneville has proposed, contradict other policies in place, and change the intended focus.

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<sup>380</sup> MSR May 11 Leverage Policy Comments at 7-9; MSR August 2 Comments at 16-18

MSR also urges Bonneville to consider reducing capital spending before engaging in revenue financing. MSR argues it is a better option for Bonneville to defer or abandon capital projects for others to pursue than to require Transmission customers to revenue finance capital projects.<sup>381</sup>

One of the mechanisms in the Leverage Policy that the Administrator may use to manage leverage is capital spending reductions.<sup>382</sup> Whether the Administrator chooses to use this tool will depend on the circumstances of each rate period. Bonneville cannot make a blanket commitment to reduce capital spending as its first and primary choice. The Administrator must have flexibility to choose which tools to use to address leverage. Flexibility is necessary to ensure that the Administrator can choose the appropriate tools to address the agency's leverage in light of the circumstances of the particular situation. For instance, the Administrator should be able to weigh whether to reduce capital spending against the importance of forecast capital projects, Bonneville's financial situation, borrowing authority, and other factors.

As another alternative, MSR suggests that Bonneville categorize \$350 million of Transmission Services' financial reserves as restricted status for a working capital fund for Power Services. In consideration for Power Services being able to draw on this \$350 million in liquidity, Transmission Services would be allowed to borrow an additional \$350 million in Federal borrowing before revenue financing of any capital asset would be required. Whether Transmission would be compensated for Power Services reliance on Transmission Services' financial reserves would be subject to further discussions.<sup>383</sup>

Bonneville finds this alternative problematic for the same reasons noted above. Specifically, MSR's proposal addresses access to capital, but does not address business line or agency leverage. MSR's proposal is also inconsistent with the Financial Reserves Policy.

MSR suggests that Bonneville impose a cap on the combined rate impacts of the Leverage Policy and other rate pressures. MSR requests that Bonneville adopt a rate mechanism similar to that previously proposed in the phase-in of the FRP. MSR notes that although Bonneville may have assessed that on an *ad hoc* basis, Bonneville should use a formal structure to achieve this result.<sup>384</sup>

Contrary to MSR's assertion, Bonneville has not set any rate caps in the FRP and does not plan to do so in the Leverage Policy. Bonneville considered the effects of these policies on rates and included a phase-in of the Leverage Policy for Transmission Services to address those effects.

MSR also recommends that Transmission Services have access to incremental growth in its excess reserves above projected levels in BP-18 for the end of FY 2017. Transmission is

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<sup>381</sup> MSR August 2 Comments, at 15.

<sup>382</sup> Leverage Policy at § 4.3.1.

<sup>383</sup> MSR August 2 Comments at 16.

<sup>384</sup> *Id.* at 18.

projected to end FY 2018 with about \$118 million more in reserves than projected in BP-18. MSR contends that these reserves should be used to mitigate the cost of the Leverage Policy. MSR also contends that allowing Transmission to use these reserves will mitigate the inequity of Transmission's lack of access to its reserves as a result of Power's consumption of \$700 million in reserves over the past 10 years.<sup>385</sup>

As previously discussed, the use of financial reserves is managed by the FRP. The Leverage Policy does not supersede the FRP. If an RDC is triggered for the FRP, then it is the Administrator's responsibility to determine the purpose, if any, for which such excess reserves may be used. The possible uses include paying down additional debt and funding new capital investments, both of which would reduce the debt-to-asset ratio.

#### *Powerex's Alternative*

Powerex suggests that Bonneville develop a process for adjudicating inter-business-line equity issues when it develops financial policies.<sup>386</sup> Powerex notes that this will help Bonneville equitably account for borrowing authority between the business lines.

Bonneville appreciates Powerex's suggestion, but it does not believe that Powerex's proposal is feasible. Bonneville designs its financial policies with the intent of meeting agency and business line needs. Establishing a formal process to adjudicate inter-business-line equity issues would significantly constrain the flexibility that Congress intended to give to the Administrator to address uncertainties that Bonneville faces.

#### *NIPPC's Alternative*

NIPPC proposes that the Leverage Policy be revised so that Transmission Services' debt-to-asset ratio will not be reduced until Power customers have fully funded their portion of the agency's cash reserves to meet the targets in the FRP.<sup>387</sup> NIPPC further proposes that if Bonneville uses revenue financing to reduce its debt, then it should split the revenue financing between Power and Transmission based on their relative use of Bonneville's borrowing authority.<sup>388</sup>

Bonneville recognizes that the FRP and Leverage Policy can affect one another, but they are separate and distinct policies that support Bonneville's financial health in different ways. NIPPC's proposal would hinder Bonneville's ability to manage its leverage through the Leverage Policy and maintain Transmission Services' leverage ratio. In that sense, NIPPC's proposal to condition Bonneville's implementation of the Leverage Policy on its business lines' compliance with the FRP's cash reserves targets is inappropriate. The FRP and the Leverage Policy are intended to track different elements of financial health. Creating interdependencies will convolute and complicate the implementation of both policies. As stated previously, allocating revenue financing or repayment of debt based on use of

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<sup>385</sup> *Id.* at 18-19.

<sup>386</sup> Powerex May 11 Comments at 3.

<sup>387</sup> NIPPC August 2 Comments at 2.

<sup>388</sup> *Id.* at 3.

borrowing authority fails to completely consider a business line's leverage circumstances. Borrowing authority is not the only source of debt used by each business line. Required revenue financing or repayment of debt should be based on the entire debt position of a business line when compared to its revenue-generating assets.

### **Decision**

*Bonneville will not modify the Leverage Policy as proposed by Commenting Parties, Powerex, MSR, or NIPPC.*

#### **4.5. Out-of-Scope Comments**

A few commenters submitted comments outside the scope of this process. Bonneville notes these comments here, but does not respond to them as they are beyond the scope of Bonneville's decision to adopt the Leverage Policy.

Mason 3 submitted comments concerning whether Bonneville should extend WNP-1 and WNP-3 debt past 2028.<sup>389</sup>

The Commenting Parties suggest that Bonneville attempt non-Federal financing to the extent practicable, including extending WNP-1 and WNP-3 debt to help relieve the pressure on Bonneville's Federal borrowing authority.<sup>390</sup>

AWEC suggests that Bonneville explore issuing debt directly, similar to the Tennessee Valley Authority.<sup>391</sup>

## **5. NATIONAL ENVIRONMENTAL POLICY ACT ANALYSIS**

Bonneville has assessed the potential environmental effects that could result from the Leverage Policy, consistent with the National Environmental Policy Act (NEPA), 42 U.S.C. § 4321, et seq.

As previously discussed in this ROD, the proposed Leverage Policy is intended to provide needed guidance on managing one aspect of the agency's accumulation and repayment of debt by setting near-term, mid-term, and long-term business-line debt-to-asset ratio targets. The debt-to-asset ratio is a business metric commonly used to measure the financial health of an entity's ability to repay debt obligations. Managing leverage through debt-to-asset ratios is a key component of building Bonneville's financial resiliency and is intended to help strengthen the agency's financial health. How the Leverage Policy will actually be implemented through rate and other actions will be determined through future Bonneville rate proceedings and other Bonneville forums, as described in Section 4 of the Leverage Policy (attached as Appendix 1 of this ROD).

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<sup>389</sup> Mason County May 11 Comments at 3.

<sup>390</sup> Commenting Parties May 11 Comments at 12-13.

<sup>391</sup> AWEC May 11 Comments at 1.

The decision to adopt the Leverage Policy thus is primarily administrative and financial in nature, and is not expected to result in reasonably foreseeable environmental effects. Furthermore, it is a policy guidance document; actual implementation actions pursuant to the Leverage Policy will occur at a later date through determinations in the appropriate forums. Accordingly, Bonneville has determined that the decision to adopt the Leverage Policy does not require further consideration or documentation under NEPA. To the extent that any future implementing actions for the Leverage Policy would have the potential to result in environmental effects, Bonneville will conduct appropriate NEPA review for these future actions at that time.

## **6. CONCLUSION**

For the reasons articulated above, the Administrator adopts the Leverage Policy attached to this Record of Decision as Appendix 1.

Issued at Portland, Oregon this 25th day of September, 2018.

/s/ Elliot E. Mainzer

Elliot E. Mainzer

Administrator and Chief Executive Officer



Appendix 1  
Leverage Policy



## Leverage Policy

### 1. Background and Purpose

The Leverage Policy (Policy) establishes a policy framework to guide BPA in managing its leverage position, using the metric of the debt-to-asset ratio. This common business metric compares BPA's total debt against its revenue-producing assets that ultimately will repay its total debt. This Policy supports the debt utilization Financial Health Objectives identified in BPA's 2018-2023 Strategic Plan ("Strategic Plan") and Financial Plan 2018 ("Financial Plan").

BPA's debt-to-asset ratio significantly impacts its overall financial health. A high ratio increases BPA's future fixed costs (interest expense) which will either increase rates or require BPA to reduce costs in other areas of the business to maintain the same level of total costs despite a rise in fixed costs. Further, a high ratio may negatively impact BPA's credit ratings, which can result in higher interest rates. A high ratio may also indicate BPA has less available borrowing authority to fund its future capital investments. Broadly, a high ratio hampers BPA's ability to respond in times of financial stress and increased uncertainty by limiting its financial flexibility.

BPA currently has a high debt-to-asset ratio relative to similarly-situated utilities. At the end of FY 2017, BPA's ratio was approximately 90 percent, compared to an industry average of 54 percent. By individual business line, Power Services' debt-to-asset ratio was 98 percent and Transmission Services' was 79 percent. Power Service's ratio is projected to decline to approximately 82 percent over the next decade primarily because it is expected to repay as much or more debt than it borrows each year. Transmission Services, on the other hand, is projected to borrow as much as \$3.5 billion more debt than it will repay over the same timeframe, resulting in its debt-to-asset ratio growing to nearly 90 percent.

Prior to this Policy, BPA had no specific guidance setting leverage targets or directing certain actions be taken to achieve leverage-related financial objectives. Any actions to manage its leverage position would have been the result of indirect or *ad hoc* decision-making. Due to this lack of guidance—and BPA's historical heavy reliance on debt and method for planning debt repayment—BPA's debt-to-asset ratio has been high historically. This Policy provides crucial near-term and long-term guidance on the actions BPA can take to maintain its financial strength.

### 2. Scope

The Policy affects the leverage condition of the agency and each individual business line by establishing target ranges for leverage and providing guidance on actions BPA will take to achieve these targets.

The Policy is intended to provide a consistent framework within which BPA can manage its leverage position. To that end, the Policy will constitute precedent that BPA will adhere to in future rate cases absent a determination by the Administrator that the Policy must be modified to meet BPA's changing operating environment.

### **3. Targets**

The Policy sets near-, mid-, and long-term targets.

- 3.1.** Near-term: BPA will not allow an agency or individual business line debt-to-asset ratio to increase from rate-period to rate-period.
- 3.2.** Mid-term: BPA as an agency and each individual business line will achieve a debt-to-asset ratio between 75-85% by 2028.
- 3.3.** Long-term: BPA aspires to achieve agency and business line debt-to-asset ratios of 60-70%.

### **4. Implementation**

- 4.1.** The Policy will be implemented each rate period. BPA will monitor and annually report out its progress toward meeting the Policy's targets.
- 4.2.** BPA will calculate the debt-to-asset ratios existing at the end of the preceding rate period for each business line ("base ratios"). BPA will compare the base ratios to forecast ratios to ensure that the ratios, at a minimum, are not forecast to increase by the end of the upcoming rate period.
- 4.3.** BPA will take action(s) to reduce any agency and individual business line debt-to-asset ratio that is forecast to be higher at the end of the upcoming rate period than its base ratio. These actions may include, but are not limited to, one or more of the following:
  - 4.3.1.** reducing planned capital spending,
  - 4.3.2.** discontinuing regulatory treatment of certain investments,
  - 4.3.3.** additional debt repayment, and
  - 4.3.4.** revenue-financing capital investments.

- 4.4. Actions related to reducing planned capital spending and changes to regulatory treatment of certain investments will be addressed through Bonneville's capital review process, such as the Integrated Program Review or its successor.
- 4.5. Actions related to additional debt repayment above the minimum levels established by the repayment methodology and revenue-financing capital investments will be addressed in the applicable Power and Transmission rate proceeding.
- 4.6. BPA also plans to take additional action if it is necessary in order to achieve the mid- and long-term targets. These actions will be determined on a rate case by rate case basis.

## **5. Phase-in Provision for Transmission**

Due to the potentially significant impacts of this Policy on Transmission's rates, BPA will implement a phase-in during BP-20 allowing an exception to the Leverage Policy's requirement to hold Transmission's debt-to-asset ratio flat (§3.1). The phase-in will allow Transmission's debt-to-asset ratio to rise by an amount determined by the Administrator from the end of BP-18 to the end of BP-20, but will require the ratio to be equal to or below the end of BP-18 ratio by the end of the next rate period, BP-22.

## **6. Calculations**

- 6.1. BPA will calculate debt-to-asset ratios using the following formula:

(Federal debt + Nonfederal debt)/(Net Utility Plant + Nonfederal generation)

- 6.2. BPA will use audited financial statements to calculate base ratios for the agency and each business line.
- 6.3. BPA will use revenue requirements to calculate forecast ratios for the agency and each business line. When calculating forecast ratios, BPA will use its forecast of capital spending and investment as a proxy for new Plant in Service (an input into the Net Utility Plant component of the above debt-to-asset ratio formula). This is because actuals include Construction Work in Progress (CWIP) in the Net Utility Plant calculation. If BPA used a forecast of when plant goes into service in the future, it would double count investments that are currently in CWIP.





