



December 4, 2020

Ms. Hillary H. Salo
Technical Director
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116
ATTN: File Reference No. 2020-700

Re: Comments on “Proposed Accounting Standards Update, Leases (Topic 842): Targeted Improvements”

Dear Ms. Salo:

Life:Powered, an initiative of the Texas Public Policy Foundation to raise America’s energy IQ, wishes to express several concerns with the [proposed update to Topic 842](#) regarding the reclassification of certain variable payment leases as operating leases. Our concerns pertain to Issue 1 of the proposed changes, specifically to their potential effect on renewable energy and energy storage projects being constructed and leased by regulated utilities and their subsidiaries.

Texas currently has the [largest amount of wind and solar generation capacity](#) of any state and is [forecast to add substantial capacity](#), particularly from solar, over the next five years. Many of these projects are planning to incorporate energy storage systems, and our understanding is that this rule change would primarily impact these projects. Our state and our ratepayers have a particular interest in the financial performance and transparency of these projects, in particular the potential effects on reliability if the projects do not perform as expected. While Texas operates the largest deregulated and competitive electricity market in the country, we sympathize with ratepayers in the majority of markets dominated by regulated utility monopolies and the potential for increased exposure to hidden costs from these projects. It is with these considerations in mind that we provide the following comments.

Our understanding is that this change [was requested](#) by the Edison Electric Institute (EEI), which represents U.S. investor-owned electric companies. Many of these companies are beginning to seek approvals from their state utility commissions to incorporate energy storage with their renewable energy projects, primarily solar projects at this time. This use of energy storage is being driven by a combination of state mandates and federal and state incentives, especially in states such as California and New York. Another key driver is the desire to sell electricity at peak prices during late summer afternoons, and this is particularly true in our home state of Texas. These driving factors will only increase as more intermittent renewable capacity is added to our electric grids.

A solar or wind facility typically sells electricity to their customers through a power purchase agreement or an operating lease. These agreements set a fixed price per unit of electricity sold, but, since the electricity output of the facility is variable, the total value of the lease payment is variable. The EEI

request notes that the addition of energy storage creates a component of the lease that does not meet the current FASB requirements for operating leases. Therefore, the value of the energy storage component must be taken as day one loss, as is required for a sales-type lease with significant variable payments. Subsequent payments are booked as income, rather than a combination of income and the recovery of a lease receivable. The requested change will allow the entirety of these variable payment leases, provided they do not depend on an index or a rate, to be classified as operating leases.

We understand the desire of EEI members to avoid large one-time accounting losses, to better harmonize U.S. standards with international standards, and to avoid the use of non-GAAP workarounds. We also recognize the unique risks that utilities face in states with increasingly stringent renewable energy mandates, which will require increasing use of energy storage technologies with long-term performance characteristics that are largely unknown. These states are creating an almost impossible situation where utilities are mandated to keep reliability high while incorporating increasing amounts of unreliable electricity from wind and solar generators.

With that said, in many states, the regulated utilities themselves lobby in favor of renewable mandates and incentives in order to require otherwise unnecessary capital investment and maximize their returns to shareholders. They are incentivized to do so because the rates they charge are set by state utility commissions to enable full cost recovery plus a guaranteed rate of return. The more projects they are able to ratebase, the greater their returns to their shareholders. As such, we have several concerns that this change will reduce transparency, one of the original reasons for creating these standards in the wake of the Enron scandal, and create opportunities for regulated utility monopolies (either directly or through deregulated subsidiaries) to pass on more risk and costs to ratepayers in the future.

One of the greatest challenges for developers of wind and solar projects is that their long-term performance is still difficult to forecast, and current evidence suggests forecasts tend to be overly optimistic. A [recent report by kWh Analytics](#), with support from the Department of Energy and the Solar Energy Industries Association, finds that solar projects are underperforming their expected annual energy output by an average of 5.4%. In year one, projects are seeing what was projected to be a bottom 10% performance year happen nearly 40% of the time. If this trend holds true, the report estimates that up to 70% of projects with a standard loan could be at risk of default after 7 years.

The performance of energy storage facilities is even more uncertain because the technologies being deployed have very short track records in commercial-scale utility applications. Furthermore, while wind and solar facilities usually employ fixed-price contracts designed to reduce the risk imposed by long payout times, energy storage projects usually sell their energy (or other ancillary services) into the market in order to capture a profit, exposing them to significant market price risk in addition to performance risk. Also, for these projects, the present value of the sum of the lease payments is often forecast to exceed the fair market value of the assets, which triggers the requirement that the leases be treated as sales-type leases.

It is easy to see why regulated utilities, their deregulated subsidiaries, and/or project developers would want to use an operating lease for energy storage, instead of a sales-type lease wherein they book the loss immediately on their balance sheet. However, this change presents a problem for investors and

regulators that evaluate these projects because the accuracy of the project's financials will depend more heavily on the accuracy of its performance projections. In a typical fixed-payment operating lease, the future cash flows are far more certain, yet this proposal grants an aura of certainty to a type of lease that does not deserve it, and, if history holds, is likely to underperform. It may be appropriate to expect a utility investor to assess this risk. It is another thing to bring this risk and reduced transparency into the realm of public utility commissions and captive ratepayers.

This change may also allow regulated utilities to perform accounting maneuvers that could saddle ratepayers with higher rates. If a utility leases an energy storage project from a developer, this rule will allow the utility to record the lease payments as an expense, rather than recording the payments as a liability on the balance sheet. The utility could then apply to incorporate that expense into their rate base, passing on the costs and the risks to their consumers. This risk could be even greater if these accounting maneuvers are applied to a new battery installation at an existing, underperforming solar installation. The utility's request to the utility commission to pass through these costs and risks is especially likely to be granted if the state has adopted an aggressive renewable portfolio standard and must build more energy storage to maintain reliability.

Even further, the utility could create a special-purpose subsidiary to build the project and set its own terms for the lease. The deregulated subsidiary could set favorable terms at the expense of the regulated utility, which would then be able to pass on the costs to ratepayers. The utility de-risks the project and gets a profit boost for its shareholders at the expense of its ratepayers, which is the type of situation that regulated markets are supposed to avoid. Granted, this maneuver could occur with any operating lease for a solar or wind project, but this rule would enable this practice to proliferate further, reduce transparency, and exacerbate the imbalance between utility profits and ratepayer protections.

Seeing these problems—and knowing that more foreseen and unforeseen consequences related to regulated utilities are likely to result from this change—we urge the FASB to:

1. Exclude regulated utilities and their deregulated subsidiaries from this tax treatment. Public utilities should be held to a higher level of transparency, and their captive ratebase gives them the highest bond ratings and lowest borrowing costs, offsetting the need for this treatment.
2. Exclude the application of this tax treatment for any existing assets, so that losses from existing renewable energy installations may not be transferred to a new energy storage installation and, in turn, to ratepayers.

We thank the FASB in advance for considering these reforms and hope that the FASB will closely consider many of the potential consequences of this change not just on the companies it affects but also on their customers.

Sincerely,

Jason Isaac
Director, Life:Powered
Texas Public Policy Foundation