

January 15, 2018

**VIA COMMISSION E-FILING SYSTEM**

British Columbia Utilities Commission  
6th floor, 900 Howe Street  
Vancouver, BC V6Z 2N3

**Attention: Mr. Patrick Wruck, Commission  
Secretary**

Norton Rose Fulbright Canada LLP  
1800 - 510 West Georgia Street  
Vancouver, BC V6B 0M3 CANADA

F: +1 604.641.4949  
[nortonrosefulbright.com](http://nortonrosefulbright.com)

**Matthew D. Keen**  
+1 604.641.4913  
[matthew.keen@nortonrosefulbright.com](mailto:matthew.keen@nortonrosefulbright.com)

Assistant  
+1 604.641.4527  
[rosalind.endo@nortonrosefulbright.com](mailto:rosalind.endo@nortonrosefulbright.com)

Our reference  
16-3822

Dear Sir:

**BC Hydro F2017-F2019 Revenue Requirement Application (RRA)  
Association of Major Power Customer of BC (AMPC) – Supplemental Final Argument**

In accordance with the Commission's timetable, please find enclosed the Supplemental Final Argument of the Association of Major Power Customers of BC regarding BC Hydro's proposed rate freeze.

Please contact the writer if you have any questions.

Yours very truly,



for: Matthew D. Keen

MDK/roe

Enclosure

8175172.03

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**BRITISH COLUMBIA UTILITIES COMMISSION**

**BRITISH COLUMBIA HYDRO AND POWER AUTHORITY  
F2017-F2019 REVENUE REQUIREMENTS APPLICATION  
PROJECT NO. 3698869**

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**ASSOCIATION OF MAJOR POWER CUSTOMERS OF BC  
SUPPLEMENTAL RATE FREEZE FINAL ARGUMENT**

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**January 15, 2018**

## Association of Major Power Customers of BC (“AMPC”)

### BC Hydro Fiscal 2017 to Fiscal 2019 Revenue Requirements Application (“RRA”)

#### SUPPLEMENTAL RATE FREEZE FINAL ARGUMENT

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##### I. INTRODUCTION AND OVERVIEW

1. As previously explained, AMPC is an industry association that represents major industrial operators in BC, including in the pulp and paper, forestry, mining, electrochemical and petrochemical industries, in matters of electricity regulation. Many AMPC members are energy intensive and trade-exposed BC Hydro customers who are disproportionately affected by changes to industrial electricity rates. AMPC’s mandate is to advocate for competitive, fair, and efficient BC Hydro rates for industrial customers.<sup>1</sup>
2. In this argument, AMPC supports BC Hydro’s revision to its application for a “rate freeze” in F2019, forgoing its earlier-proposed 3% rate increase over F2018, for the following reasons:
  - (a) Failing to implement the freeze now will be disruptive and economically inefficient, contrary to Bonbright principles. The individual bill amounts at issue are material for large industrial customers, who have planned for the bulk of F2019 with knowledge of the government’s rate freeze platform.
  - (b) As AMPC has previously urged, and the BC Government now agrees, imposing a cap on BC Hydro’s revenue requirement through a rate freeze should drive it to find operational efficiencies and cost reduction opportunities, diminishing intergenerational equity concerns through an efficient price signal.
  - (c) A one year rate freeze represents an immaterial deviation from government and BC Hydro status quo plans to slow and limit the pace of rate increases over time. Speculative intergenerational effects are at worst minimal, and may in practice be non-existent. Hypothetical, and largely academic, arguments concerning intergenerational inequity between customers fail to take into account the significant uncertainties in the future costs and revenues of BC Hydro. These effects should be given little weight by the Commission.
  - (d) The positions of customers directly affected, such as AMPC, should be given greater weight.
3. In short, the Commission should reject the notion, suggested by some parties, that taking a pragmatic approach here would be unprincipled. There are sound reasons to accept the proposed rate freeze, and, indeed, the proposed freeze is fully supported by the Commission’s ratemaking jurisdiction under the *Utilities Commission Act*.<sup>2</sup> AMPC further submits that the rate freeze should be implemented through a corresponding reduction to BC Hydro’s revenue requirement, and accordingly recommends that the Commission approve the proposed one year rate freeze on that basis. AMPC elaborates below.

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<sup>1</sup> Ex. C-9-7, AMPC Evidence, Q/A 2, p. 2.

<sup>2</sup> R.S.B.C. 1996, c. 473 (the “UCA”).

## II. ARGUMENT

### A. Customer Disruption and Economic Inefficiency

4. As the Commission and all parties to the proceeding are aware, the rate freeze was part of the recent successful provincial election campaign platform. Ratepayers watched that campaign, and, certainly in the case of AMPC members, took note of government's confirmation that the freeze would be implemented.
5. AMPC members have planned their 2019 budgets with the government's platform in mind. Failing to give effect to the requested freeze at this stage would be disruptive and contrary to the Bonbright principle of rate stability. Some customers may have to reallocate funds to increase electricity spending by up to 3% (depending, of course, on price elasticity effects on individual customer behaviour). The associated uncertainty inhibits business' ability to be efficient in their planning and operations. AMPC submits that these considerations should take precedence over other, less certain Bonbright criteria, discussed further below.
6. There are non-trivial amounts at play. The 3% represents an approximately additional \$23 million of unplanned costs that must be borne by industrial customers that are often trade exposed, and unable to pass the cost on to customers.<sup>3</sup>

### B. Efficiency Incentive

7. A further reason that AMPC supports the proposed rate freeze is the increased incentive to drive BC Hydro to find further operational efficiencies, to make up for the lost revenue. The UCA requires the Commission "to have due regard to the setting of a rate that encourages public utilities to increase efficiency, reduce costs and enhance performance".<sup>4</sup> As AMPC's written evidence and Argument in Chief note, AMPC made this argument earlier in this proceeding, and also during BC Hydro's revenue requirement application for the 2012-2014 fiscal years.<sup>5</sup>
8. Government has now expressed the same view. Minister Mungall announced the rate freeze on November 8,<sup>6</sup> and was quoted in the press as stating: "We know there are savings to be had there."<sup>7</sup> Premier Horgan, speaking in the legislative assembly the next day, likewise suggested that BC Hydro could make up for the revenue losses stemming from the rate freeze: "I expect BC Hydro to find those savings, not at a cost to taxpayers, not at a cost to ratepayers"<sup>8</sup>.
9. BC Hydro argues, in both its Argument<sup>9</sup> and IR responses,<sup>10</sup> that the rate freeze will

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<sup>3</sup> Based on \$770 million of industrial revenues: BC Hydro 2016/17 Annual Service Plan Report, p. 105, <https://www.bchydro.com/content/dam/BCHydro/customer-portal/documents/corporate/accountability-reports/financial-reports/annual-reports/bchydro-2016-17-annual-service-plan-report.pdf>

<sup>4</sup> s. 60(1)(b)(iii).

<sup>5</sup> AMPC Final Argument, p. 1; ex. C-9-7, AMPC Evidence, pp. 4 and 11-12.

<sup>6</sup> BCSEA 4.1.2, citing <https://news.gov.bc.ca/releases/2017EMPR0021-001875>.

<sup>7</sup> *B.C. government proposes short-term freeze on B.C. Hydro rates*, Online: Vancouver Sun (November 8, 2017), <<http://vancouversun.com/news/local-news/b-c-government-puts-a-freeze-on-b-c-hydro-rates>>.

<sup>8</sup> British Columbia, Legislative Assembly, *Official Report of Debates (Hansard)*, 41<sup>st</sup> Parliament, 2<sup>nd</sup> Session, No 58 at 1972 (9 November 2017).

<sup>9</sup> BC Hydro Supplemental Final Argument, p. 6, para. 5.

provide government “time” to take further steps to reduce ratepayer costs. AMPC concurs that there are a myriad of steps that government could take in the near term as part of a larger and coordinated suite of rate reforms,<sup>11</sup> for the purpose of retaining existing industrial load or competing with other jurisdictions to attract new loads.<sup>12</sup>

10. But AMPC’s point here goes beyond what BC Hydro has articulated. AMPC’s point is that, *irrespective* of future government review and actions, the rate freeze’s lower rate cap ceiling provides a price signal to BC Hydro that is likely to result in additional efficiencies (unlike “cost plus” regulation). The proof lies in the “significant steps” that BC Hydro has taken during the test period (and rate plan to date) to minimize amounts added to the Rate Smoothing Deferral Account (RSDA).<sup>13</sup> The freeze also moves the shareholder closer to bearing the risk of revenue shortfalls as part of incentive regulation.

### C. Government Policy

11. AMPC supports BC Hydro’s view in its supplemental argument that (i) government policy is to now slow the pace of past rate increases, and (ii) the Commission should give weight to government policy.
12. Indeed, the current record already shows that there have been significant rate increases for the Transmission Service Rate customers in BC since F2011, and there is good reason for government’s new policy:
  - Tier 1 pricing has increased by 42%, an increase of 51% when the cumulative impact of PST is included (again recognizing that PST is poised to change).<sup>14</sup>
  - As BC Hydro’s IR response sets out, despite rate caps, proceeding with the scheduled rate increases would result in a further cumulative increase of 10.9% over the test period (F2017 through F2019).<sup>15</sup>
  - The Hydro Quebec study confirms the rapid escalation of BC’s industrial rates relative to other regions in Canada too.<sup>16</sup>
  - BC Hydro’s increases surpass those of any other Canadian jurisdiction, and risk the competitiveness of the BC economy.<sup>17</sup> Again, BC Hydro’s industrial rates are

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<sup>10</sup> BCSEA 4.1.1 and 4.1.4, and BCUC 4.2.2 and 4.6.3.

<sup>11</sup> Government could lower water rentals or direct new rates to market surplus BC Hydro energy, for example, or simply accept a reduced equity return and re-implement one or more standard practices used by utility regulators elsewhere in North America, and formerly used in BC (e.g., rate rebalancing following a standard cost of service study, calculating BC Hydro’s equity return instead of prescribing a net income amount, having the Commission set BC Hydro’s equity return and deemed capital structure directly, or no longer treating regulatory accounts as assets that earn a return).

<sup>12</sup> E.g., AMPC understands that Manitoba and Quebec have recently been aggressively competing for new cryptocurrency server farm installations with other hydro-dominated, cool weather jurisdictions that have strong fibre access.

<sup>13</sup> E.g., BCUC 4.5.1.

<sup>14</sup> Ex. C-9-7, AMPC Evidence, Q/A 3, p. 4.

<sup>15</sup> BCSEA 4.4.2.

<sup>16</sup> Ex. C-9-7, AMPC Evidence, Q/A 2, pp. 3-4 and Appendix “A”, p. 17.

<sup>17</sup> Ex. C-9-7, AMPC Evidence, Q/A 2, pp. 3-4 and Appendix “A”, p. 17.

the fourth most expensive out of the 12 Canadian locations surveyed, up from the second lowest-cost jurisdiction in less than five years.<sup>18</sup> In other words, most of the locations included in the survey now offer cheaper industrial rates than BC does.

13. The NDP government addressed this issue by making the long term reduction of BC Hydro rates part of its energy policy. Premier Horgan's August 24, 2017 Mandate Letter (the "Mandate Letter") to BC Hydro's Chair<sup>19</sup> states that BC Hydro must:

"Freeze BC Hydro rates and develop a refreshed plan to keep electricity rates low and predictable over the long-term while making significant investments to expand the system and maintain aging infrastructure" [emphasis added]

14. AMPC concurs that the Commission should give some weight to government policy. Section 60 of the UCA expressly requires the Commission to "consider all matters that it considers proper and relevant affecting" the rate it is setting, and BC Hydro's argument shows government policy has been a relevant consideration in the past. Where, as here, the alternatives presented (rate freeze vs. 3% rate increase) are both squarely within the Commission's ratemaking jurisdiction and the Commission's choice reflects a balancing of policy interests, government policy is properly considered.
15. Beyond BC Hydro's point, however, the Commission should also consider the other side of the coin: there are adverse effects to what would be, in practice, *reversing* a government policy that has been in place for much of 2017 (anticipated following the summer change in government and publicly committed to in writing in the August mandate letter).

#### **D. Intergenerational Equity, Deferral Account and Rate Plan**

16. Based on the procedural conference and its review of the information requests (IRs) posed to BC Hydro, AMPC expects some parties will oppose the proposed rate freeze on the grounds that it would cause unacceptable intergenerational inequity. That is, as the 3% is needed now, delaying its collection makes future customers pay the costs of today's customers. AMPC also anticipates concerns about the associated carrying costs (i.e., additional costs that would not otherwise be incurred). Parties might also oppose the freeze based on perceived rate shock based on increases that exceed the 2.6% previously forecast for F2020 and beyond.
17. In other circumstances, featuring larger numbers or a longer period, these concerns would be entirely appropriate. Here, however, they are largely theoretical, subject to many uncertainties, and should not be given significant weight. The Commission should place more weight on avoiding the disruption of cancelling an already announced rate freeze.
18. AMPC considers the intergenerational equity, carrying cost and rate shock concerns largely theoretical because they rely on a number of hollow premises. Neither the carrying cost nor rate shock concerns reflect material amounts. BC Hydro's IR

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<sup>18</sup> Ex. C-9-7, AMPC Evidence, Q/A 3, p. 4 and Appendix "A", p. 16.

<sup>19</sup> Ex. B-23, Attachment 1.

responses report that the annual carrying cost is \$5.9 million,<sup>20</sup> and that winding up the RSDA as currently planned would increase the envisaged 2.6% rate increases between F2020 and F2024 to 3.8%.<sup>21</sup> That scale does not pose rate shock concerns.

**Scenario 2**

F19 Rate Freeze followed by 3.8% rate increases for F20-F24	F2015	F2016	F2017	F2018	F2019	F2020	F2021	F2022	F2023	F2024
Rate Increase (%)	9.0	6.0	4.0	3.5	0.0	3.8	3.8	3.8	3.8	3.8
Return on Equity (%)	11.96	12.26	11.84	11.60	11.23	10.67	10.34	10.07	9.84	9.68
Net Income (\$ million)	581	655	685	698	712	712	712	712	712	712
Water Rentals (\$ million)	361	358	380	350	350	345	352	368	388	391

19. AMPC notes in that regard that most of the 1.2 percentage point discrepancy between the projected F2020 and F2024 rate increases with and without the rate freeze arise because rates start lower in F2020 due to the rate freeze, and reflect rates “catching up” to recover the shortfall. The below table illustrates this:

	F2019	F2020	F2021	F2022	F2023	F2024
<b>Cumulative Rate increase with Rate Freeze</b>	0%	3.8%	7.7%	11.8%	16.1%	20.5%
<b>Without Rate Freeze</b>	3%	5.7%	8.4%	11.2%	14.1%	17.1%
<b>Relative difference in Rates</b>	97%	98.2%	99.3%	100.5%	101.8%	102.9%

20. The Commission in any event has tools to ensure that rate increases do not give way to rate shock in the future, if that concern should credibly materialize (e.g., additional smoothing). The Commission accordingly should not place significant weight on rate shock oriented concerns.
21. Further, to the extent that the lower rate cap drives new efficiencies, price elasticity effects increase revenues beyond the Application’s assumptions, or government takes further action in conjunction with the rate freeze (all of which should happen), intergenerational equity concerns diminish and possibly vanish. It is, with respect, a conceit to argue otherwise. Rate caps are a powerful incentive mechanism, whose effectiveness cannot be understated. In this regard, AMPC disagrees somewhat with BC Hydro’s implication in IRs that the application of Bonbright principles at this stage favours the rate freeze.<sup>22</sup> More precisely, it is clear that the principle against undue disruption would be breached, and it is premature to draw other conclusions in the circumstances.

<sup>20</sup> BCUC 4.1.2.

<sup>21</sup> BCOAPO 4.147.1.

<sup>22</sup> BCSEA 4.1.13. Also see BC Hydro’s supplemental final argument, p. 10.

## E. Implementing the Rate Freeze

22. BCUC IRs raise the question of whether the Commission should implement the any rate freeze by authorizing an increased transfer to the Rate-Smoothing Deferral Account (“RSDA”), as BC Hydro requests, or instead by making the 3% a “shareholder” cost.<sup>23</sup> That is, the Commission could implement the rate freeze by reducing the overall revenue requirement by \$142 million. AMPC supports the latter, consistent with its past submissions.<sup>24</sup>
23. AMPC has repeatedly argued that additional efficiencies exist and justify a general, non-specific reduction to BC Hydro’s revenue requirement.<sup>25</sup> Government now agrees that those efficiencies exist, and further agrees that they justify rate action. While BC Hydro’s Application amendment adopts these conclusions, it asserts, artificially, that any improvements can only be expected for F2020 (as of April 1, 2019): the “planned comprehensive review...will target potential offsetting cost savings that would impact rates *after* the current test period.”<sup>26</sup> [emphasis added]
24. BC Hydro therefore proposes to transfer the \$142 million shortfall caused by the rate freeze to the RSDA, rather than reduce revenue requirement, arguing that the mechanics of Direction No. 7 require the Commission to do so.<sup>27</sup> BC Hydro further asserts that its forecast costs should be treated as “prudently incurred costs”, which it must be allowed to recover. That assertion is fundamentally incorrect, eliding the fact that BC Hydro must prove the reasonableness (prudence) of its forecasts,<sup>28</sup> and reflects confusion between recovery of past costs and forecast costs.
25. BC Hydro is also engaging in a backwards-looking analysis, namely that it must first identify cost savings before the Commission can reduce its revenue requirement. This is antithetical to fundamental utilities regulation principles. This proceeding’s evaluation of BC Hydro’s application is done on a forecast basis. BC Hydro can control its costs during the next 15 months (i.e., over the current test period) and, like any regulated utility, has an ongoing obligation to identify and reduce its costs.
26. As such, claims by BC Hydro and its shareholder that additional efficiencies are expected to be found in the short-term through a comprehensive review undercut any suggestion that BC Hydro’s forecast costs for F2019 are *all* needed to provide reliable electricity service and thus reasonable (prudent). It is hence difficult for the Commission to decide anything but that BC Hydro’s forecast expenses requirement should be reduced by up to \$142 million. This approach is more correct than using the RSDA because it properly places the risk of finding efficiencies with the shareholder, rather than with ratepayers, better incentivizing BC Hydro as required by section 60(1)(b)(iii) of the UCA. AMPC notes, parenthetically, that this approach would also mitigate all concerns regarding intergenerational inequity that arise from the rate freeze.

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<sup>23</sup> BCUC 4.2.2 and 4.2.3.

<sup>24</sup> *Supra* note 5.

<sup>25</sup> AMPC Argument at para. 12.

<sup>26</sup> BC Hydro Supplemental Argument at para. 1.

<sup>27</sup> BC Hydro Supplemental Argument, pp. 10 and 13 and footnote 31; also see BCUC 4.2.2 and 4.2.3.

<sup>28</sup> *ATCO Gas and Pipelines Ltd. v. Alberta (Utilities Commission)*, 2015 SCC 45 at para. 35. In the context of utility forecasts, the Supreme Court of Canada found that the terms prudence and reasonable are akin.

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27. Presumably in anticipation of this argument, BC Hydro notes that the Minister’s mandate letter states that it is expected to “manage its programs within its existing budget programs” and that the future comprehensive review of BC Hydro would apply “after the current test period [emphasis in original]”.<sup>29</sup> BC Hydro further suggests that its forecast revenue requirement already reflects significant steps to control costs.<sup>30</sup>
28. With respect, the letter and efforts to date do not relieve BC Hydro of its obligation to identify and reduce costs on an ongoing basis:
- If the mandate letter’s passing comment about “existing budget programs” is interpreted as government policy prohibiting adjustment of the revenue requirement, irrespective of the UCA, then such letters would insulate the Commission from *any* review. The Minister is entitled to provide whatever mandate to BC Hydro she chooses, but that has little bearing on whether the Commission approves the costs incurred in striving for that mandate as reasonable (prudent). The Commission cannot consider itself bound by this mandate letter, because to do so would be to fetter its own discretion.
  - The fact that the comprehensive review is intended to apply after the current test period does not impact the reasonableness (prudence) of the costs BC Hydro forecasts it will incur in *this* test period. Consistent with general principles of utility regulation, the Commission should require BC Hydro to incorporate any and all available efficiencies into this test period.
  - Again, although BC Hydro claims it has taken significant steps to control costs, the fact that it and its owner expect to be able to find more necessarily implies that it currently projects unreasonably high F2019 costs.
29. There should also be no question that Direction No. 7 allows the Commission to reduce BC Hydro’s revenue requirement. Under its mechanics, the Commission must ensure that the rates it approves allow BC Hydro to collect sufficient revenue in each fiscal year to enable it to (a) provide reliable electricity service, (b) meet all of its debt service, tax and other financial obligations, and (d)(iii) for F2019 and subsequent fiscal years, achieve an annual rate of return on deemed equity necessary to yield a distributable surplus of \$712 million.
30. Reducing the revenue requirement by \$142 million should not place any of the above factors at risk. This amount is not directly tied to any of BC Hydro financial obligations, nor is it necessary to yield the distributable surplus required by the Direction. And, for the reasons outlined above, this amount cannot be reasonably said to be required to provide reliable electricity service – if this is not the case, then BC Hydro’s and government’s claims of more efficient operations are inaccurate (and in any event, government has multiple tools available to assist BC Hydro if required at that time – see footnote 11 above). As a result, the Commission is within its jurisdiction to reduce the revenue requirement.

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<sup>29</sup> BC Hydro Argument at para. 5.

<sup>30</sup> BC Hydro Argument at para. 6.

**III. CONCLUSION**

31. The ultimate and overwhelming conclusion must be that as the rate freeze amounts are small relative to revenue requirements, any residual harm to future generations of customers is also small, if it exists at all, and this hypothetical uncertainty should be tolerated to avoid the very real disruption and economic inefficiency that cancelling the rate freeze would cause. Further, the Commission should give particular weight to the arguments of customers who will be directly affected by any rate increases.
32. Based on the foregoing, AMPC respectfully requests that the Commission approve the proposed rate freeze for F2019. It can do so by transferring the associated incremental amount to the RSDA, or it can more properly reduce BC Hydro's F2019 revenue requirement, consistent with standard utility regulation and the Commission's jurisdiction under section 60 of the UCA. That way the shareholder is properly incented and bears the risk of finding the efficiencies claimed.

All of which is respectfully submitted this 15<sup>th</sup> day of January, 2018.

**Norton Rose Fulbright Canada LLP**



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Matthew D. Keen

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Michael Manhas

Counsel to the Association of Major Power Customers of British Columbia