BC HYDRO F-20 AND F-21 REVENUE REQUIREMENTS APPLICATION

FINAL ARGUMENT

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I would like to acknowledge the management at BC Hydro for the tremendous amount of work they endured in develop the rate submission for 2019 and 2020, and in particular to respond to the large number of written information requests and the oral hearings. This process has stretched for over 14 months and involved at least 10,000 pages of responses to four rounds of detailed (often too detailed) information requests from the Commission staff and interveners, and also involved 11 days of oral hearings to glean additional information and test theories.

The amended rate request is for a cumulative two-year increase of 0.8% to ratepayers' bills, with an increase of approximately 1.7% in April 2019 and a decrease of approximately 1.0% in April 2020.

The load forecasts and the revenue and expenditure requirements were adjusted in August 2019 to reflect the 2018/19 actual results and more recent forecasts. No adjustments were made to reflect the recent impact on power sales as a result of the government-ordered economic contraction resulting from the COVID-19 pandemic.

Improved Accounting Practices

The new government is to be complimented for making serious efforts to tackle the most obvious accounting deficiencies at BC Hydro. The government accepted Auditor General Bellringer's recommendation that BC Hydro adopt national accounting standards (which require an independent third-party to oversee regulatory accounts).[1] The auditor general's qualification of the government's 2016/17 and the 2017/18 financial statements, which was in part due to the accounting at BC Hydro, certainly spurred the government to action.

The new government also ordered that the Rate Smoothing Regulatory Account (RSRA) be wound up, ending the practice of recording unearned revenue to keep rates artificially low while protecting the planned revenue and, by extension, the net income

[1] https://www.bcauditor.com/sites/default/files/publications/reports/OAGBC_RRA_RPT.pdf

target. This change resulted in an operating loss for one year, but the additional debt of some $1.1 billion remains.

In February 2019, the new government ended the tight restrictions on the discretion of the BCUC to oversee BC Hydro's operations and to set the annual rates.[2] This "enhanced" discretion did not include allowing the Commission to set an appropriate net income target for 2019 and 2020.[3] The enhancement did not allow the Commission to reset the relative revenue shares (the cost burden) between the three major client groups; the government reserved any changes in relative costs to itself.

Despite these obvious examples of the lack of full independence, Auditor General Bellringer accepted the assurance that the cabinet would not require the BCUC to achieve a specified net income after 2020. In July 2019 she announced that the BC Hydro portion of the government's statements were acceptable. In her explanation of her opinion on the 2018/19 statements Ms Bellringer stated that her withdrawal of the qualification was based on the promised independent "framework" for the BCUC. She also stated that: "Government's plans provide for an appropriate regulatory framework, and allow BCUC to provide the scrutiny and authority required by the accounting standards." Note the future tense of "promised" independent framework, and "plans" to provide for an appropriate regulatory framework.

Later in the document she again referred to the planned independence of the regulator: "With these changes in government regulation and direction, the removal of the RSRA, and government's commitment to restore the authority of the BCUC, we agree with government's assessment that BC Hydro's use of rate-regulated accounting is now appropriately reflected in the SFS [summary financial statements], and have therefore removed our qualification for this year."[4]

Fundamental Objectives

Throughout the protracted proceeding, and despite the massive amount of information produced, the two key objectives remained constant; the government's desire for rate affordability, and the cabinet order to ensure that the net income target of $712 million be achieved.

The overall effect can be summarized as a rate plan which ensures net income certainty, and rate stability for current ratepayers, at the expense of a higher debt burden for future ratepayers.

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[2] OIC 51/19 of 14 February 2019.

[3] The target of $712 million for 2019/20 was carried forward from the previous government's 10-year financing plan, and appears high given the extremely low risk to the shareholder because of all the regulatory accounts transfer risk to the ratepayers.

[4] http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_auditor_general_removes_qualification_19_july_2019/pdf/commentary_auditor_general_removes_qualification_19_july_2019.pdf p. 2.

Short-Term Rate Affordability Drives the Request

Back on 14 February 2019, the government released the results of review of financing options for BC Hydro, which included a forecast for rate increases for 2019 to 2023 that was below the plan of the previous government. The rate increase in the new plan was lower than the earlier plan because cost increases in the early years were partially offset by redirecting the 5% rate rider (DARR surcharge), designed to pay down the energy deferral account balances, to support address operating cost increases.

Also, a higher rate increase was avoided for 2019 and 2020 due to the return of some 3% (some $360 million over two years) to ratepayers in the form of a credit resulting from adopting the national accounting standard for a revenue item.

The decision to redirect the 5% deferral account rate rider to cover operating cost increases keeps the net rate increase low for current ratepayers. An alternative could have been to retain some or all of the 5% to reduce the net balance in the regulatory accounts and accelerate the reduction in total debt faced by future generations of ratepayers.

The government's priority on short-term rate affordability was again demonstrated when it continued the previous government's prohibition on the BCUC rebalancing rates to better match the revenue by major customer class with the cost of servicing these customers. Currently, large industrial customers are paying 100% of the cost of service, while commercial businesses are paying 123.5%. The 1.8 million residential customers are the big winners as their rates cover only 90.8% of their costs.[5]

The populist approach to rate-setting was clear when the government stated that "a near-term rebalancing of BC Hydro's rates could conflict with government's commitment to keep life affordable for British Columbians. The decision to prohibit rate rebalancing is a matter of public policy."[6]

A Longer Perspective Is Required

The decision to seek the lowest possible rate increase for the short-term (F20 to F21) is probably a popular choice for most of the interveners who represent user groups. But using the 5% surcharge and the windfall accounting change credit to achieve a small rate increase does not prepare ratepayers for a likely steep increase in rates in F24 or F25, when the net cost of the Site C project will be included in the rate request.

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[5] https://www2.gov.bc.ca/assets/gov/farming-natural-resources-and-industry/electricity-alternative-energy/electricity/bc-hydro-review/final_report_desktop_bc_hydro_review_v04_feb12_237pm-r2.pdf p. 19.
[6] Ibid. p. 20.

In late May of 2019, the Manitoba Public Utilities Board (PUB) approved a 2.5% increase in the electricity rates of Manitoba Hydro, effective 1 June 2019.[7] Of particular interest is that all the additional revenue raised will be placed in a deferral account to moderate the impact on future rates of major capital projects that are coming onstream. Rather than follow the Manitoba example of preparing ratepayers for a significant increase in operating costs, the government has decided to keep the short-term rate increases as low as possible.

The Manitoba regulator utilizes the Cost of Service model to set rates, where the focus is usually on cost and revenue forecasts within the test period. The Manitoba Public Utilities Board chose to make an exception in the last rate decision to front-load some of the expected increase to smooth the transition to higher rates. It stated that:

> As the known costs of these major new generation and transmission capital projects [Keeysak dam and Bipole III] will form a significant part of Manitoba Hydro's revenue requirement beyond the test year, it is appropriate to take steps today to assist in mitigating future rate increases. This is consistent with the Board's longstanding concern that customer rate changes should be on a stable and predictable basis. Without implementing rate smoothing through a rate increase in the test year, combined with the capital costs of Bipole III ..., the costs associated with Keeyask and the potential for those costs to enter into Manitoba Hydro's 2020/21 revenue requirement could lead to rate shock for consumers.[8]

The need to increase revenues to offset rising costs has been noted by many commentators. In November 2017, Jock Finlayson of the Business council of British Columbia said that "The reality is, the cost of power is going to be going up in British Columbia, Site C or no Site C. All you have to do is look at Hydro's balance sheet to understand why.... It's a huge dilemma for our elected officials, because they know the public doesn't want to hear that – a lot of my members don't want to hear that, to be candid."[9]

Nothing has changed in the intervening years. The government still seeks to keep rate increases as low as possible while keeping the net income high.

Cabinet-Mandated Net Income

Despite the claims of enhancing the authority of the BCUC, the government chose to prohibit the regulator from setting an appropriate return on equity target for the current test period.

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[7] http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_manitoba_hydro_rate_increase_29_may_2019/pdf/commentary_manitoba_hydro_rate_increase_29_may_2019.pdf

[8] Ibid. p.

[9] https://www.theglobeandmail.com/news/british-columbia/on-hydro-horgan-borrows-a-trick-from-the-liberal-repertoire/article37027362/

Apparently, the government believed that the $712 million net income from BC Hydro was important to achieving its 2019/20 and 2020/21 fiscal plan target, as the net income from self-supporting Crowns (also called government business enterprises) is counted as government revenue. Reducing to net income to reflect a more appropriate risk level for calculating the return on equity would result in lower revenue and a lower surplus, even though no actual cash is transferred as the dividend is indefinitely suspended.[10]

The variety of regulatory accounts have the effect of protecting the net income target established by the government from changes in cost. The deferral of variances in revenue also has the effect of securing the net income target.

Recording Unearned Revenue

The elimination of the RSRA ended the practice of BC Hydro recording the difference between the forecasted revenue requirement, and the revenue generated from the allowed rate increase, as earned revenue. However, the public utility still intends to record variances between the planned and actual revenue as earned revenue in the Non-Heritage Deferral Account (NHDA). In its final argument BC Hydro confirmed that load (revenue) losses resulting from the economic contraction related to the COVID-19 would be recorded as additions to the cost of energy deferral accounts.[11]

BC Hydro argues that because the Commission allowed Fortis BC to create a revenue variance account it should receive the same consideration.[12] This effectively increases the debt to preserve the net income. The deferred revenue is treated as a regulatory asset, and one must question whether the BCUC should be giving permission to create this class of asset.

The auditor general of Ontario condemned that government's 2017 plan to defer unearned revenue in a regulatory (asset) account. She said that "A promise or commitment to raise revenue in the future is not an asset today" and "future revenue raised to pay off the debt should be recorded when it is earned—that is, when electricity is consumed by ratepayers."[13]

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[10] The net income of both BC Hydro and ICBC is counted as government revenue although no cash is actually transferred in the form of a dividend; see http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_another_perspective_22_february_2020/pdf/commentary_another_perspective_22_february_2020.pdf

[11] https://www.bcuc.com/Documents/Arguments/2020/DOC_57721_2020-04-01-BCH-FinalArgument.pdf p. 254.

[12] https://www.bcuc.com/Documents/Proceedings/2020/DOC_56820_B-28-BCH-Rebuttal-Evidence-Public.pdf p. 10.

[13] https://www.auditor.on.ca/en/content/specialreports/specialreports/FairHydroPlan_en.pdf p. 15.

The BCUC should seek the opinion of the B.C. auditor general on whether the recording of unearned revenue by BC Hydro conforms to accepted accounting practice.

Recommendation

Given that we are now into the second month of the second year of the test period, the Commission should approve the requested rate increases. Any increase, even if added to the next rate test period, would present an unplanned cost for many customers.

The effects of the COVID-19 virus are a factor as well. The economic contraction resulting from the government's strategy to slow the spread of the COVID-19 is currently reducing electricity sales, especially to the commercial sector. Normally, where short-term costs are fixed, one would expect the revenue decline to lower the net income. But BC Hydro has stated that it will use the energy cost deferral accounts to record the lost revenue as earned revenue, thereby preserving the net income.

This highlights the post-truth accounting construct that has developed respecting BC Hydro's finances, as regulatory accounting transforms more operating costs into debt liability faced by future generations of ratepayers. In effect, BC Hydro is printing money. The reliance on recording unearned revenue lost through the COVID-19 economic contraction makes the whole rate-setting process even more illusory.

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Other Items??