

**BEFORE THE BRITISH COLUMBIA UTILITIES COMMISSION**

**British Columbia Hydro and Power Authority (BC Hydro)**

**Project No. 3698622/Order G-40-11**

**F2012 to F2014 Revenue Requirements Application**

**DIRECT EVIDENCE OF ANTHONY J PULLMAN**

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**Q. Please state your name and describe your background and experience as it relates to this proceeding.**

A. My name is Tony Pullman. I am a consultant specializing in energy and regulatory matters. My curriculum vitae is attached as Appendix A. I have not testified previously  
5 before the BC Utilities Commission, although from 2005 to 2010 I was a part-time Commissioner.

**Q. What is the purpose of your testimony?**

A. I was retained by the Canadian Office and Professional Employees Union Local 378  
10 (COPE 378) to advise it on matters pertaining to BC Hydro's F2012-F2014 Revenue Requirements Application.

By letters dated January 10 and 27, and March 15, 2012, COPE 378 submitted that: "[H]ere, uniquely, the potential problem is under-collection. The real issue is whether the final rate increase should be greater than what BC Hydro has applied for" (Exhibits C-2-10 and C-2-11), and "In our submission, the most significant task facing the Commission in this  
15 proceeding is the necessity of getting a firm handle on the runaway trajectory of these [deferral] accounts. That will entail developing a longer-term strategy to tame the deferrals and get them under control" (Exhibit C-2-15).

**Q. What are your views on the use of deferral accounts by utilities?**

A. In principle I have always believed that for rate regulated utilities, such as BC Hydro,  
20 the actions of a regulator can create assets and liabilities for rate-making purposes and that under these conditions, rate-making trumps generally accepted accounting principles. Thus the action of a regulator can direct a utility to set rates and keep its books on a basis that would not be possible for other companies whose rates were not set by an independent regulator.

**Q. Have you read the Auditor General's report on BC Hydro's accounting practices as they concern deferral accounts?**

A. Yes I have and I think that the Government's response of adopting US GAAP for rate regulated industries was appropriate:

5 "The retention of rate regulated accounting in British Columbia is a policy decision that the government has made to maintain rate stability and one that is also being made in other jurisdictions. In Ontario, Hydro One has adopted full US GAAP, including rate regulated accounting; others include Fortis Inc. with operations in British Columbia and Alberta, Enbridge Gas Distribution Inc., and TransCanada  
10 Corporation. The implications of rate regulation will continue to be transparently disclosed in the audited financial statements of both BC Hydro and the Province (see Note 4 in BC Hydro's 2010/11 Annual Report and Note 37 in the Notes to Consolidated Summary Financial Statements in the 2010/11 Public Accounts)"(Exhibit B-1,Appendix GG p. 8of 19).

15 I do have two comments to make. The first is that the use of the words "rate stability" by the government seems to imply keeping rates artificially low , rather than avoiding rates that fluctuate up and down at the whim of financial or commodity markets, much like gasoline.

The Auditor General addressed rate stability as follows:

20 "While deferral accounts can help ensure rate stability in the near term, over the long term they have the potential for unfairness to future ratepayers if significant costs incurred today are recovered from future ratepayers, who may receive little or no benefit. This concept of a potential unequal matching of the costs and benefits is known as intergenerational inequity" (Exhibit B-1, Appendix GG, p.16 of 19).

25 BC Hydro added, in response to BCUC 1.4.2 seeking its comments on the AG's comment cited above, the somewhat laconic observation: "In addition, a competing objective to intergenerational equity is keeping rates low".

The second point is that what was not addressed by the Auditor General or by the government is that this Commission is responsible, inter alia, for setting BC Hydro's rates  
30 and for establishing its accounting principles. COPE 378 shares the concern not just of the Auditor General but also of a number of BC Hydro's stakeholders – namely that the growth of the number accounts and the dollar value deferred has become excessive. In addition, COPE 378 has its own concern that the so-called "energy deferral accounts" have been inappropriately used to "affect rates", as have a number of other deferral accounts.

Accordingly I have a number of general recommendations for the Commission in respect of the on-going operation of the deferral accounts that may help to curb the growth of the amounts deferred and help in their reduction in a rational and systematic fashion.

**Q. Please summarize your recommendations.**

- 5 A. I have a number of general recommendations that I think the Commission should institute to try to minimize the growth of the balances in BC Hydro's deferral accounts, as well as a number of specific recommendations in respect of BC Hydro's current Application. They are as follows:
- 10 1. That the Commission not approve transfers to the NHDA in respect of forecast cost increases in energy. This has been the method followed by BC Hydro in recent years to reduce rate increases.
  2. That the Commission not approve BC Hydro's application to roll the costs of GMS3 into the HDA, and direct it to reverse the \$29.5 million entry concerning the opportunity value of water.
  - 15 3. That the Commission not allow BC Hydro to make general refunds to all its customers if there are amounts outstanding under the energy deferral accounts, and, similarly, that the Commission not allow BC Hydro to arbitrarily apply credit balances in regulatory accounts against rate increases, but to apply any unused credit balances to reduce the balances in the energy deferral accounts.
  - 20 4. That the Commission, on a go-forward basis, consider the accounts that collect variances to be "Regulatory Balancing Accounts", and direct BC Hydro to develop a plan that recovers the variances in the year following their arising.
  - 25 5. That the Commission not allow BC Hydro to open a new deferral account without setting a date certain for the commencement of amortization, and that the Commission direct BC Hydro to commence amortization of the following deferral accounts in the test period.
  6. That the Commission direct BC Hydro to charge interest to deferral accounts based on the cost of short-term Commercial Paper rather than its weighted average cost of debt.
  - 30 7. That the Commission reconsider the use of the rider methodology to recover energy deferral amounts.
  8. That the Commission review the operation of the Trade Income Deferral Account, and disallow BC hydro's revisions to the Trade Income forecasted in the test period.

- 9. That the Commission disallow part of BC Hydro’s proposed SMI deferral.
- 10. That the Commission reject BC Hydro’s proposal to establish an Outsourcing Implementation Costs Regulatory Account.
- 11. That the Commission direct BC Hydro to cease deferring as DSM costs, those costs that support its DSM program.

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**Recommendation 1**

**Q. Please discuss your recommendation with respect to the operation of the Heritage Deferral Account (HAD) and the Non Heritage Deferral Account (NHDA).**

A. My main concern with the NHDA is that BC Hydro has started to use it as a parking-spot for energy cost increases which it would otherwise have to recover from its customers. The most egregious instance of this was in the F2011 NSP when BC Hydro charged \$222.5 million of forecast energy cost increases to the NHDA as an alternative to increasing its rates by about 6%.The transaction was opaquely described in the settlement documentation as “NHDA Baseline Adjustment”. In effect, BC Hydro was creating earnings of \$222.5 million, out of which I have no doubt bonuses and dividends could be declared and paid.

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I would recommend that the Commission direct BC Hydro to use the HDA and the NHDA as Regulatory Balancing Accounts for the collection and recovery of variances between forecast and actual revenues or expenditures and not variances between forecasts on an ex-ante basis.

**Q. Does your recommendation have any impact on BC Hydro’s Application?**

A. Yes. In the current (amended) Application BC Hydro proposes to charge the following amounts of increased forecast energy costs straight to the NHDA:

Year	F2012	F2013	F2013	Total
\$millions	\$65.9	\$103.2	\$46.2	\$215.3

25 BC Hydro ascribes the increase in the forecast Cost of Energy in the F2012 to F2014 period as being “primarily due to an increase in forecast energy sales and an increase in the forecast volume of IPP purchases” (Exhibit B-1, p.1-15).

BC Hydro attempts to justify this transfer on the grounds of “custom and practice” citing its transfer both in the F09/F10 RRA and in the F2011 NSP (Exhibit B-15, BCUC 1.9.5).

BC Hydro states that in the F09/F10 RRA it proposed to defer the increase in the cost of energy reflected in the evidentiary update, but that the Commission denied BC Hydro's proposal and consequently there was no such deferral in F2009 or F2010 (Exhibit B-23, BCUC 2.19.3).

- 5 I would recommend that the Commission specifically disallow the transfers of these amounts and direct BC Hydro to include them in the test period revenue requirements.

## Recommendation 2

### Q. Do you have any further recommendations in respect of the HDA or the NHDA?

10 A. My other recommendation for these accounts is that the Commission deny BC Hydro's application to transfer the balance from the GM Shrum Unit 3 (GMS3) Regulatory Account to the HDA. My reasons are as follows:

- 15 • The accounts are in my view more in the nature of "Regulatory Balancing Accounts" for the collection and recovery of variances between forecast and actual. The variances can be either debit or credit and should ideally be recovered in as short time-frame as possible from BC Hydro's customers;
- 20 • Exhibit A2-11-1 reproduces BC Hydro F12 Q3 Deferral Account Report - December 31, 2012 which includes in Schedule A-2 sets out the "Deferral Account Rules", and specifically BCUC Decision, October 29, 2004, Page 41, concerning the Heritage Deferral Account (HDA), which includes the following criteria, which bear little resemblance to the variances that otherwise comprise the account:
  - 3. "[S]ignificant unplanned major maintenance costs greater than \$1 million related to single event equipment or infrastructure failure.
  - 25 ○ 4. Significant unplanned major capital expenditures having an incremental annual impact on the Income Statement greater than \$1 million related to single event equipment or infrastructure failure or caused by weather related events."
- 30 • As the events at GMS 3 inform us, a considerable amount of time elapses before the causes of the failure are ascertained, before insurance (if any) can be claimed, and before the necessary repairs and/or replacement can be performed. BC Hydro states that the failure took place in March 2008 and the unit was returned to service in May 2009.

**Q. What are your recommendations for GMS3 Regulatory Account?**

A. It is far from clear whether the expenses incurred at GM Shrum unit 3 were capital in nature and should be capitalized and amortized over the remaining life of the generation equipment at GM Shrum. However, I think that given the expenditure level, it is more than likely that the useful life of the turbine was extended and the productive capacity of the station increased, and as a result, I would recommend that the Commission instruct BC Hydro to capitalize the amount (other than the “water credit” addressed below) and amortize it over the remaining life of the generation equipment at GM Shrum, effectively immediately. I consider it unreasonable that expenditures that BC Hydro incurred over three years ago in 2008-2009 should not be being amortized in 2012.

In addition, I recommend that the Commission direct BC Hydro to reverse the amount credited to the HDA and charged to the GMS 3 deferral account of \$29.5 million in respect of the opportunity value of water. I consider that the original entries in F2008 and F2009 were inappropriate, given the nature of the expenditures.

I do not think this recommendation will have any material impact on BC Hydro’s revenue requirements in the test period.

**20 Recommendation 3**

**Q. Please explain your third recommendation.**

A. I recommend that the Commission not allow BC Hydro to make general refunds to all its customers so long as there are amounts outstanding under the energy deferral accounts. This will demonstrate that BC Hydro and its stakeholders are serious about the need to reduce the energy deferral accounts to zero on a periodic basis as HC2 requires.

In the same vein, I recommend that the Commission i) direct BC Hydro not to unilaterally close its deferral accounts without the Commission’s approval before closing them, and ii) not allow BC Hydro to arbitrarily apply credit balances in regulatory accounts against rate increases, but to apply any unused credit balances first against any outstanding balances on the energy deferral accounts. I would point out an egregious instance of this in the F2011 NSP where BC Hydro decided that it no longer needed the \$104.7 million its customers had contributed to the Total Finance Charges Regulatory Account and agreed to write the balance off against the F2011 Revenue requirement, rather than apply the credit balance to reduce the considerable (c. \$800 million) balance in the energy deferral accounts. Again, this will demonstrate that BC Hydro and its stakeholders are serious about the need to reduce the energy deferral accounts to zero on a periodic basis as HC2 requires.

**Q. Does your recommendation also have an impact on BC Hydro’s current Application?**

A. Yes. BC Hydro has proposed to apply the credit balances in the following regulatory accounts against the revenue requirement in F2012:

Regulatory Account	Amount (\$millions)
Total Taxes	\$13.4
Amortization of Capital Additions	\$9.5
Total Finance Charges	\$4.0
Total	\$26.9

5 I recommend that the Commission determine whether the above-captioned Regulatory Accounts serve any future purpose, and if it determines that they do not, direct BC Hydro to apply the balances against the balances in the energy deferral accounts, rather than reduce the revenue requirement in F2012.

10 **Recommendation 4**

**Q. Please explain your fourth recommendation.**

A. My next recommendation is that the Commission, on a go-forward basis, consider the accounts that collect variances to be “Regulatory Balancing Accounts”, and to allow BC Hydro to recover the variances in the year following their arising.

15 I use the expression “Regulatory Balancing Accounts” as they are known and used in California to collect and recover variances between forecast cost item and actual.

The following is a quote from the 2011Annual Report of PG&E:

20 “The utility [PG&E] generation balancing account is used to record and recover the authorized revenue requirements associated with Utility-owned electric generation, including capital and related non-fuel operating and maintenance expenses.... and....  
 The Utility is generally authorized to recover 100% of its prudently incurred electric fuel and energy procurement costs. The Utility tracks energy procurement costs in balancing accounts and files annual forecasts of energy procurement costs that it expects to incur during the following year. The Utility’s electric rates are set to  
 25 recover such expected costs.”

I consider BC Hydro's energy deferral accounts to be virtually identical to California's regulatory balancing accounts, and that they serve the same purpose - that is to collect variances (both debit and credit) for the protection of utility and customers alike and allow for their prompt recovery. In addition, I have identified a number of deferral accounts  
 5 whose purpose appears to be to collect variances between forecast and actual, including:

- Foreign Exchange Gains and Losses;
- Amortization of Capital Additions;
- Total Finance Charges; and
- Non-Current Pension Cost.

10 I would recommend that the Commission direct BC Hydro to amortize these any other balancing accounts over a much shorter period, which in most cases will be the ensuing 12 months.

Failing this, I would recommend that the Commission direct BC Hydro to recover each year's balances on a straight line basis, rather than on the method it currently follows,  
 15 which still retains vestiges of the probabilistic approach that the Commission adopted back in 2003. At that time it seemed logical to assume that poor water years would equal out the good water years and that the energy deferral balances would even out over time.

BC Hydro states that: "the probability distribution of the simulated annual transfers to the Deferral Accounts is not symmetric. Approximately two-thirds of the time there is expected  
 20 to be a net increase in the total balance in the Deferral Accounts" (Exhibit B-1, Appendix H, p.6).

Should the Commission decide to retain the DARR to recover the balances, I would recommend that the cap and collar be removed from the table, so that the table is extended to reflect balances in excess of \$500 million (both debit and credit). BC Hydro appears to  
 25 concur with this concept in its response to BCUC 2.32.1.

**Q. What is your recommendation to the Commission in respect of the current Application?**

A. Obviously, the Commission cannot direct BC Hydro to commence recovery of the full amount in the energy deferral accounts over the next 12 months, but I would recommend  
 30 that the Commission direct BC Hydro prior to filing its next RRA to adopt a plan to zero out the accounts that will i) recover the balances in the energy deferral accounts at the end of the test period and ii) establish a revised methodology to recover variances as they arise in the future in a more systematic and rational manner.

## Recommendation 5

### Q. Please explain your fifth recommendation.

5 A. My next recommendation is that the Commission i) not allow BC Hydro to open a new deferral account without setting a date certain for the commencement of amortization, and ii) direct BC Hydro to commence amortization in the test period for the following deferral accounts:

- First Nations Negotiation and Settlement Costs Regulatory Account;
- Home Purchase Option Plan (HPOP); and
- Rock Bay.

10 It is clear from BC Hydro's responses to the two rounds of IRs that one of the reasons why BC Hydro has not proposed that amortization of these accounts commence is because it seeks to keep its rate increases below 3.91%.

15 It is also clear that while the benefits underlying the amounts deferred are being enjoyed by the ratepayers the costs are not being reflected in the rates and that this violates the most basic accounting and regulatory tenet – the matching of costs and benefits.

## Recommendation 5a

### Q. What is your recommendation for the First Nations Negotiation and Settlement Costs Regulatory Account?

20 A. BC Hydro states that has reached settlements with the Kwadacha and Tsay Keh Dene First Nations. Both settlements included a lump sum payment in F2010 and ongoing annual payments starting in F2010.... and that in May 2011, it reached a settlement with the St'at'imc First Nation which included a lump sum payment in F2012 and ongoing annual payments.

25 I recommend that the Commission direct BC Hydro to commence amortization of these payments in the test period, as well as to include the ongoing annual payments in the test period revenue requirements. I would also point out that, to the extent that the lump sum payments were in respect of so-called "historical infringements" then a more suitable accounting treatment might be to capitalize the payments to the original capital account and to amortize them along with the underlying assets.

## **Recommendation 5b**

### **Q. What is your recommendation for the Home Purchase Option Plan (HPOP)?**

5 A. I note that BC Hydro states that the completion of the final home sale in Tsawwassen occurred in August 2011, and that it “expects to know the final net costs of the HPOP by the end of F2012” (Exhibit B-1, p.7-xx).

10 This seems another instance where BC Hydro suggests that amortization not commence until the costs in question have been totally ascertained. The fault with this position is that it overrides the matching principle, and fails to reflect the benefits of the costs being deferred. In the HPOP case the expenditures were incurred as part of VITR and should in my view be capitalized to that account and amortized with VITR. I also consider that the importance of knowing the exact amount to be amortized to be overstated. Both accounting and ratemaking can operate effectively using informed estimates.

Consequently I recommend that the Commission direct BC Hydro to start amortization of the amounts in the HPOP in the test period.

## **15 Recommendation 5c**

### **Q. What is your recommendation for the Rock Bay Regulatory Account?**

A. That the Commission direct BC Hydro to commence amortization in the test period.

## **Recommendation 6**

### **20 Q. Please explain your sixth recommendation.**

A. My next recommendation is that the Commission direct BC Hydro to charge interest to deferral accounts based on the cost of short-term Commercial Paper that it borrows from the Province to fund short-term assets such as its deferral accounts, rather than use its weighted average cost of debt.

25 I calculate that the difference between the interest charged using BC Hydro’s WACD and the CP rate over the test period is \$134.7 million as the following table shows:

Interest (\$mm)	F2012	F2013	F2014	Total
Energy	39.4	39.4	40.3	119.1
Other	15.0	28.3	41.2	84.5
Total	54.4	67.7	81.5	203.6
Short-Term Rates	11.1	18.7	39.1	68.9
Difference	43.3	49.0	42.4	134.7

(Source: Application, Amended Appendix A, Tab 2.2, and COPE378 calculation)

In response to COPE 2.76.3, which asked BC Hydro to confirm that it is financing its deferral accounts using the provincial government’s commercial paper (CP) program, BC Hydro replied that “BC Hydro does not fund regulatory accounts using commercial paper, but uses a portfolio approach to debt financing such that all financing is done through a mix of short-term and long-term debt”.

In its 2008 IEP/LTAP application BC Hydro advanced to same argument to justify using its WACD in economic analyses, and the Commission rejected BC Hydro’s reasons for using its embedded cost of debt to perform any economic analysis and found that its debt portfolio management approach and its fixed/floating mix were not relevant for the evaluation of a proposed project (Decision p.203). I consider the Commission’s decision then to be relevant in this instance. I would point out that BC Hydro’s WACD includes debt issued long before the growth of BC Hydro deferral accounts. Similarly, I do not believe that BC Hydro can seriously consider using 30-year debt to fund its short-term deferral accounts.

The impact of BC Hydro’s policy is that BC Hydro’s current customers get a reduction in the test period in the cost of providing them service of \$134.7 million, and this amount is carried forward to be recovered from customers in future years.

**Recommendation 7**

**Q. Please explain your seventh recommendation.**

A. My next recommendation, that the Commission reconsider the use of RS1901, the DARR, to recover energy deferral amounts, probably needs no action on the Commission’s part at this time. However, I make the observation that the use of a uniform Rider to

5 recover the energy deferrals may run afoul of Rate Design. As the Commission well knows the provincial government's 2007 Energy Plan encouraged utilities to adopt rates that encouraged conservation, which BC Hydro has complied to the extent that it has introduced two tier rates for most of its customers. What makes a two-tier rate a conservation rate is the setting of the second tier at the cost of new supply. Should BC Hydro's Tier Two rates ever achieve that goal then it seems illogical to start loading the second tier with a surcharge to recover variances incurred in the provision of the (cheaper) Tier One heritage based power. Put another way, the second tier price is "just and reasonable" because it reflects the cost of new supply. Can the same be said of it if it reflects the cost of new supply plus a Rider?

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## Recommendation 8

**Q. Please explain your eighth recommendation.**

A. My next recommendation concerns the Trade Income Deferral Account (TIDA) and how it operates for rate-making purposes. BC Hydro admits that "Trade Income is not closely related to water inflows and there is no basis on which to forecast differences between forecast and actual Trade Income" (Exhibit B-1, Appendix H p.). Notwithstanding this, it is amortized on the same basis and in "lock-step" with the HAD and the NHDA. I recommend that the Commission direct BC Hydro to consider alternative methods of getting the benefits of Trade Income into its customers' hands.

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**Q. What is your recommendation with respect to the current Application?**

A: I point out that BC Hydro forecast Powerex's net income for the test period to be \$69.0, \$74.0 and \$79.8 million (F2012-F2014) respectively in the Original Application on March 1, 2011, and that in the very same month BC Hydro made a presentation to bond rating agencies where it stated:

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"Over the previous five years, Powerex (PX) income has ranged from \$12 to \$259 million. Market and economic conditions, recovery expectations, reduced BCH system flexibility and the strength of the C\$ dollar may materially impact PX and its ability to achieve net income at the same level as in recent years for the foreseeable future. The estimated average annual net income is \$50 to \$100 million over the F2011 - F2014 period" (my emphasis).

30

However, on August 11, 2011 BC Hydro announced in a press release that it would reduce the amount of rate increase it required by, inter alia, increasing its forecast of Trade

Income. It subsequently achieved this by increasing its forecast by \$136.2 million, as follows:

(\$MM)	Original	Amended	Increase
F2012	69.0	133.0	64.0
F2013	74.0	113.0	39.0
F2014	79.8	113.0	33.2
Total	222.8	359.0	136.2

I consider this to be a groundless manoeuvre, as any overestimate will be rolled into the TIDA when BC Hydro’s forecast fails to materialize. It seems to me that the Commission should accept BC Hydro’s estimate on the condition that any variance is for the account of the Shareholder. This will hopefully incent BC Hydro to propose *bona fide* estimates.

Should the Commission, on the other hand, accept BC Hydro’s re-estimate as *bona fide*, it may wish to consider what relevance the last five years of Powerex’s net income had when forecasting next year’s net income, given the significant change in Powerex’s circumstances explained in its presentation to the rating agencies emphasized above.

### Recommendation 9

**Q. What is your recommendation for the Smart Metering and Infrastructure (SMI) Program?**

A. BC Hydro proposes to defer an amount of \$401.4 million in the test period relating to SMI comprising the following costs:

(\$million)	F2012	F2013	F2014	Total
Operating costs	46.4	50.4	15.2	112.0
Amortization of new meters	13.6	32.4	38.3	84.3
Accelerated amortization of existing meters	38.8	27.3		66.1
Financing charges	9.1	22.8	29.2	61.1
Return on equity	7.1	17.1	22.2	46.4
Interest	4.3	10.4	16.8	31.5
<b>Total</b>	<b>119.3</b>	<b>160.4</b>	<b>121.7</b>	<b>401.4</b>

(Source: Exhibit B-1 Amended Table 7-4, Amended App A. Sch 2.2 and p.7-24)

BC Hydro states that “its approach also protects against short-term rate impacts associated with the inherent uncertainty of the timing of both the costs and benefits” (BCUC 2.145.2).

BC Hydro also states that:

5           “Requested additions to the SMI Regulatory Account in F2012 through F2014 are  
not comprised solely of costs related to the smart metering component of the SMI  
Program. The SMI Program is designed to comply with and the associated Smart  
Meters and Smart Grid Regulation. Accordingly, requested additions to the SMI  
10           Regulatory Account relate to BC Hydro’s actions regarding all components required  
to comply with section 17 of the Clean Energy Act and the Smart Meters and Smart  
Grid Regulation” (Exhibit B-15, BCUC 1.289.1).

Section 17 of the *Clean Energy Act* defines "smart meter" as a meter that meets the prescribed requirements, and includes related components, equipment and metering and communication infrastructure that meet the prescribed requirements, and states that:

- 15           (2) Subject to subsection (3), the authority must install and put into operation smart meters and related equipment in accordance with and to the extent required by the regulations.
- (3) The authority must complete all obligations imposed under subsection (2) by the end of the 2012 calendar year.
- 20           (4) The authority must establish a program to install and put into operation a smart grid in accordance with and to the extent required by the regulations.

The Regulations proscribe that all meters and related infrastructure must be in operation by December 31, 2012, while the “smart grid” in section 4 relates to:

25           “the establishment and operation of a connectivity model and the installation and  
operation of (i) at least 9 000 but no more than 35 000 system devices, and (ii)  
computer hardware and software systems to enable the authority to perform  
electricity balance analyses for the electric distribution system, and estimate the  
amount of electricity supplied from a portion of the electric distribution system to  
unmetered loads that are not known to the authority and to estimate the location of  
30           those loads”.

These must be up and running by December 31, 2015.

I do not find the linkage that BC Hydro suggests exists between the new meters and the devices in the CEA, namely that the CEA somehow obliges BC Hydro to install the meters by

the end of 2012, but that it should not start to recoup the costs from its customers until January 1, 2016 when the devices “to enable the authority to perform electricity balance analyses” have been installed and are operational.

**Q. Please summarize what this means.**

- 5 A. It is clear that the law requires BC Hydro to have the new meters in place and all the necessary hardware and systems in place for them to be performing their function by December 31, 2012. This means that the Commission should not allow BC Hydro to defer the costs of the meter program beyond that date and that depreciation should commence on that date and that the meters and related hardware go into rate base on that day.
- 10 Similarly the amortization of the costs deferred on the meters and hardware can commence amortization on January 1, 2013.

It will be reasonable, in my view, that the Commission allow BC Hydro to continue to defer costs relating to “the establishment and operation of a connectivity model and the installation and operation of (i) at least 9 000 but no more than 35 000 system devices, and

15 (ii) computer hardware and software systems to enable the authority to perform electricity balance analyses for the electric distribution system” until December 31, 2015.

**Q. Please summarize your recommendations to the Commission in respect of Smart Meters and the F2012-F2014 RRA.**

- A. My recommendation is that the Commission treat the installation of the new meters
- 20 as being in progress up until December 31, 2012. In that period the costs of the meters would attract IDC and the related costs would be deferred up to that date. On January 1, 2013 I would recommend that the new meters go into Rate Base and be reflected in the revenue requirement from that date. Since BC Hydro’s financial year will end on March 31, 2013, it would seem reasonable to make the transition on that date.

25 Accordingly I recommend that the Commission direct BC Hydro as follows:

- to cease deferring SMI operating costs as at March 31, 2013;
- not to commence the amortization of the new meters until April 1, 2013;
- to capitalize interest during construction on the new meters until March 31, 2013;
- to put the new meters into rate base on April 1, 2013 on which date BC Hydro would

30 start to collect its return on them. For avoidance of doubt there would be no return earned or deferred until that date;

- to recover the unamortized cost of the existing revenue meters prior to March 31, 2013, and to charge any remaining unamortized costs to retained earnings;

- to commence amortization of the deferred costs relating to the new meters on April 1, 2013; and
- to continue to defer the costs of the connectivity model until the Project is complete in 2015.

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## **Recommendation 10**

### **Q. What is your recommendation for the Outsourcing Implementation Costs Regulatory Account?**

10 A. BC Hydro proposes to defer \$30.7 million by seeking the Commission’s approval to establish what it terms the “Outsourcing Implementation Costs Regulatory Account”. The amount comprises the following: costs of ABSU wind down and costs of new service providers’ start-up of approximately \$25 million, which BC Hydro claims to be “commercially sensitive”, BC Hydro transition costs of \$2.3 million, advisory and legal costs of \$3.5 million, and miscellaneous and contingency of \$0.6 million (Exhibit B-16, COPE  
15 1.45.5).

BC Hydro states that it is proposing this as part of its plan to limit rate increases to 3.91% in F2013 and F2014.

20 BC Hydro also admits that while it is proposing to defer all the costs and not to commence amortization until F2015 (when all the actual total costs will be known), it has reflected all the benefits it can identify in the test period as credits to the revenue requirement.

I would recommend that the Commission not allow BC Hydro to create this account, but rather to expense the amounts it claims it will incur in the test period and to allow the savings it believes it will garner as they occur.

## **25 Recommendation 10**

### **Q. Please explain your recommendation concerning BC Hydro’s deferral policy for its DSM expenditures.**

30 A. My final recommendation addresses BC Hydro’s deferral policy for its DSM expenditures and is that the Commission direct BC Hydro to cease deferring program support costs as of its DSM deferral.

BC Hydro proposes to defer and recover over a 15-year period the following “soft costs” relating to its Power Smart program:

Year (\$million)	F2012	F2013	F2014	Total
Rate Structures	5.5	4.7	6.5	16.7
Residential SEA	1.4	1.5	1.7	4.6
Commercial SEA	1.9	2.0	2.0	5.9
Industrial SEA	1.5	1.6	1.7	4.8
Public Awareness	7.8	8.0	8.5	24.3
Community Engagement	6.6	8.0	7.8	23.4
Technology Innovation	1.9	2.0	2.0	5.9
Codes and Standards	2.5	2.4	2.4	7.3
Information Technology	1.6	0.8	0.8	3.2
Indirect and Portfolio Enabling	10.6	9.9	10.9	31.4
Total	41.4	40.8	44.3	126.5

SEA = Sector Enabling Activities  
(Numbers may not add due to rounding)

5 BC Hydro cites Order G-55-95 and CICA Handbook section 3064 “Goodwill and Intangible Assets” as its authority to continue to defer these soft costs.

I would point out that the Commission’s Order in this regard dates from 1995 when i) the CICA Handbook addressed Research and Development costs and ii) DSM was in its infancy in this province, and the decision to allow utilities in BC to defer “indirect administration costs and allocated overhead” stated:

10 (b) Direct program costs, indirect administration costs and allocated overhead, shall  
be deferred according to the intent of section 3450 - Research and Development, of  
the Canadian Institute of Chartered Accountants, Accounting Recommendations  
Handbook. Generally speaking, those criteria treat research costs as expenses and  
15 treat as assets, those development costs that have a high probability of achieving net  
financial benefits.

A review of the section 3064 of the CICA Handbook cited by BC Hydro demonstrates that the rules have become more stringent since 1995, as follows:

“examples of such activities are:

- the design, construction and testing of pre-production or pre-use prototypes and models,
- the design of tools, jigs, moulds and dies involving new technology,
- the design, construction and operation of pilot plant that is not of a scale economically feasible for commercial production,
- the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes systems or services.”

Section 3064 of the CICA Handbook goes further:

“50. The following are not components of the cost of an internally generated intangible asset:

- (a) selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to making the asset ready for use;
- (b) clearly identified inefficiencies and initial operating losses incurred before an asset achieves planned performance; and
- (c) expenditure on training the staff to operate the asset. “

and

“7. Expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognized as intangible assets.”

I consider it questionable whether the administrative costs of BC Hydro’s PowerSmart program would qualify for deferral under CICA rules, since:

- i) they are of an administrative nature and are not preparing an asset for use and
- ii) if PowerSmart is not an “internally generated brand” then I do not know what is.

Finally I would point out that there are two other Crown Corporations in Canada that defer and amortize DSM expenditures (Hydro Quebec and Manitoba Hydro) and that neither defers program costs. In the US the practice in most jurisdictions appears to be to recover DSM expenditures as incurred.

Accordingly I recommend that the Commission direct BC Hydro to cease the deferral of the program costs noted above and instead include them in the revenue requirement, with effect from April 1, 2011.

**Q. Can you summarize your recommendations in these proceedings?**

A. The following table summarizes, by financial year, the amounts by which I consider BC Hydro has understated its revenue requirement:

<b>Summary (\$Millions)</b>	<b>F2012</b>	<b>F2013</b>	<b>F2014</b>	<b>TOTAL</b>
Transfers to NHDA	65.9	103.2	46.2	215.3
Closure of Regulatory Accounts	26.9			26.9
Amortization of GMS3				
Amortization of FN Settlement				
Amortization of HPOP				
Amortization of Rock Bay				
SMI Operating Costs			16.9	16.9
Amortization of New Meters			38.3	38.3
Amortization of Old Meters	38.8	27.3		66.1
SMI Financing Charges			29.2	29.2
SMI ROE			22.2	22.2
SMI Interest			16.8	16.8
Amortization of SMI Deferral				
Outsourcing	16.3	10.8	42.4	69.5
Interest Deferred	43.3	49.0	42.4	134.7
Trade Income Forecast	64.0	39.0	33.3	136.3
DSM Program Admin Costs	41.4	40.8	44.3	126.5
Total	296.6	270.1	332.0	898.7
F12-F14 Rate Smoothing	-62.3	-0.5	62.8	0.0
<b>Additional Revenue Requirement</b>	<b>234.3</b>	<b>269.6</b>	<b>394.8</b>	<b>898.7</b>

5 **Q. Do you have any comments on this table?**

A. Yes. First that there are some blanks on it as I have no way of calculating the correct amortization for a number of Regulatory Accounts (GMS3, FN Settlement, HPOP and SMI), and second that the calculation of Interest Deferred on the regulatory accounts will have to be recalculated as I have recommended a number of changes to the regulatory account  
10 balances.

The second observation is the sheer size of the difference between what BC Hydro seeks as its revenue requirement in the test period, and the actual cost of providing that service. It is clear that BC Hydro’s proposed use of the deferral mechanism obscures from its customers and the public the cost of providing electric service, to an enormous degree. It is  
15 also clear, as the next table shows, that one cost element that was not “on the table” was BC

Hydro’s return on equity, which remained essentially intact between the original and amended Applications:

\$MM	F2012	F2013	F2014	TOTAL
ORIGINAL RETURN	610.5	583.5	625.1	1,819.1
AMENDED RETURN	594.5	566.4	599.1	1,760.0
DIFFERENCE	16.0	17.1	26.0	59.1
PERCENTAGE				3.2

(Source: Appendix A Sch 1.0)

**Q. How do you recommend the Commission address the difference?**

5 A. As I said at the beginning of my testimony, jurisdiction over BC Hydro’s rate making and accounting rests with the Commission. I would recommend first that the Commission acknowledge and quantify the scale of the difference between what BC Hydro has applied for and what it should have applied for.

10 Second, it must have BC Hydro’s best forecast of where its costs of service are headed over the next decade.

These will inform the Commission as to the most suitable plan for recovering BC Hydro’s accumulated balances of what I would characterize as its operating costs.

15 In addition, I would recommend that the Commission establish, on a go-forward basis, a plan whereby BC Hydro can recover the variances on its “Regulatory Balancing Accounts” in as short a time frame as possible.

Finally, I would recommend that the Commission establish new guidelines concerning the establishment of Regulatory Accounts on a go-forward basis.

So far as concerns the understatements by BC Hydro in F2102, F2013 and F2014, I have the following recommendations for the Commission:

20 I realize that BC Hydro has closed its books for its financial year ended March 31, 2012. Accordingly I would propose that the Commission give BC Hydro the opportunity to recover the amount of \$234.3 million by means of a rider. Should BC Hydro’s shareholder not wish the utility to avail itself of this opportunity, then the amount will have to be written off against retained earnings.

5 So far as concerns F2013, it should be possible for the Commission to give BC Hydro the opportunity to collect the amount of \$296.6 million from its customers by way of a rider that could start with the issue of the Commission's Decision. Again, should BC Hydro's shareholder not wish BC Hydro to avail itself of this opportunity, then the amount will have to be written off against retained earnings.

For F2014, I do not foresee a problem adjusting the rates to allow BC Hydro the opportunity to recover its costs of operation as well as its return, as the Commission's Decision will presumably be issued prior to April 1, 2013.

**Q. Does this complete your testimony?**

10 A. Yes it does.

# APPENDIX A

## Anthony J Pullman C.A.

### Business Experience

#### **British Columbia Utilities Commission**

Commissioner (Part-Time)

2005-2010

- Participated as a Panel Member on oral public hearings, and participated in a large number of written proceedings, primarily related to:
  - Applications for Certificates of Public Convenience and Necessity (CPCN) for such diverse utility projects as electric transmission lines, hydroelectric generating equipment, gas pipelines and LNG facilities ;
  - Rate Design Applications;
  - Acquisition Plans;
  - Energy Supply Contracts; and
  - Revenue Requirement Applications.

#### **ATCO Power Limited**

Senior Vice President Finance

2002-2004

Vice President Finance and Administration

1993-2002

- Managed all finance, financial reporting and accounting and strategic and business planning activities for the ATCO Group's IPP Business Unit having assets of \$2.4 billion and operations in Canada, United Kingdom and Australia.
- Led the financing/refinancing of 9 IPP projects raising \$4 billion of limited recourse debt in London, New York, Sydney and Toronto.

#### **ATCO Ltd.**

Vice President, Planning and Budgeting

1988-1993

Vice President, Controller

1985-1998

- Prepared and presented to the Board strategic and business plans for the ATCO Group of companies.

- Led all aspects of controllership, including financial reporting and accounting, taxation, internal audit, insurance and information systems for ATCO Ltd's traditional operations worldwide.

### **Alberta Power Limited**

Vice President, Controller

1980-1985

- Managed all accounting, budgeting and rate regulation matters.
- Responsible for preparing rate applications; responses to interrogatories, cross examination of intervenors, and final argument before the Public Utilities Boards of Alberta, the Yukon and Northwest Territories, as well as the National Energy Board.

### **Touche Ross & Co. Chartered Accountants**

Graduate trainee to Manager

1967-1980

- Managed audits and consulting assignments for a diverse group of clients.
- Participated in consulting engagements for the National Energy Board between 1975 and 1979, concerning Trans Canada Pipelines (1975), Interprovincial Pipeline (1975-6), Arctic Gas Pipelines (1975-6) and Foothills Pipelines (1979).
- Testified before National Energy Board (1978), Alberta Public Utilities Board (1978) and Alberta Local Authorities Board (1980)

## Education

BA, MA, (Oxford University)

## Professional Affiliations

Alberta Institute of Chartered Accountants

## Governance Experience

### **Alberta Blue Cross Plan**

Director

1989-1998

Vice- Chairman

1994-1996

Chairman

1996-1998

- Oversaw transition of the business from a division of the Alberta Hospitals Association to a stand alone enterprise with its own provincial legislation.
- As Vice-Chairman chaired the Plan's Audit Committee.

- Negotiated employment contract with CEO and instituted annual evaluations. Developed succession plan for CEO and key employees.
- While Chairman represented the Plan as a director of the **Canadian Association of Blue Cross Plans** and of the **Blue Cross Life Insurance Company of Canada**, chairing the latter's Audit Committee.

**Calgary District Hospital Group**

Trustee	1985-1991
Vice-Chairman	1987-1989
Chairman	1989-1991

- As Chairman, handled all media interviews; presided over corporate reorganization and the development of a new management model and chaired numerous stakeholders' meetings to develop the "role and scope" of the 1,000 bed teaching hospital.

**Other Governance Experience**

Organization	Position	Period
Calgary Public Library Board	Trustee	1979-1980
Edmonton Convention Centre Authority	Director	1983-1985
Protection Mutual Insurance Company	Canadian Advisory Board Member	1985-1994
Calgary Police Commission	Commissioner	1992-1993
West Island College Society of Alberta	Director	1998-2003
	Chairman	2001-2003
Together Against Poverty Society	Director	2010-