

February 24, 2020

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British Columbia Utilities Commission
Suite 410, 900 Howe Street
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Attention: Patrick Wruck, Commission Secretary

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Our reference
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BCUC File 62951
Batch 59886

Dear Mr. Wruck:

**BC Hydro F2020-F2021 Revenue Requirements Applications (RRA)
Association of Major Power Customers of BC (AMPC)
Opening Statement of Patrick Bowman (InterGroup Consultants)**

We are legal counsel to AMPC in this matter and write on its behalf to provide an opening statement from Patrick Bowman of InterGroup Consultants. Mr. Patrick Bowman will deliver this statement at the Oral Hearing on Tuesday, February 25, 2020.

If you have any questions, please contact the writer.

Yours very truly,



(for) Matthew D. Keen

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Opening Statement of Patrick Bowman (InterGroup Consultants)

February 25, 2020

I. Introduction

The purpose of this opening statement is to introduce InterGroup's pre-filed expert testimony (Exhibit C11-11) to the BCUC. InterGroup has also reviewed BC Hydro's Rebuttal Evidence (Exhibit B-28), attended parts of the first week of the oral hearing, and reviewed parts of the transcript.

InterGroup was retained by the Association of Major Power Customers and asked to analyze the effects of BC Hydro's Revenue Requirements Application on industrial customers. Our role is as independent witnesses providing opinion evidence to the Commission that is fair, objective and non-partisan, seeking to help the Commission manage this period of change.

II. Phase I Review Context

As a starting point, this Revenue Requirement Application (RRA) comes after a prolonged period of government-directed policy initiatives. Further to the BC Government's Phase I BC Hydro Review, this RRA is part of the phased return of BC Hydro to full regulation, and there will be multiple related but separate proceedings before the BCUC in the near future. They will affect rates, and the Commission Panel's directions in response to the RRA should take this context into account and address what information BC Hydro should bring forward.

III. Overview of InterGroup's Conclusions

The scope of InterGroup's assignment was to review and test the reasonableness and competitiveness of BC Hydro's revenue requirement for F2020 and F2021.

At a high level, InterGroup's report reached four key conclusions:

- 1) BC Hydro has had significant rate increases over the past decade. In comparison, similar Canadian jurisdictions have had much smaller electricity cost increases. This creates an issue for industrial competitiveness, which threatens BC Hydro's loads, and thus the rates for all customers.
- 2) The Application reflects fortunate events affecting the deferral accounts in a way that masks significant increases in BC Hydro's actual cost to operate, while continuing a significant revenue stream to government.
- 3) The Commission Panel should provide BC Hydro with clear direction about topics that arise in this RRA but that will also be the focus in upcoming applications. Otherwise, issues arising in this Application will not be resolved and can be expected to repeat in the future.
- 4) There are specific adjustments that BC Hydro should make to its revenue requirement, primarily related to the inputs chosen for the Evidentiary Update BC Hydro filed in August (Exhibit B-11; public version filed in October in Exhibit B-19). Our recommendations are for BC Hydro to use current and properly-tested information affecting the test years.

Our pre-filed testimony includes recommendations for the Commission Panel to make findings which may not relate one-to-one to changes to revenue requirement today.

1 InterGroup has had sustained involvement in utility regulation in a wide range of Canadian
2 jurisdictions. Our experience suggests that when regulators make “directional” findings, they
3 provide guidance to all parties about priorities and how regulation will unfold. The utility can
4 know the priorities it is expected to address; future decision-makers can benefit from a sort of
5 roadmap; and, perhaps most importantly, customers can see and benefit from the stability and
6 predictability that arises from having all parties know the broad direction that will be followed.

7 **IV. Summary of Pre-Filed Testimony**

8 **Principles, Overview, Background and Context (Sections 2-4):** We reviewed BC Hydro’s
9 revenue requirement forecast and underpinning methodology for reasonableness, in line with
10 regulatory and ratemaking principles based on our experience reviewing revenue requirements
11 in other jurisdictions. BC Hydro stands out in several areas, particularly its focus on revenue
12 and cost certainty and its extensive use of deferral/regulatory accounts. We identified multiple
13 larger picture considerations that are integral to understanding BC Hydro’s current rates
14 situation.

15 **Industrial Rate Competitiveness (Section 4.1):** The key issue of industrial rate
16 competitiveness is addressed in AMPC’s Evidence at Section 4.1 and Appendix B. It shows
17 that BC Hydro was a cost leader among the low-cost jurisdictions in Canada through to 2008,
18 which is no longer maintained. Industrial customers establish themselves and the size of their
19 operations in BC based in part on low-cost power, because energy makes up a large
20 percentage of their total operating costs. Because rate competitiveness affects industrial
21 customers differently than other customer groups, the Commission Panel should flag industrial
22 competitiveness as a priority for BC Hydro. If industrial customers reduce consumption or new
23 loads do not arise, then all of BC Hydro’s customers’ rates must rise.

24 **Recovery of Full Revenue Requirement (Section 4.2):** But for redirecting favourable Deferral
25 Account Rate Rider (DARR) funds into government-directed net income, customers would have
26 seen a material rate reduction in F2020, all else being equal. We detail in AMPC’s response to
27 BCUC IR 1.1 (Exhibit C11-14) that BC Hydro’s RRA otherwise indicates a revenue shortfall of
28 about \$738.7 million for F2020, or a rate increase of 15.1% (\$511.5 million for F2021, about
29 10.4%). We think this finding is material to:

- 30 a) the lens that should be placed on BC Hydro’s costs in this RRA and the next.
- 31 b) understanding the context for government earnings and returns prior to the coming rate
32 of return review.

33 We note that BC Hydro’s Rebuttal Evidence (Exhibit B-28, page 6) mischaracterizes
34 InterGroup’s conclusions, stating that, “InterGroup views BC Hydro’s rate proposals for the Test
35 Period to be an “unfortunate outcome” for ratepayers and seems to prefer the structure of the
36 previous 10 Year Rates Plan.” This is simply not correct. In fact, InterGroup states that
37 “Implementing the previous 10-year plan for these years would have continued to harm the
38 competitiveness of BC Hydro rates” (Exhibit C11-11, page 19).

39 Our analysis looks at how much the proposals leverage favourable variances that BC Hydro did
40 not control, so that the Commission Panel has a clear understanding of the degree of internal
41 cost pressures this RRA imposes on customers.

1 **Rate Smoothing Balance and Fair Rate of Return (Sections 4.3 and 4.4):** In Section 4.3, we
2 question whether BC Hydro could have realistically collected the outstanding rate smoothing
3 amounts. Section 4.4 focuses on BC Hydro's entitlement to its net income.

4 There are three questions that are important to ask:

- 5 1) Does BC Hydro have any material "equity" contributed by the shareholder?
- 6 2) Does the shareholder bear much, if any, risk on which to earn risk-based "equity"
7 compensation?
- 8 3) Has government already tapped any entitlement to returns from customers through
9 above-cost policy directives?

10 We recommend that the BCUC provide clear direction to BC Hydro to answer these questions
11 as part of any "rate of return" filing. Otherwise, BC Hydro may pursue a generic "cost of capital"
12 approach that does not address larger policy questions relevant to a Crown-owned utility. It is
13 relatively uncommon to review cost of capital as a finance-oriented exercise for Crown-owned
14 utilities. BC Hydro's prescribed net income creates rate pressures and competitiveness
15 challenges, and in the face of those pressures it is appropriate for this Commission Panel to
16 indicate what information would be useful for the next rate of return proceeding.

17 **Excessive Regulatory Account Complexity (Section 4.5):** In the matter of deferral accounts
18 generally, Section 4.5 highlights two issues. First, BC Hydro's overly complex deferral accounts
19 undermine the transparency of BC Hydro's costs. That is, BC Hydro's extensive use of deferral
20 accounts may reduce the pressure to control costs as a way to manage rate increases. The
21 BCUC should direct BC Hydro to simplify the regulatory and deferral accounts as a long-term
22 priority, to help ensure BC Hydro's costs are fully regulated, and are transparent to the regulator
23 and impacted parties. Second, deferral accounts materially reduce shareholders' risks and
24 should also be part of BC Hydro's net income review.

25 **IPPs and Other Cost Issues Impacted by Government (Section 4.6):** On the matter of IPPs
26 and other cost pressures, we did not prepare any new analysis in Section 4.6. The conclusions
27 from the "Zapped" government report on IPPs are clear. Going forward, the BCUC should
28 ensure that future rate reviews consider and test the prudence of all costs included in revenue
29 requirements.

30 **Industrial Rate Design and Rebalancing (Section 4.7):** Regarding industrial rate design and
31 rebalancing, this is a major item of concern discussed in Section 4.7. As BC Hydro returns to
32 "full regulation", it is important for the Commission Panel to understand that rate design and
33 rebalancing are issues now, because these issues also affect competitiveness. There are no
34 restrictions on the Commission Panel directing BC Hydro to prepare proper studies or
35 expressing concern about general rate fairness.

36 **Specific Issues in the F2020-F2021 RRA (Section 5.0):** The second major component of our
37 report addresses specific recommendations from InterGroup about F2020 and F2021 test year
38 rates.

39 **Powerex Net Income Forecast (Section 5.1):** The Commission Panel should direct BC Hydro
40 to update its test year forecast (based on a five year average of actuals) to include F2019
41 actuals, in the same manner as BC Hydro has updated actuals elsewhere. BC Hydro proposes
42 not to update its forecast methodology to include F2019 conditions because they are "unlikely to

1 reoccur to the same extent going forward” (Exhibit B-17, AMPC IR 3.3.2). The impact is
2 material, at \$55.7 million per year. We make four comments:

- 3 1) Using a five year average is intended to avoid any need to figure what may or may not
4 reoccur. Updating for F2019 only affects 20% of the forecast (1 year in 5) so is not
5 depending on reoccurrence. The intent of the method is to avoid this type of discretion.
- 6 2) Powerex Net Income has been typically underforecast by BC Hydro (4 out of 5 years
7 from F2015 to F2019).
- 8 3) Although it did not update the Powerex forecast, BC Hydro updated the market electricity
9 purchases forecast in June 2019 for the test years, to increase the unit costs (compared
10 to the original October 2018 forecast). Further, after updating, the market unit costs are
11 now above the F2015-F2018 level and closer to the five-year average. BC Hydro’s
12 response to Undertaking 24 (Exhibit B-46) confirms that Powerex’s results up to the end
13 of Q3 F2020 are consistent (if not ahead of) this recommendation.
- 14 4) BC Hydro sought to extend the 2018 Powerex Letter Agreement indefinitely to allow
15 forward purchases of market electricity. This agreement was put in place because Mid-C
16 markets had decreased supply driving day-ahead market prices up, and BC Hydro
17 indicates it has no basis to believe this F2019 market condition will reverse itself.

18 **Finance Charges and Debt Management Regulatory Account (Section 5.2):** As the cost of
19 interest is a real cash outflow in the test years, Section 5.2 explains that the best available
20 information should be used. We make recommendations about using information that was or
21 should have been available for the Evidentiary Update for long-term and short-term interest
22 rates.

23 It is already known that long-term debt has been locked in at rates below the RRA forecast for
24 the test years, which will reduce BC Hydro’s costs. Such known variances in actual expenses
25 and cash requirements are not ideal situations to adjust via a regulatory deferral account and
26 instead, should be included in test year forecasts.

27 On short-term debt, a reliable public source (BC Treasury Board) has updated rate forecasts
28 from the January 2019 forecast used by BC Hydro. Rates have lowered materially.

29 Similarly, it appears sinking fund earnings have been ahead of forecast. During a period when
30 overforecasting debt costs has been a sustained problem for utilities including BC Hydro, each
31 of these items merits using reasonably up-to-date actual borrowing costs and updates to
32 interest rates from the BC Treasury Board, where such changes are material.

33 **Pension Costs (Section 5.3):** This issue is about stability. Pension costs are primarily non-
34 cash items that in many cases will not be paid out until well into the future. The value of such
35 obligations varies over time according to the assumed discount rate, but such changes can
36 reverse multiple times before ever being paid. Even though this item is non-cash and relates to
37 future payments, BC Hydro proposes to collect an additional \$50 to \$60 million per year, based
38 solely on new discount rates in the Evidentiary Update.

39 We were surprised by this change in BC Hydro’s Evidentiary Update given BC Hydro has
40 previously expressed concern that “pension costs are highly sensitive to changes in the
41 discount rate”, and proposed a five-year average mechanism to mitigate this instability in a
42 previous RRA.

1 The issue is exacerbated by the *de minimis* evidence filed by BC Hydro to support the discount
2 rate change in its Evidentiary Update, and the fact that the change is material – the previous 5
3 years saw discount rates remain in a tight range of 3.81% to 3.94% and now, in one update, the
4 rate decreased to 3.33%. The RRA does not credit ratepayers with the offsetting known benefits
5 of eliminating MSP premiums during the same timeframe.

6 For both Finance Charges and Pension Costs, BC Hydro therefore proposes to include only the
7 most speculative and least consequential change (the pension discount rate) that raises
8 revenue requirement, and not include known and highly reliable changes that benefit ratepayers
9 (interest rates and MSP premiums) – this is inconsistent with prudent and fair ratemaking.

10 **Depreciation (Section 5.4):** In the matter of depreciation, Section 5.4 notes that a study is long
11 overdue and that there is reason to expect that broader industry trends toward longer lives may
12 benefit ratepayers. It is our understanding that BC Hydro now plans to move forward with a
13 study. BC Hydro notes it cannot complete the study even for the next RRA. This is unfortunate,
14 but we understand there is likely the need to run a proper RFP process to retain expertise,
15 complete a familiarization of the professional with BC Hydro's unique account structure, and
16 process large volumes of data that may not have been maintained for depreciation purposes.
17 This underlines the importance and need for early and clear BCUC direction to study and report
18 on future topics to achieve regulatory efficiency and responsiveness.

19 **Corrections and Clarifications:** BC Hydro's Rebuttal Evidence claims six factual errors in
20 InterGroup's report (starting on page 16 of Exhibit B-28):

- 21 ▪ Four of the "errors" are effectively typographical or transposition issues that have no material
22 impact on InterGroup's conclusions or recommendations:
 - 23 ○ The first bullet notes that the DARR in future could be positive or negative.
 - 24 ○ The third bullet notes that only a small minority of hydro assets of the older
25 vintages retired before the "average" life of 75 years – here, InterGroup sourced
26 the wrong column at 99.75% of the cohort assets, rather than 89.31%, but the
27 underlying conclusion remains valid.
 - 28 ○ The final two items (fifth and sixth bullets) appear to be errors in InterGroup's
29 reading of the debt hedge values presented, but they have no impact on
30 InterGroup's recommendations, as the recommendations do not distinguish
31 between hedged and non-hedged debt.
- 32 ▪ The second bullet claims that InterGroup's Table 5-9 values for the pension cost impact on
33 test years are incorrect because one set uses gross values, and the other net values after
34 allocation to capital spending. This appears to be true. It is key to note, however, that the
35 impact on costs reported by InterGroup remains valid (except for the BC Hydro error of \$1
36 million discussed at Transcript, Volume 7, page 861). The pension discount rate update is
37 still an issue affecting nearly \$60 million in annual costs for the F2020 and F2021 test years.
- 38 ▪ The last item is not an error at all. While the fourth bullet notes discount rates were not
39 updated mid-way through the F2017-F2019 RRA process, the issue being discussed by
40 InterGroup was the challenge of testing updated forecasts. In that RRA, as the discount rate
41 was not updated, it did not require new testing.

42 Thank you.