

June 30, 2020

Attn: Marija Tresoglavic, Acting Commission Secretary
British Columbia Utilities Commission
Suite 410, 900 Howe Street
Vancouver, BC V6Z 2N3

Dear Mesdames/Sirs:

**Re: Project No. 1599045 (BCUC Staff Consultant Report)
BC Hydro Performance Based Regulation (PBR)**

As per Commission Order G-70-20, I enclose herein a discussion of high-level topics and questions, regarding the BCUC Staff Consultant Report by PEG (Pacific Economics Group) Research in this matter.

PBR and the Macroeconomic Background of Utility Operations

In section 3 of the report (page 8, last paragraph) PEG informs: "In our second recent white paper for Lawrence Berkeley National Laboratory we presented the further argument that the efficacy of Cost of Service Regulation (COSR) varies with the business conditions that utilities face. It further suggests on page 9, first paragraph: "When business conditions are chronically unfavourable... the cost of utilities tends to grow faster than their revenue". When discussing chronically unfavourable conditions, on page 10, paragraph 3 the report suggest that one of the "two most important sources of potential financial attrition for electric and natural gas utilities" is the declining "trend in average use of energy by residential and commercial customers".

Later in the report, in section 7.2, when discussing Multi-year Rate Plans (MRP's) it is suggested that: "MRP's have been used in North America since the 1980's. They were first used on a large scale for railroads and incumbent telecommunications carriers. Companies in these industries faced significant competitive challenges and complex, changing customer needs that complicated COSR. MRPs streamlined regulation and afforded companies in both industries more marketing flexibility and a chance to earn superior returns for superior performance"¹.

Q1: The report seems to deduce that macroeconomic factors, pertaining to either the economy at large or the industry at hand (i.e. subject to regulation) contribute to either favouring or disfavouring of COSR vs. PBR. Has PEG observed any discernable links between the stage in the life-cycle development of an industry subject to regulation and the need for PBR as opposed to COSR? For example,

¹ PEG Report: "PBR: Basic Features and Possible Applications to BC Hydro", Page 34, Last Paragraph.

is it PEB's assertion that given sufficient passage of time, the reaching of a mature technological "wall", and/or chronically unfavourable business conditions – that the regulation of all industries subject to regulation will naturally trend towards PBR?

Q2: In the examples brought forth of early PBR regulation, I observe that among the first industries to be subjected to the use of MRP's in North America were railroads and telecommunications carriers, industries which were incentivized from having marketing flexibility to establish their service territories and build robust customer and asset bases; and where it was desirable for such utilities to go about carving their markets aggressively. To what extent, was PBR regulation for these industries suitable given the competitive backdrop to their operations, so that superior performance in market penetration would be rewarded with superior payout? In hindsight, would MRP regulation have worked as well in the absence of this competitive backdrop?

PBR and Vertically Integrated Utilities

In section 7.2 of the report, which describes precedents to MRP use, PEG outlines that "MRP's have also been used on many occasions to regulate retail services of gas and electric utilities"², including in certain provinces in Canada such as BC, Alberta, Ontario and Quebec. This section of the report also observes that, some of this PBR form of regulation was enacted during or post-transition to retail competition.

Q3: How big a factor is the existence of retail competition (in gas or electric utilities) in enabling or favouring adaptation of MRP's in regulation?

Q4: In PEG's experience, what significant parallels could help (or otherwise, what differences could hinder) the adaptation of MRP's for a large-scale vertically integrated utility, such as BC Hydro?

Q5: Customer mobility, which is enabled through competition in the gas and electric retail services, is a big factor in these utilities' pursuit of cost streamlining and value offering. For a vertically integrated utility such as BC Hydro, what would best serve as proxy for customer mobility, under PBR regulation?

PBR and Performance Incentive Mechanisms (PIM's)

Q6: Under COSR, utilities (including vertically integrated utilities) routinely track (measure and report on) certain performance indicators or metrics, be these reliability, customer service or conservation targets. In PEG's experience, do utilities under PBR regulation track (on average) a larger number of performance

² PEG Report: "PBR: Basic Features and Possible Applications to BC Hydro", Page 35, Paragraphs 1 & 3.

metrics, or is tracking in the context of incentive mechanisms the factor which brings a keener focus on this aspect of a utility's performance?

Q7: Has PEG come across any quantifications of the incremental internal effort related to tracking of performance metrics, on the part of those utilities that have a long history under MRPs or other forms of PBR regulation?

Q8: As some PBR mechanisms rely on operating or cost data of other utilities, how long (i.e. how many months or years) it has taken select (i.e. known to PEG) jurisdictions to transition to PBR, in terms of establishing both the determination of "peer" utilities and the business practices for data collection and sharing?

Q9: In PEG's experience, what practices if any, have been successfully employed by incumbent utilities or regulators to ensure an acceptable balance among system-wide vs. regional performance metrics for vertically integrated utilities?

Revenue Decoupling as a Form of PBR

Section 4 of the PEG report, discusses revenue decoupling as one of two methods that are widely used in North America for relaxing the revenue/usage link, which itself is seen as a form of PBR because "it reduces incentives that utilities have to boost the utilization of their systems"³. Further in Section 4.1, it suggests decoupling "... encourages a wide range of DSM initiatives and DGS..."⁴, while acknowledging: "Revenue decoupling may not be desirable for all services. For example, some customers may have a demand for utility services that is particularly sensitive to the terms of services. Utilities under decoupling may in such cases be insufficiently attentive to retaining the business of these customers. Quite commonly, only revenues from residential and commercial business customers are decoupled. These customers account for a high share of a distributor's base rate revenue and are often the primary focus of DSM programs"⁵.

Q10: In the case of BC Hydro, to what extent could the possible adoption of revenue decoupling as a form of PBR, contribute to erosion of domestic load in the form of DSM, DGS, and the like; and heighten systemic risks associated with a declining domestic load base?

Q11: BC Hydro's F2020-F2021 Revenue Requirements Application (RRA) revealed that BC Hydro's present system conditions of a domestic surplus energy are expected to last well into the 2030's⁶. How would the potential

³ PEG Report: "PBR: Basic Features and Possible Applications to BC Hydro", Page 19, Paragraph 1.

⁴ PEG Report: "PBR: Basic Features and Possible Applications to BC Hydro" Page 20, Paragraph 1.

⁵ PEG Report: "PBR: Basic Features and Possible Applications to BC Hydro", Page 20, Paragraph 2.

⁶ BC Hydro F2020-F2021 Revenue Requirements Application, PDF Page 1243, Appendix C, Comprehensive Review of BC Hydro – Phase 1 Final Report, Page 3.

adoption of revenue decoupling (with the ‘disincentives’ that it would bring about regarding boosting the utilization of the BC Hydro system), play out over the next decade under the conditions of a sustained domestic energy surplus?

Q12: To what extent the possible adoption of revenue decoupling as a form of PBR, ought to consider BC Hydro’s DSM wherewithal going forward? For example, what line of sight to BC Hydro’s Demand Side Management (i.e. DSM direction, size of spending, programs, beneficiary customer groups, etc.) ought to be in place and how far in advance, for PBR determinations to be sufficiently informed?

PBR and Shared Benefits

In section 2 of the report, the opening paragraph speaks of the “benefits’ sharing objective” of electric utility regulation: “The power industry policies of government agencies should try to bolster the industry’s net social benefits and share them fairly. The net benefits of the industry are the difference between its (gross) benefits and its costs”.

Q13: Where a utility’s costs (incurred to date) haven’t been fully recovered through rates, and where such unrecovered costs have been deferred to (i.e. accumulated in) regulatory accounts, as is the case with BC Hydro - what are PEG’s views as to the forward rate of recovery of such deferred costs under PBR? Would adoption of PBR have a bearing on the rate of recovery of BC Hydro’s deferred costs, one way or another, as compared to COSR?

All of which is respectfully submitted.

Sincerely,

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