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By Email

British Columbia Utilities Commission
Suite 410, 900 Howe Street
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**Attention: Marija Tresoglavic, Acting Commission
Secretary**

Dear Sirs/Mesdames:

**Re: British Columbia Hydro and Power Authority (“BC Hydro”)
F2020 to F2021 Revenue Requirements Application ~ Project No. 1598990**

BC Hydro’s Responses to Panel Questions in Exhibit A-38

We have addressed below, on behalf of BC Hydro, the questions posed by the Panel in Exhibit A-38. In essence, BC Hydro’s submission is as follows:

- The legal effect of section 3 of Direction No. 8 is that it deems \$712 million as meeting the fair return standard in the current Test Period. That is, the BCUC must set rates in each year of the Test Period that will allow BC Hydro to recover the reasonable cost of serving customers and afford BC Hydro a reasonable opportunity to earn \$712 million. (Questions 1 and 4)
- The fair return standard, even as modified by s. 3, allows the BCUC to assess the reasonableness of the forecast costs, and to disallow incurred costs determined to have been imprudent. When reviewing BC Hydro’s revenue requirements, the BCUC’s fundamental obligation under the UCA is the same irrespective of how much of the Test Period has passed. (Question 2)

The practical implications associated with a delayed decision under this legal framework include additional financial risk being imposed on BC Hydro and challenges in responding to any prospective BCUC directives (see Questions 2 and 7). These challenges underscore the merits of both (1) BC Hydro shifting towards an earlier filing date for future revenue requirements

applications as contemplated in BC Hydro’s accompanying letter, and (2) reducing the length of future proceedings relative to the current process. It is the combination of both of these steps that will best promote fair and efficient regulation.

1. Given that it will likely be 17 to 18 months into the test period by the time the final decision is issued for this proceeding, does this timing limit the amount of expenditures that the Panel can disallow for recovery because section 3 of Direction No. 8 requires the BCUC to “ensure” that the rates set for the test period “allow the authority to collect sufficient revenue in each fiscal year to enable the authority to achieve an annual rate of return on deemed equity that would yield a distributable surplus of \$712 million”? [emphasis added]

The legal effect of section 3 of Direction No. 8 is that the fair return standard is deemed to have been met in the Test Period if BC Hydro has a reasonable opportunity to earn a distributable surplus of \$712 million in each year.

The Panel has noted the word “ensure” in section 3, which might appear on its face to preclude any disallowances. BC Hydro submits that the provision, read in the context of the Direction No. 8 as a whole and the UCA would not support that interpretation. Direction No. 8 has prescribed recovery of a number of costs, but otherwise left it open to the BCUC to undertake a review the reasonableness of BC Hydro’s forecast revenue requirements.

Sections 59 and 60 use similarly absolute wording in defining just and reasonable rates, but the courts have interpreted those provisions as providing only *a reasonable opportunity* for the utility to earn a fair return. Section 60(1)(b) of the UCA states that in setting a rate the Commission must have due regard to setting a rate that “is not unjust and unreasonable” which means “insufficient to yield...a fair and reasonable return” (s. 59(5)). Despite that definitive wording, the B.C. Court of Appeal has made it clear that the right is a right to an opportunity to earn the allowed return:

The Utilities Commission Act empowers the commission to determine what is a fair and reasonable rate of return upon the appraised value of the property of regulated utilities, but, having done so, requires the commission to set rates so as to allow recovery of a rate which permits an opportunity to earn that return.¹ [Emphasis added.]

The Supreme Court of Canada in *ATCO 2006*, similarly held:

Under the regulatory compact, the regulated utilities are given exclusive rights to sell their services within a specific area at rates that will provide companies the opportunity to earn a fair return for their investors. In return for this right of exclusivity, utilities assume a duty to adequately and reliably serve all customers

¹ *Hemlock Valley Electrical Services Ltd. v. British Columbia (Utilities Commission)*, 1992 CanLII 5959 (B.C.C.A.) at para. 57.

in their determined territories, and are required to have their rates and certain operations regulated.²

Thus, the BCUC should read section 3 of Direction No. 8 in light of the common law, which shows that the absolute terms have been interpreted as meaning that the utility is to be given the opportunity to earn a fair return.

The question, then, is whether BC Hydro has a reasonable opportunity to earn a fair return if the BCUC were to disallow costs so late in the Test Period. Generally, the BCUC has the jurisdiction to disallow costs that are imprudently incurred or that are not used and useful in providing utility service. Neither the timing of the decision, nor section 3 of Direction No. 8 prevents the BCUC from exercising that power.

BC Hydro noted in its Reply Submissions that, among interveners in this proceeding, calls for any disallowances were few in number.³

2. Whether a final decision for this proceeding if issued earlier in the process would make a difference in the amount of expenditures that the Panel can disallow for recovery due to the requirement of section 3 of Direction No. 8.

No, it would not.

When reviewing BC Hydro's revenue requirements, the BCUC's fundamental obligation under the UCA is the same irrespective of how much of the Test Period has passed. Revenue requirements are determined on a forecast basis, and BC Hydro has included in the forecast only those costs that it believes are reasonable and prudent. If the BCUC disagrees, based on a fair assessment of the evidence, it should exclude those costs regardless of whether they have been incurred.

BC Hydro has had to continue incurring costs to run the business while this proceeding unfolds. In terms of the BCUC's assessment of the evidence as to the prudence of BC Hydro's spending decisions during the Test Period while on interim rates, it is fair and reasonable to apply the BCUC's standard "no-hindsight" prudence test that has always been applied to incurred and committed costs.⁴ For example, the prudence of BC Hydro's expenditures in fiscal 2020 should be judged based on what was known at the time they were incurred, not based on what is now known about the COVID-19 pandemic or other events that have arisen since.

In light of this legal framework, the practical implications of a decision coming late in the Test Period are three-fold:

² *Atco Gas and Pipelines v. Alberta (Utilities Commission)* ("ATCO 2006") [2006] 1 SCR 140, at para. 63: <https://scc-csc.lexum.com/scc-csc/scc-csc/en/17/1/document.do>

³ BC Hydro Reply Submissions, e.g., paras. 14 to 17.

⁴ See BC Hydro's Reply Argument, paras. 151 to 154.

- (a) The primary impact of the passage of time on interim rates is not to limit the BCUC's assessment of costs, but rather to expose BC Hydro (and, ultimately, its shareholder) to greater financial risk. The less time remaining in the Test Period after the final rates are approved, the more difficult it will be for BC Hydro to adjust its spending in response to disallowed costs.
- (b) Conversely, if the BCUC decides to approve rates that are higher than those requested to allow for new spending that was not contemplated in BC Hydro's forecasts, it is more difficult for BC Hydro to re-adjust its business to undertake the work.
- (c) BC Hydro may be limited in its ability to react to the BCUC's prospective directives or suggestions during the Test Period or in the next RRA, given how little time remains.

All of these implications underscore the merits of both (1) shifting towards an earlier filing date for future revenue requirements applications, in the manner the BCUC has proposed in Exhibit A-37 with the caveats now identified by BC Hydro, and (2) striving to reduce the length of future proceedings relative to the current process.⁵ It is the combination of both of these steps that will best promote fair and efficient regulation.

3. Whether the timing of the decision is irrelevant, and the only consideration is that the approved level of expenditure and cost recovery would have provided the required return if it could have been implemented in a timely manner.

As discussed in the response to Question 2, the law is generally applied in the same manner regardless of the timing of the decision but there can be different practical implications with a decision that occurs later in a test period. The potential for unfairness to occur for the utility if too much of a test period lapses before final rates are set, and the practical challenges associated with implementing BCUC directives, supports both (a) the shift of filing date for future applications earlier as contemplated in BC Hydro's accompanying letter, and (b) striving to complete the process as expeditiously as reasonably possible.

With respect to point (b), the length of the current proceeding was associated to a significant degree with BC Hydro's return to full regulation. BC Hydro submits that it will be possible to reduce the length of proceedings now that a regular cycle of revenue requirements proceedings is occurring.

⁵ The current process has taken approximately 18 months so far, from the initial filing on February 25, 2019 to the filing of his letter on July 24, 2020.

4. The common law notion of “regulatory compact” requires that a utility be provided with the opportunity to earn a reasonable return on invested capital. Is section 3 of Direction 8 simply a restatement of the regulatory compact, substituting a fixed return of \$712 million for a “reasonable return,” or does it afford BC Hydro some additional certainty regarding its return?

The former. As stated in response to Question 1, the requirement is for the BCUC to provide BC Hydro with a reasonable opportunity to earn a return of \$712 million in each year of the Test Period.

5. If, pursuant to the rates set by the BCUC, BC Hydro fails to collect sufficient revenue to achieve the stipulated distributable surplus amount, does that mean that ratepayers must pay the deficiency in the subsequent test period? Why or why not? Conversely, if BC Hydro achieves a distributable surplus that is greater than the stipulated amount pursuant to the rates set by the BCUC, does that mean that BC Hydro must refund to ratepayers the excess surplus in the subsequent test period? Why or why not?

No, it does not mean that ratepayers must pay the deficiency in the subsequent test period.

The requirement on the BCUC in the current Test Period is for rates to be set at a level that will allow the utility, on a forecast basis, an opportunity to earn a fair return (in this case, \$712 million). Having done so, and the shareholder bears the risk (receives the benefit) of earning less (more) than \$712 million. Variances between the allowed return and achieved return are not recovered from / returned to customers in subsequent test periods.

The Supreme Court of Canada cited the well-established rule against retroactive ratemaking in the *Atco 2006* case:

The Board was seeking to rectify what it perceived as a historic overcompensation to the utility by ratepayers. There is no power granted in the various statutes for the Board to execute such a refund in respect of an erroneous perception of past over-compensation. It is well established throughout the various provinces that utilities boards do not have the authority to retroactively change rates.⁶

6. Aside from the fact that BC Hydro’s annual return on deemed equity is a fixed dollar amount, whether section 3 of Direction No. 8 changes how the BCUC can regulate and set rates for the test period for BC Hydro compared to an investor owned utility.

The approach is the same as an investor owned utility, with the only difference being that section 3 of Direction No. 8 deems an allowed return of \$712 million to be a fair return for the years in the current Test Period. The responses to the prior questions explain why that is the case.

7. Certain events initiated by the BCUC, in the course of “regulating... the authority” could potentially give rise to an expenditure in F2020 or F2021 that is not anticipated in the

⁶ *ATCO 2006*, para. 70. See also para. 136: <https://scc-csc.lexum.com/scc-csc/scc-csc/en/17/1/document.do>

revenue requirement. Examples of this include: a BCUC directed audit or review; an unanticipated hearing ordered by the BCUC; or an Administrative Penalty. What consideration, if any, should be given to the expenditures that arise from such an event? Does section 3 of Direction 8 require the panel to consider these when setting rates? In the case of an administrative penalty, section 109.5 of the Utilities Commission Act (UCA) states: “In setting rates for a public utility, the commission must not allow the public utility to recover from persons who receive or may receive service from the public utility the costs of paying an administrative penalty imposed under this Part.” Does this section of the UCA require a different approach to penalties than other expenditures when considering section 3 of Direction 8?

The BCUC should apply the established legal principles governing just and reasonable rates and the fair return standard (with \$712 million deemed to be a fair return), such that section 3 of Direction No. 8 should not affect the BCUC’s approach to these matters. Please see our response to Questions 1 and 6 regarding the impact of section 3 of Direction No. 8.

As a general rule, the BCUC should be determining rates on a forecast basis based on the evidence. Having said that, the BCUC can and should draw on its general knowledge and expertise as regulator of the utility. The BCUC can and should also take judicial notice of its own decisions (both the decision in this Application and other decisions), BCUC regulatory cost levies and compliance actions, for example. Applied in the context of the examples in the question, this means:

- If the BCUC knows at the time of writing its decision on the Fiscal 2020-Fiscal 2021 Revenue Requirements Application that it has ordered (or will include in its decision on this Application) some action that can be reasonably expected to have cost implications, it should provide for some mechanism to ensure that rates reflect the reasonable cost of providing service. If those costs cannot be determined or reasonably estimated, the appropriate response that is consistent with just and reasonable rates may be to establish a regulatory account so that the disposition of those costs can be addressed in a future application.
- Truly unforeseen events that are not flowing from known BCUC actions and occur after the decision in this Application would be a different matter. In forward-test year cost of service ratemaking, variances from forecast are at the risk (benefit) of the utility barring the availability of a deferral account that captures the type of costs that are subject to the variance. However, the utility is always free to apply for a prospective change in rates or a rate rider, or seek prospective approval for a deferral account, if it believes rates are no longer just and reasonable due to a subsequent unforeseen event. For example, if, one month after the BCUC’s decision on this Application, the BCUC were to order an audit or hearing that was not anticipated by BC Hydro in its forecast, BC Hydro would be free to apply for a deferral account to capture those costs.
- The legal rules governing penalties are different. Section 109.5 reflects a legislative policy decision that the BCUC should dispense with consideration of whether or not a

penalty is a recoverable cost. The penalty is, by virtue of s. 109.5, payable even where payment results in the utility being unable to earn its allowed return.

The determination of just and reasonable rates requires consideration of the various puts and takes to achieve an overall result that is fair to both customers and the utility. Any concerns on the part of the BCUC with respect to certain discrete costs reflected in BC Hydro's forecast revenue requirements⁷ should still be considered in the broader context of the evidence that BC Hydro is facing cost pressures in many areas over and above what are reflected in the rates sought. We discussed this evidence starting at paragraph 12 of BC Hydro's Final Submissions, noting for instance:

BC Hydro has thus far attempted to absorb additional costs associated with these demands. However, BC Hydro "expect[s] that it will be difficult to continue to do so, depending on factors such as the pace and nature of changes."⁸ The magnitude of the task is highlighted by the fact that BC Hydro, at the time of the oral hearing, was tracking slightly over budget on operating costs in fiscal 2020. The Executive Team was working to identify further cost reductions to stay on budget for the year.⁹

BC Hydro submits that the proposed rates are just and reasonable having regard to all relevant evidence and considerations.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

Yours truly,

FASKEN MARTINEAU DuMOULIN LLP

[Original signed by]

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⁷ The proposed rates reflect the forecast revenue requirements as updated in the Evidentiary Update.

⁸ Exhibit B-12, BCUC IR 2.214.1.

⁹ Tr. 5, p. 374, ll. 4-14 (Wong).