COMMENTS RESPECTING BC UTILITIES COMMISSION PANEL REQUESTS of JULY 6TH AND 15TH 2020, REGARDING the TIMING of BC HYDRO'S RATE APPLICATIONS and NET INCOME ISSUES

SUBMITTED BY

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PROBLEM DEFINITION

In its 6 July 2020, request the Panel raised the issue of the appropriate balance between a timely review of BC Hydro's rate application and providing a decision on the rate change for the test period that minimizes the "ratepayer risk."

The concern about a timely review (described as regulatory efficiency) is evident in prolonged review of the current RRA, which includes the rate changes for 2019 and 2020. BC Hydro filed its F20 to F21 request in February 2019, followed by an evidentiary update in October 2019, which included the actual audited results for FY2019/20 and the first quarter results for 2020/21.

The 15 July 2020 request raised several questions respecting the cabinet direction to set the F20 and F21 rates to allow BC Hydro to collect sufficient revenue to yield a distributable surplus (net income) of $712 million in each fiscal year.

While the two requests for comment are related, the second is more specific to the cabinet requirement to achieve a financial target for the FY2019/20 and FY2020/21.

THE 6 JULY QUERY – EXHIBIT A-37

A Question of Materiality

In general, the degree of scrutiny into the justification for a rate change should bear some relationship to either the size of the change, or whether the change is based on a significant policy change in the acquisition or sale of the power.

The time required for the review of the current request has been excessive in relation to the value of the rate change requested, or for the policy implications involved in BC Hydro's planned expenditures. While there was some suggestion that the current RRA would receive more scrutiny because the government has restored more of the regulator's discretion in setting BC Hydro rates, the prolonged process cannot be justified on this basis.

An initial review of the rate increases proposed for 2019 and 2020 would suggest that the increase is rather minor. However, BC Hydro is redirecting funding for paying down deferred costs to funding operational costs, and using a one-time credit to offset other expenditure increases. When these offsets are considered the question becomes one of what happens to the rates when these offsets are no longer available? As this question concerns matters outside the scope of the test period the question was not properly addressed.

A More Focussed Review

The Panel is raising a concern about the length of the review process, but the Panel has it within its power to manage this process to achieve a timelier decision. For example, the number of information requests could be limited to perhaps two rounds per intervener, and it could designate two or three aspects of BC Hydro's operations for each review, rather than the full review of all aspects of the public utility's operations during each RRA. Is the benefit of what amounts to an unfettered full operational audit every two years worth the cost in terms of better outcomes? Particularly when the outcome is judged by the objective of rate stability rather than paying actual cost (generational equity).

A more focussed review process was also one of the recommendations of the 2014 Independent Task Force review of the B.C. Utilities Commission.[1]

Variances Transferred to Future Test Periods

The phrasing of the question by the Panel, where a prolonged process heightens the risk to the ratepayer, is questionable given the large number of regulatory (deferral) accounts. Since the financial crisis of 2008, and the change to the IFRS accounting standard, the growth in the number and range of these regulatory accounts has ensured that annual rate changes have been moderated, while allowing the annual net income targets set by government to be achieved.

The cabinet-ordered Rate Smoothing Regulatory Account, begun in 2014/15, was an obvious example of an accounting device designed to ensure that the pre-determined net income target was achieved. With the demise of this account any revenue (load) variance will again be recorded in the Non-Heritage Deferral Account. The definition of this cost of energy deferral account has been modified through successive rate reviews to the current practice of formally allowing the deferral of revenue shortfalls from the

[1] https://www2.gov.bc.ca/assets/gov/farming-natural-resources-and-industry/electricity-alternative-energy/electricity/bcuc_review_final_report_nov_14_final.pdf pp. 21-22.

budget target. Without this deferral a revenue shortfall from the budget would normally result in a lower net income.

BC Hydro prefers to refer to the application of the wide range of regulatory accounts as ensuring that the ratepayers (eventually) pay actual costs. They also serve the purpose of protecting the target net income from the vagaries of changes in costs and sales. While some of the regulatory accounts were mandated by the government, most have been agreed to by the BCUC with the support of most of the interveners who represent consumer groups. The result for the 2012 to 2019 period has been lower rate changes each cycle, and a higher net balance in the regulatory accounts.[2]

Why then does the Panel now believe that approving expenditures and revenue targets “after the fact” is a risk to the ratepayer? Based on past practice, most of the key variances between the target (budget) and the actual results in any given year will be deferred and incorporated into a future rate request. Of course, the Commission may wish to review the operation of many of these regulatory accounts to ensure that they still perform a useful purpose (such as the Debt Management account), or conform to current accounting standards.

Future RRAs Depend on Decisions on Key Targets

The Panel raised the notion of a PBR system to set BC Hydro’s rates during the RRA, and hived off a separate process to explore the question. Given the recent restoration of much of the Commission’s discretion to set BC Hydro’s rates it would seem prudent to ensure that the current rates fairly represent the apportion of costs between current and future ratepayers.[3]

Also, it appears that the Commission will regain the authority to set the Return on Equity (ROE) beginning in the F22 year. Before the Commission can consider a shift to a PBR system it must establish a ROE that is appropriate to reflect the extremely low risk to the shareholder incorporated into the current rate-setting model. The current ROE (and the resulting net income) is higher than necessary given the current array of regulatory accounts. The government explained that the two year delay in Direction 8 in restoring the BCUC’s authority to set the ROE was to allow it time to determine an appropriate level.

> As an outcome of Phase 1 of the Review, the government will re-empower the BCUC to set BC Hydro’s allowed net income, following a two-year transition period for Fiscal 2020 and Fiscal 2021 where BC Hydro’s allowed net income of $712 million will remain in place. This transition period will allow time for the BCUC to review BC Hydro’s next Revenue Requirements Application and to undertake a separate process to determine

[2] The net balance in the regulatory accounts rose from $1.7 billion in 2009/10 to $5.4 billion in 2017/18. The 2018/19 figure was lower due to the write off of the Rate Smoothing Regulatory Account.
[3] The government has removed the BCUC’s authority to initiate any review of the fair apportionment of the costs between customer classes, such as residential, commercial and large industrial users.

> an appropriate rate of return prior to resuming the regulation of BC Hydro's allowed net income in Fiscal 2022. Government may provide policy guidance to the BCUC and/or participate in regulatory proceedings to inform this process.[4]

In its comments respecting the Phase 2 Interim Report on BC Hydro the Association of Major Power Consumers noted that an ROE of approximately 15% is embedded in the rates, and that the government should "support a position that focuses on a return to competitiveness and the lowest level of annual return feasible in order to protect ratepayers, as determined by the BCUC."[5]

The BCUC has not indicated the process by which it intends to establish or benchmark the ROE for 2021/22 and future years.

The Commission must also review the assumptions concerning the appropriate debt to equity ratio, and how rapidly the corporation can be expected to achieve this target.

BC Hydro's Response

In its 24 July 2020 reply, BC Hydro notes that all parties need to focus on the most pertinent issues when reviewing future RRAs, and the review of the F22 rate application should be shortened because the detailed review of the F20 and F21 request will (we hope) be just concluded.

BC Hydro makes a good suggestion when it states that any underlying concerns of the Panel with the budgets should be noted in its decision on the F20 and F21 rates, which allows BC Hydro to focus on these aspects. This links to my suggestion that the appropriate ROE, and the appropriate debt to equity ratio target, be areas of focus in the next application.

On the third page the corporation discusses the timeliness problem, when an earlier filing of the RRA will not provide the most accurate information, because the forecast for the current year and the budget for the upcoming year is released with the provincial budget in mid-February of each year.

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[4] https://www2.gov.bc.ca/assets/gov/farming-natural-resources-and-industry/electricity-alternative-energy/electricity/bc-hydro-review/final_report_desktop_bc_hydro_review_v04_feb12_237pm-r2.pdf p. 17.

[5] https://www2.gov.bc.ca/assets/gov/farming-natural-resources-and-industry/electricity-alternative-energy/electricity/bc-hydro-review/ampc_comments_on_bch_phase_ii_report_-_final.pdf p. 4.

THE 15 JULY 2020 QUERY – Exhibit A-38

Direction 8 Limits the Discretion of the Commission

The issues raised in the 15 July 2020 query revolve around setting the rates for FY2019/20 and FY2020/21 such that BC Hydro can collect "sufficient revenue in each fiscal year to … achieve an annual rate of return on deemed equity that would yield a distributable surplus of $712 million" as required by Direction 8.

Despite the government's claim that most of the Commission's authority to set BC Hydro's electricity rates, this is a clear limitation on the rate-setting independence of the Commission.

One might ask why the Panel believes that this restriction needs to be discussed at this late stage in the F20 to F21 review, especially as this limitation on the BCUC's authority to set the net income expires on 31 March 2021. Why does the Panel believe that the implications of this part of the cabinet direction need to be canvassed now?

The implication of section 3 is that the Panel may need to increase the requested rate target to offset any disallowed expenditure (or regulatory credit to the ratepayers). Direction 8 makes the net income a fixed amount, not a variable resulting from the normal vagaries of costs and expenditures during the financial year (which will be exacerbated by the impact of COVID-19).

BC Hydro's Response

BC Hydro's response of 24 July 2020 provides a useful summary of the court decisions related to the wording of section 3 of Direction 8. Giving BC Hydro a "reasonable opportunity" to achieve the required net income would still require offsetting any adjustment to BC Hydro's budget (revenue and expenditure plan) with a higher or lower rate adjustment to provide that opportunity.

Given that the process is now almost into month 17 of the 24 month test period, such an adjustment would be impracticable.

BC Hydro's response to the fifth question posed by the Panel is of interest. The first part of the question relates to a situation where BC Hydro's actual revenue is less than the forecast (budget) level. BC Hydro said that such a situation would not mean that ratepayers must pay the deficiency in the subsequent test period. But this is contrary to how it is defining the Non-Heritage Deferral Account, where revenue shortfalls are recorded as received and deferred to this account to be charged to ratepayers in a future test period.[6] In its final argument BC Hydro confirmed that load (revenue) losses

[6] https://www.bcuc.com/Documents/Proceedings/2019/DOC_53488_B-1-BCH-F20-F21-RR-Application.pdf p. 7-25 (Pdf 915/3006).

resulting from the economic contraction related to the COVID-19 would be recorded as additions to the cost of energy deferral accounts.[7]

Thus, we are back to the issue of just what level of risk is there to the shareholder, and what should be the appropriate return on equity to reflect this risk?

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