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Sent via eFile

BCUC REVIEW OF BC HYDRO PBR REPORT
EXHIBIT A2-8

Mr. Fred James
Chief Regulatory Officer
Regulatory & Rates Group
British Columbia Hydro and Power Authority
16th Floor - 333 Dunsmuir Street
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Re: British Columbia Utilities Commission – Review of British Columbia Hydro and Power Authority's Performance Based Regulation Report – Project No. 1599045 – BCUC Staff Consultant Response to BCSEA Information Request No. 1

Dear Mr. James:

British Columbia Utilities Commission staff submit the following for the record in this proceeding:

Pacific Economics Group Research LLC
Response to BCSEA Information Request No. 1
Dated November 16, 2020

Sincerely,

Original signed by:

Marija Tresoglavic
Acting Commission Secretary

/cmv
Enclosure

1.0 Topic: Recommended PBR Elements
Reference: Exhibit A2-5, Staff Consultant Report; Exhibit A2-7, Staff Consultant Presentation

1.1 Please provide a table showing each of the new PBR elements that Dr. Lowry recommends be implemented for BC Hydro (i.e., that are not currently in place), the pros and cons of each for ratepayers, and the pros and cons of each for BC Hydro and its shareholder the BC Government.

PEG Response

Dr. Lowry has not yet made final recommendations for a PBR strategy for BC Hydro.

2.0 Topic: PBR Financial Incentive
Reference: Exhibit A2-5, Staff Consultant Report; Exhibit A2-7, Staff Consultant Presentation

Preamble:

The BC Government has numerous levers, such as setting water rentals and payments in lieu of taxes, for adjusting the amount of revenue it receives from BC Hydro, separate from earnings based on a return on equity (whether under PBR or COSR).

Currently, the BC Government is transitioning to a more traditional mechanism in which its shareholder's income from BC Hydro is based on actual, not deemed, debt/equity and a return on equity to be determined by the BCUC (in a future proceeding). This comes after many years during which the BC Government had complete control over the size of its earnings from BC Hydro. The BC Government recently absorbed a $1.1 billion write-off of BC Hydro's Rate Smoothing Regulatory Account in order to put BC Hydro's finances on a better footing for limiting future rate increases.

This suggests to BCSEA that it is unlikely that a financial incentive under a PBR framework would be large enough to motivate the shareholder to require BC Hydro to contain costs that BC Hydro would otherwise have incurred.

2.1 In Dr. Lowry's view, would the prospect of enhanced earnings through incentives under PBR be an effective motivator for the BC Government (BC Hydro's Shareholder) to cause BC Hydro to contain costs more under PBR than it would under COSR?

PEG Response

PEG believes that PBR can improve BC Hydro's performance incentives and the efficiency of its regulation and therefore merits serious consideration. Please see the responses to Zone II ratepayers group questions 2.1 and 8.1 for further discussion of the incentive issue.

3.0 Topic: Existing PBR Elements
Reference: Exhibit A2-5, Staff Consultant Report; Exhibit A2-7, Staff Consultant Presentation

"Refinements to the existing PBR provisions in BC Hydro's regulatory system merit consideration": Exhibit A2-5, p.112, underline added.

"The regulatory system of BC Hydro has included several PBR mechanisms over the years": Exhibit A2-5, p.108, underline added.

3.1 Please list what Dr. Lowry means by "the existing PBR provisions in BC Hydro's regulatory system."

PEG Response

These provisions are enumerated on pages 108-110 of PEG's report.

4.0 Topic: PBR and Publicly Owned Utilities
Reference: Exhibit A2-5, Staff Consultant Report, pp.65-69

4.1 Would Dr. Lowry agree that the PEG Report's discussion of theoretical and empirical research regarding PBR and publicly-owned utilities indicates few if any positive results?

PEG Response

The results of these studies provide grounds for concern but do not suggest that PBR should be eschewed. PEG found only a few papers that specifically addressed the effect of PBR on publicly-held utilities. The theoretical papers reviewed found that the impact of PBR would be greater for privately-held utilities but did not find that it would have no impact on publicly-held utilities. Profit may matter less because publicly-held utilities have other goals, but some of these goals are not antithetical to operating efficiently.

Results of empirical studies of power distributors in Australia and Sweden were not encouraging. However, such studies may not control adequately for pertinent business conditions. For example, publicly-held utilities may have had more need for replacement capex during the sample period. Other studies did not indicate that public utilities tended to be superior cost performers. PEG's own cost benchmarking in Alberta and Ontario has not found privately-held utilities to be superior performers on balance.

4.1.1 If so, please comment on the implications for applying new PBR elements to BC Hydro.

PEG Response

Due attention should be paid to BC Hydro's provincial ownership in considering PBR provisions for the Company. There may, for example, be a special need to oversee internal employee incentives.

4.1.2 If not, please provide the specifics of the positive results regarding PBR and publicly-owned utilities indicated by the research reviewed in the PEG Report.

PEG Response

Please see the response to question 4.1.

5.0 Topic: Marketing Flexibility
Reference: Exhibit A2-5, Staff Consultant Report, pp.65-69; Exhibit A2-7, Staff Consultant Presentation, p.64

The PEG Report defines the term Multi-Year Rate Plan (MRP) as follows:

> "Multi-Year Rate Plan (MRP): A common approach to PBR that typically features a multiyear rate case moratorium, an attrition relief mechanism, and several PIMs." [p.116]

On pages 110 to 111, the PEG Report states:

> "Our review of BC Hydro's business and BCUC regulation prompts the following comments on the suitability of PBR for BC Hydro.
>
> ... As a vertically integrated utility serving many large-load customers, <u>the marketing flexibility that MRPs can facilitate can help BC Hydro retain and attract large-load customers</u>. AMI has already been installed and can facilitate better rate designs. However, increased marketing flexibility might require an MRP that doesn't have earnings sharing." [p.111, underlined added]

Under the heading "BC Hydro Regulation" on page 64 of his presentation, one of Dr. Lowry's points is: "Marketing flexibility has been limited." [Exhibit A2-7, p.64]

5.1 In what ways is BC Hydro's marketing flexibility limited, in Dr. Lowry's view?

<u>PEG Response</u>

It is Dr. Lowry's understating that each rate and service offering must be individually approved. This cumbersome process has provided the Company with some flexibility. Multiyear rate plans can free up more time to address rate and service offerings and can potentially facilitate more light-handed regulation of optional offerings.

5.2 Please explain how a Multi-Year Rate Plan (as defined by PEG) facilitates marketing flexibility, in general or in the case of BC Hydro, as compared to marketing flexibility under a COSR framework.

<u>PEG Response</u>

This matter is discussed on page 55 of PEG's February report.

5.3 Can Dr. Lowry provide an example of a Multi-Year Rate Plan (as defined by PEG) facilitating marketing flexibility for a publicly-owned utility?

<u>PEG Response</u>

No. However, most MRPs for publicly-held utilities have to date applied to power distributors, and these have historically not needed extensive marketing flexibility. There are examples of marketing flexibility for privately-held utilities. See for example, the discussion in Sections 7.7 and 9.2 of PEG's report.

5.4 When PEG refers to BC Hydro's "AMI" (advanced metering infrastructure), is PEG referring to the metering in place for large-load customers, or the Smart Meters installed for residential and small general service customers?

PEG Response

Both.

5.5 Please explain why obtaining increased marketing flexibility under a Multi-Year Rate Plan (as defined by PEG) might require an MRP that doesn't have earnings sharing.

PEG Response

Earnings sharing maintains the link between marketing initiatives and rates between rate cases. It thereby increases concerns about cross subsidization. If, for example, a utility provides an excessive discount on a new rate, it may thereby reduce surplus earnings available for sharing or increase an earnings deficit that ratepayers must fund.

5.6 Can Dr. Lowry provide examples of new marketing initiatives that BC Hydro could consider? Please discuss how these would be affected by the new PBR elements that Dr. Lowry recommends.

PEG Response

The Company could, for example, with stronger incentives and light-handed regulation of optional tariffs develop various green power (e.g., 100% renewable) packages and special rates for electrification of transportation.