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LAW CORPORATION

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 Michael F Robson*
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 Brittney S Dumanowski

Rose-Mary L Basham, QC, Associate Counsel*
 Josephine M Nadel, QC, Associate Counsel*
 James D Burns, Associate Counsel*
 Duncan J Manson, Associate Counsel*
 Hon Walter S Owen, QC, QC, LLD (1981)
 John I Bird, QC (2005)

+ Law Corporation
 * Also of the Yukon Bar
 ** Also of the Alberta Bar
 **± Also of the Ontario Bar
 ** Also of the Washington Bar

PO Box 49130
 Three Bentall Centre
 2900-595 Burrard Street
 Vancouver, BC
 Canada V7X 1J5

Telephone 604 688-0401
 Fax 604 688-2827
 Website www.owenbird.com

January 7, 2021

VIA ELECTRONIC MAIL

British Columbia Utilities Commission
 6th Floor, 900 Howe Street
 Vancouver, B.C. V6Z 2N3

Direct Line: 604 691-7557
 Direct Fax: 604 632-4482
 E-mail: cweafer@owenbird.com
 Our File: 23841/0221

Attention: Marija Tresoglavic, Acting Commission Secretary

Dear Sirs/Mesdames:

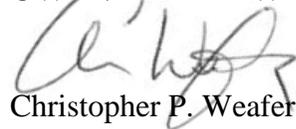
Re: British Columbia Utilities Commission (“BCUC”) Review of British Columbia Hydro and Power Authority’s Performance Based Regulation Report ~ Project No. 1599045

We are counsel to the Commercial Energy Consumers Association of British Columbia (the “CEC”). Attached please find the CEC’s second set of Information Requests to the BCUC with respect to the above-noted matter.

If you have any questions regarding the foregoing, please do not hesitate to contact the undersigned.

Yours truly,

OWEN BIRD LAW CORPORATION



Christopher P. Weafer

CPW/jj
 cc: CEC
 cc: BC Hydro
 cc: Registered Interveners

**COMMERCIAL ENERGY CONSUMERS ASSOCIATION
OF BRITISH COLUMBIA (“CEC”)**

INTERVENER INFORMATION REQUEST ON SUPPLEMENTARY EVIDENCE

**British Columbia Utilities Commission Review of British Columbia Hydro and
Power Authority’s Performance Based Regulation Report
Project No. 1599045**

January 7, 2021

46. Reference: Exhibit B-8, page 3

A4. The BCUC should have three broad goals with respect to its regulation of BC Hydro’s revenue requirement: to set rates at efficient levels, to maintain adequate, safe and reliable service and to ensure financial integrity through the recovery of reasonable and prudently incurred costs and by providing an opportunity to earn a fair return on investment.⁷ These goals are consistent with the statutory framework set out by the *Hydro and Power Authority Act* and the *Utilities Commission Act*.⁸ They have been echoed in previous submissions in this proceeding.⁹

All forms of regulation can provide incentives to achieve these goals.¹⁰ The question to consider in this proceeding is what form of regulation will provide the most effective incentives for BC Hydro to operate efficiently and provide safe and reliable service, given its unique aspects. The answer to this question does not have to be a binary choice between Cost of Service

46.1 Please confirm or otherwise explain that ‘efficient levels’ would encompass cost-effective spending such that the benefit/cost ratio is optimized in spending, and excludes wasteful or unnecessary spending.

46.2 Please confirm or otherwise explain that ‘efficient levels’ would encompass spending conducted on regulatory activities, with the expectation that they are undertaken in a cost-effective manner and that the open and transparent regulation of BC Hydro is a beneficial value.

46.2.1 Please provide BC Hydro’s view of cost-effective regulatory spending.

- 46.3 Please provide any other considerations that are encompassed in BC Hydro's definition of 'efficient levels'.
- 46.4 Does an 'efficient level' consider the affordability of customer bills and the ability of customers to pay? Please explain why or why not.
- 46.5 How should the Commission evaluate 'efficient levels'?
- 46.6 Please confirm that ratepayers as a whole are best off when the utility optimizes the cost-benefit relationship of its spending, such that expenditures are undertaken to optimize the benefit and in the timeliest manner (not necessarily the quickest or latest).

47. Reference: Exhibit B-8, page 5 and 6

- First, BC Hydro's mandate is set out through a Mandate Letter¹⁷ and Service Plan¹⁸. Exceeding allowed net income is not identified as an expectation or desirable outcome anywhere in either of these two documents. Efficiency and cost control are emphasized throughout but the focus of these efforts is to keep rates affordable for customers¹⁹, not to increase shareholder returns;
- Second, BC Hydro's actual net income is consolidated into the Government of B.C.'s financial statements. The Government of B.C. plans its budget based on BC Hydro achieving its allowed net income – no more and no less. In other words, BC Hydro is expected to achieve an actual net income that is as close to its allowed net income as possible. At the same time, the Mandate Letter and Service Plan set out expectations for BC Hydro to provide safe, reliable, affordable and clean electricity. The Government of B.C. expects BC Hydro to meet these expectations and achieve its allowed net income while keeping rates as affordable as possible;

47.1 Please confirm or otherwise explain that keeping rates affordable applies to commercial rates as well as to residential rates.

47.1.1 If no, please explain why not.

47.2 Please confirm or otherwise explain that to BC Hydro's knowledge, stimulation and management of the economy and support for economic development are normally important objectives of the provincial government.

47.3 Please confirm that BC Hydro would also be expected to meet environmental, First Nations relations, and other social objectives reasonably required of BC Hydro.

48. Reference: Exhibit B-8, page 6 and 7

Dr. Weisman has previously explained that the lack of a profit maximization mandate can pose a problem for the application of PBR to Crown Corporations but that this problem can be overcome through the implementation of a compensation structure that encourages management to behave as if profit-maximization is mandated.²⁶

48.1 Are most PBR regimes developed for companies with profit-maximization objectives? Please explain and provide quantitative evidence to the extent it is available.

48.2 From a simplistic viewpoint, is it fair to say that being encouraged to behave as if BC Hydro has a profit-maximizing mandate could significantly complicate the value of trying to 'align' ratepayer and utility objectives? Please explain why or why not.

48.3 Please confirm that BC Hydro can adequately 'align' ratepayer and utility objectives without a profit maximizing mandate and can better do so with a cost-effectiveness mandate.

49. Reference: Exhibit B-8, page 8

However, in the case of BC Hydro, Public Sector Employers' Council policy restricts incentive-pay to a limited number of senior management employees, in the form of a salary holdback.²⁷ Specifically, the Public Sector Employers' Council's Guide to B.C. Public Sector Compensation and Expense Policies states:

Bonus programs are no longer permitted and must be phased out for executive and excluded employees where they exist. Instead, a hold back of up to 20 per cent of maximum base salary may be implemented for senior executives in place of a bonus program.²⁸

While a salary holdback is a form of incentive pay, the maximum amount awarded to an individual employee is capped. Within this cap, the amount awarded to each individual employee reflects individual employee performance as well as BC Hydro's results against its Service Plan performance measures, which represent the mandate provided to BC Hydro by the Government of B.C. As explained above, this mandate does not include profit maximization and accordingly, none of BC Hydro's Service Plan performance measures reflect this objective.

In addition, it is important to recognize that the public may not accept profit maximization as a legitimate objective of a Crown Corporation. This is demonstrated by the experience of Hydro-Quebec where public backlash saw efficiency gains under PBR as customers being "overcharged"²⁹ and the Government of B.C. subsequently introduced legislation to set electricity distribution rates and remove the requirement for a PBR mechanism to be

- 49.1 Would BC Hydro be required to adopt a 'Profit Maximization' approach if PBR were to be implemented in its typical fashion? Please explain.
- 49.2 Could BC Hydro cost-effectively introduce increased incentive pay systems? Please explain why or why not.
- 49.3 Can incentive pay systems be introduced in a manner that requires quantified metrics demonstrating the value of improvements made vs 'business as usual' in order for incentive pay to be provided? Please explain why or why not.

50. Reference: Exhibit B-8, page 10

- While the BCUC's Decision on BC Hydro's Fiscal 2017 to Fiscal 2019 Revenue Requirements Application, which prompted this proceeding, emphasized cost control³⁵, the BCUC's more recent Decision on BC Hydro's Fiscal 2020 to Fiscal 2021 Revenue Requirements Application, expressed concern that cost cutting may be too aggressive.³⁶ In other words, to the extent that the BCUC's interest in pursuing PBR was rooted in a desire to bolster BC Hydro's cost control efforts, that impetus may no longer apply. In fact, it is possible that the BCUC's more recent concerns are better addressed through a cost of service approach that allows for line-by-line scrutiny of BC Hydro's revenue requirement.

50.1 Please provide an order of magnitude estimate of what it would cost for an independent management consultant, hired by the BCUC, to review BC Hydro operations for cost-effectiveness.

51. Reference: Exhibit B-8, page 11 and page 13

Q6. Does BC Hydro support Dr. Lowry's suggestion of moving to a three-year test period?³⁷

A6. Yes. Multiyear Rate Plans are intended to incent efficient performance by creating a multi-year disconnect between allowed revenue and actual costs so that a utility must perform within a pre-determined revenue envelope to achieve its allowed return.³⁸ BC Hydro's current regulatory system already takes this approach by setting rates based on forecast costs for multiple years.³⁹ A three-year test period would create a greater disconnect between BC Hydro's allowed revenue and actual costs.

- Second, a multi-year cost forecast is subject to line-by-line public scrutiny through the regulatory process. Any potential excess amounts can be questioned, often through an oral hearing, and disallowed. This scrutiny is particularly strong in the case of BC Hydro, as a Crown Corporation, owned by the Government of B.C., with a significant public profile. Automatically escalating allowed revenue for customer growth or inflation, after the last test year, would reduce the frequency of this scrutiny;

51.1 With respect to the statement: ‘incent efficient performance by creating a multi-year disconnect between allowed revenue and actual costs so that a utility must perform with a pre-determined revenue envelope to achieve its allowed return’, is the underlying premise is that the utility will not perform efficiently without a spending ceiling?

51.1.1 Please confirm or otherwise explain that under such an assumption, a ceiling that is too high would not be optimally beneficial for ratepayers in that it would facilitate ‘over-spending’.

51.1.2 Please confirm that under such an assumption a ceiling that is too low might not be optimally efficient in that it could incent non cost-effective ‘underspending’.

51.2 Can a well-informed Commission with a responsive utility and input from stakeholders determine an appropriate, cost-effective level for the operation of the utility?

52. Reference: Exhibit B-8, page 14

Q8. Do you support Dr. Lowry’s suggestion of eventually moving to a more comprehensive Multiyear Rate Plan with, among other things, a three to five year term and different attrition relief mechanisms to automatically escalate allowed revenue for different functions?⁴⁸

A8. No, for the same four reasons stated in our answer to [Q7](#) above.

52.1 Assuming no movement to a more comprehensive MRP, why is three years an appropriate term in BC Hydro’s view for the test period vs two, four or five? Please explain.

53. Reference: Exhibit B-8, page 15

Q9. Do you support Dr. Lowry's suggestion of regularly scheduled statistical benchmarking studies by the BCUC and BC Hydro?⁴⁹

A9. Yes. Statistical benchmarking studies would help to address any concern with regard to information asymmetry⁵⁰ or upward forecasts⁵¹ if multi-year cost forecasts are used to determine allowed revenue. These studies can provide another tool for the BCUC to set rates at efficient levels.⁵² BC Hydro provided a benchmarking study as part of its Fiscal 2020 to Fiscal 2021 Revenue Requirements Application.⁵³

Benchmarking does have limitations and the results can often be controversial.⁵⁴ Therefore, BC Hydro suggests that a beneficial first step would be to involve the BCUC and interveners in a process to set out a terms of reference to guide the objective, scope and frequency of future benchmarking studies. This process would also provide an opportunity for all parties to consider the suggestions on benchmarking that were put forward by Dr. Lowry.⁵⁵

53.1 Please confirm that performance metrics measuring BC Hydro against its own historical performance vs other comparison to other utilities with potentially different cost structures could provide useful information in assessing ongoing cost-effectiveness.

53.1.1 Would such an approach alleviate some of the issues related to benchmarking? Please explain.

54. Reference: Exhibit B-8, pages 18-19

Q12. Are there other improvements to BC Hydro's existing cost of service framework that may help to achieve the goals of BCUC regulation of BC Hydro?

A12. Yes. While shared saving performance incentive mechanisms would not be effective, information-only performance metrics, determined through a public process with the BCUC and interveners, would provide incremental incentives

to BC Hydro. BC Hydro currently reports to the BCUC on a number of performance metrics. Specifically, BC Hydro has provided Annual Service Plan performance measures as part of Revenue Requirements Applications⁶⁸, annual reports on reliability indices⁶⁹, and metrics used to manage its operations⁷⁰.

“The Commission may decide to make these performance metrics “informational only.” This means that the regulated firm’s performance on these metrics would be publicly disclosed, perhaps even reported on the Commission’s web site, but it would not be rewarded or penalized financially for compliance or lack of compliance with these performance metrics... The regulated firm may still have strong incentives to meet or exceed these performance metrics even though there are no financial rewards or penalties directly associated with compliance or non-compliance. This underscores an important observation that financial incentives are not the only type of incentives that can be used to motivate superior performance.”⁷¹

- 54.1 Please confirm or otherwise explain that under BC Hydro’s proposal the Commission would continue to have a range of tools at its disposal to ensure that utility performance remains adequate when ‘information only’ metrics are provided.
 - 54.1.1 Please describe such tools.
 - 54.1.2 Could these tools be less likely to be developed under a more traditional PBR approach? Please explain.

55. Reference: Exhibit B-8, Appendix A Dr Weisman page 1 of 19

2. I received a B.A. in economics and mathematics from the University of Colorado, an M.A. in economics from the University of Colorado, and a Ph.D. in economics from the University of Florida with a specialization in economic regulation and industrial organization. I have testified in numerous regulatory proceedings to the economic and social impacts of regulatory policies and have served as an advisor to telecommunications firms, electric power companies and regulatory commissions on economic pricing principles, the design of incentive regulation plans, the scope and pricing of mandated wholesale access and competition policy.
 3. In Canada, I have presented testimony or filed affidavits with the Canadian Radio-television and Telecommunications Commission (CRTC), the Alberta Utilities Commission and the British Columbia Utilities Commission. My submissions before the CRTC have covered a wide range of topics, including price cap regulation, local forbearance, competitor services, the essential facilities doctrine, predatory pricing and win-back rules. In the United States, I have presented testimony or filed affidavits before regulatory commissions in Arkansas, California, Colorado, Florida, Kansas, Massachusetts, Missouri and Texas. I have also submitted testimony or filed affidavits with the Federal Communications Commission, the United States Court of Appeals for the District of Columbia and the Kansas State Legislature.
- 55.1 Please comment on whether or not the utilities in Dr Weisman's experience either at the CRTC, AUC or BCUC have a similar not for profit mandate as BC Hydro.
- 55.1.1 If yes, please identify those utilities.
 - 55.1.2 If yes, please provide a basic description of the regulation of those utilities without a for-profit mandate. Are they operating under PBR or cost of service, or some other regime?
- 55.2 Is Dr. Weisman aware of, or does he have any evidence to suggest that PBR can result in unwanted impacts over time? Please explain and provide a brief overview of the negative impacts that can occur and why they might occur, if yes.

56. Reference: Exhibit B-8, Appendix A, Dr Weisman page 6 of 19

Revenue Decoupling

13. Revenue decoupling can represent an important element of a regulatory regime. The additional revenue stability provided by decoupling (i.e., delinking revenues from system use) can potentially extend the period between rate cases or rebasing (i.e., regulatory lag) and thereby strengthen incentives for performance. This is necessarily the case because the additional revenue stability can help to avoid financial windfalls and shortfalls that may trigger the need for a rate case and an earnings review.

14. Regulatory lag (i.e., length of the test period) is one of the key determinants of the incentive power of a regulatory regime. In general, the longer the test period, the stronger the incentives for superior performance, *ceteris paribus*. As discussed below, even a relatively modest increase in the length of the test period can have a significant effect on increasing the incentive power of a regulatory regime.

56.1 Is there a term length at which the disconnect between revenues and system use becomes inappropriate? Please explain.

56.2 What are the potential negative impacts of disconnecting revenues and system use? Please explain.

57. Reference: Exhibit B-8, Appendix A, Dr Weisman page 11 and page 13 of 19

27. This form of cost-of-service regulation contrasts sharply with the textbook model of cost-of-service regulation wherein the regulated firm's performance benchmark is its own earnings. Hence, when the regulated firm subject to textbook cost-of-service regulation implements efficiency improvements that increase earnings, it may be required to return any excess earnings to consumers in the form of rate reductions. This explains why this form of cost-of-service regulation is criticized on grounds that "no good deed goes unpunished."¹⁰ This form of cost-of-service regulation is an example of a *cost-plus contract*. This is the case because the prices that consumers pay tend to vary directly with the reported costs of the firm and therefore may exhibit greater volatility.

35. In general, the incentive power of a regulatory regime depends on (i) the share of the efficiency gains the regulated firm is allowed to retain; and (ii) the length of time that it is allowed to retain them (i.e., regulatory lag). As discussed below, there are trade-offs between these two dimensions of incentive power.

57.1 Please confirm or otherwise explain that to the extent that BC Hydro does not have a for-profit mandate, and does have a mandate to keep rates affordable, the return of any excess earnings to the consumer does not constitute any kind of ‘punishment’, but is actually the fulfillment of some of the company’s customer objectives and is actually a powerful motivating benefit.

58. Reference: Exhibit B-8, Appendix A Dr Weisman page 16 of 19

44. Three conclusions follow from this hypothetical, stylized example. First, the share of the efficiency gains retained by the regulated firm has a pronounced effect on the power of the regulatory regime. Second, a modest increase in the length of the regulatory regime has a significant effect on increasing the incentive power of the regulatory regime. Finally, there is a tradeoff between the length of the regulatory regime and the degree of earnings sharing.

58.1 Please discuss whether Dr. Weisman’s evidence regarding incentives relates primarily to a profit-oriented company, and how this fits in with BC Hydro’s affordability objectives.

59. Reference: Exhibit B-8, Appendix B, Mr. Kolesar page 4 of 18

Accordingly, the Commission has a range of regulatory regime alternatives by which it may achieve its objectives in regulating BC Hydro. In choosing a regulatory regime for BC Hydro, the Commission should seek to achieve a balance among the following objectives.⁴

- The regulatory regime should emulate the results achieved in a competitive market to the greatest extent possible;
- The regulatory regime should provide an opportunity for BC Hydro to recover its prudently incurred costs and earn its fair return;
- The regulatory regime should be understandable;
- The regulatory regime should avoid regulatory burden and streamline regulation to the greatest extent possible;
- The regulatory regime should make parties better off relative to other regulatory alternatives, so that both BC Hydro and its customers share in the benefits of the plan;⁵
- The regulatory regime should consider the unique circumstances of BC Hydro.

59.1 Please confirm that emulating all the results obtained in a competitive market could result in a failure to be cost-effective with respect to BC Hydro’s objectives where profit maximization for a shareholder could distort cost-effective performance under a set of objectives different from those of companies operating in a fully-competitive market.

59.2 Would it be fair to say that BC Hydro would only want some of the results of a competitive market, and that competitive markets can produce dysfunctional results sometimes?

59.3 Please confirm that the ‘unique circumstances of BC Hydro’ should incorporate the mandate to maintain customer bill affordability.

60. Reference: Exhibit B-8, Appendix B Mr. Kolesar page 8 of 18 and pages 9-10 of 18

BC Hydro is Not a Profit Maximizer

I note and agree with the comments of Dr. Weisman in the executive summary to his report:

The expected gains from adopting PBR may be subject to greater uncertainty in the case of crown corporations because they are de facto subject to two different regulatory authorities—the regulatory commission and the government owner. Nonetheless, PBR plans have been successfully applied to public enterprises.¹⁰

A matter to be considered by the Commission in this proceeding is whether BC Hydro, as a public enterprise, will be in a position to adequately respond to the more powerful incentives to seek out productivity improvements offered by PBR, given the absence of a mandate to maximize profits. In other words, will the expected gains from adopting PBR be fully realized.

Executive compensation in the Company, as approved by its board of directors, includes incentive pay for executives and directors, based on BC Hydro’s Service Plan performance measures.¹⁴ None of these performance measures can be interpreted as promoting profit maximization.¹⁵ On the contrary they

support reliable and responsive service delivery, ensure that rates are “among the most affordable in North America,” promote safety, and deliver on a number of other policy objectives such as energy conservation, clean energy and aboriginal relations.

- 60.1 Would Mr. Kolesar agree that despite the lack of a profit maximizing mandate, and in the absence of other incentives, staff at various levels of an organization may have personal/individual incentives to increase their budgets and/or spending. For example, might individuals want larger departmental budgets, more staff or better technologies whether or not it is needed for cost-effective performance of the utility and improved performance in that regard?
- 60.2 Would Mr. Kolesar agree that the incentives that “support reliable and responsive service delivery, promoting safety and delivering on a number of other policy objectives” might incent increased spending to optimize on these objectives? Please explain why or why not.
- 60.3 Does the incentive to have rates ‘among the most affordable in North America’ provide a strong incentive to keep spending only to optimal levels, or does it provide some significant leeway? Please explain.
- 60.4 Would a customer objective of providing customers with more affordable bills provide an incentive to improve cost-effectiveness?

61. Reference: Exhibit B-8, Appendix B, Mr. Kolesar page 10 of 18

The regulatory regime should emulate the results achieved in a competitive market to the greatest extent possible

Any regulatory model on the continuum from COSR to PBR will emulate the results achieved in a competitive market to the extent that it constrains the utility from exercising monopoly power and exacting monopoly rents from consumers. And arguably, if the regulatory regime also creates incentives for the utility to seek productivity improvements, then the regime will be better at emulating the results expected from a competitive market. Indeed, this is one of the arguments in favour of PBR. However, if the utility is limited in its capacity to act on the incentive to seek productivity improvements, then achievement of this this objective may be diminished relative to other regulatory objectives.

- 61.1 Would Mr. Kolesar agree that an objective of optimizing the cost-effectiveness of spending could serve to emulate the benefits of a competitive environment? Please explain why or why not.
- 61.2 What options exist for developing a culture of ‘cost-effectiveness’ in a large organization when profit maximization is not the objective?

62. Reference: Exhibit B-8, Appendix B, Mr. Kolesar page 11 of 18

The regulatory regime should avoid regulatory burden and streamline regulation to the greatest extent possible

PBR promises less regulatory burden because the term of a PBR plan is generally longer than the term under COSR and the utility is presumed to be “set free” to manage its business rather than focus on regulatory filings. However, that promise is not always so easily realized. PBR, at least at the initial stages of implementation, often requires a number of supplemental or concurrent regulatory proceedings to deal with matters such as the annual rates adjustment under the PBR formula, the periodic calculation and approval of K, Y and potentially Z factors, the monitoring of quality metrics, and alike. Alberta experienced an increase in regulatory filings under PBR, in part because of the nature of some of the Commission’s PBR plans, for which the Alberta commission was often criticized. The Commission should carefully analyze and consider the potential regulatory burden under both COSR and PBR.

- 62.1 Would Mr. Kolesar agree that the complexities of new PBR can result in significant uncertainty as to how the formula actually works and the incentives that are generated?
- 62.2 Please confirm that a clear understanding of the workings of a regulatory regime can result in reduced confusion and contention in regulatory proceedings.
- 62.3 Please discuss the risks and benefits that can accrue from changing the regulatory regime every few years.
- 62.4 Please discuss the risks and benefits from resetting a PBR, and in particular changing the elements of a PBR every few years.

63. Reference: Exhibit B-8, Appendix B, Mr. Kolesar page 12 of 18

The regulatory regime should make parties better off relative to other regulatory alternatives, so that both BC Hydro and its customers share in the benefits of the plan

Determining the relative merits of COSR and PBR and the sharing of benefits is admittedly a difficult task. COSR, because it is accounting oriented and has a shorter term, is easier for most parties to understand and the sharing of benefits as between the utility and customers is theoretically easier to demonstrate because it is possible to link rates and revenues to a calculated revenue requirement, both on a forecast and actual basis. However, because PBR breaks the link between rates and revenues and the costs of the utility (the utility's revenue requirement), it is much more difficult to demonstrate the sharing of benefits.

- 63.1 Would Mr. Kolesar agree that there can be a risk of companies 'gaming the system' under PBR?
- 63.2 Would Mr. Kolesar agree that less than optimal decision-making from a cost-effectiveness perspective can be inadvertently incented under PBR? For example might a utility choose to defer necessary spending that would otherwise be optimally spent earlier in order to achieve PBR incentives? Please explain why or why not.
 - 63.2.1 If yes, what means are available to regulators and interveners to determine whether spending is cost-effective?