SUMMARY

BC Hydro has bought interest rate hedges (insurance) to protect itself from rate hikes on $4.4 Billion of required borrowings for the Site C Dam. If Site C is terminated, then these interest rate hedges will not be needed and can be sold for roughly $200 million to other interested parties. This would reduce termination cost from $1.2 Billion to $1.0 Billion.

BACKGROUND

In late 2015, BC Hydro applied to the BCUC for a “Debt Management Regulatory Account” designed to facilitate speculation in interest rates. The original application spoke of $300 million dollars per year. Permission was granted in the spring of 2016.

 Although specific reports were requested by the BCUC, no formal reports have been provided to regulators and only sketchy references in BC Hydro’s financial reports reference this speculative activity.

In 2016, BC Hydro began a hedging program to reduce interest rate risk on 50% of planned future borrowings. The company entered into agreements to cover a total of $4.4 billion in future debt. That debt was not allocated to specific projects but would include borrowing for Site C.¹ The hedging program consists of a combination of long-term bond repurchase agreements (aka “bond locks”) and interest-rate swap agreements.

According to BC Hydro’s 2016/17 Annual Service Plan, as of March 31, 2017, the “interest rate contracts” for which debt had not yet been issued (and which have a total notional principal amount of $3.6 billion) had increased in fair value by $194 million.² That increased value has not yet been realized, but is being calculated on an ongoing mark-to-market basis.

If Site C were cancelled and BC Hydro no longer needed the billions in dollars of debt planned for that project, then BC Hydro could sell some or all of those “in-the-money” contracts and realize some of those gains now. Alternatively, BC Hydro could hold onto those contracts and, depending on future interest rates, potentially gain even more when the payments come due.

If in either case, if BC Hydro did not need to borrow billions to build Site C, then the gains from these derivative contracts could and should be used to reduce the cost of terminating the project. Accordingly, it is reasonable for the BCUC panel to reduce the forecast level of termination costs by roughly $200 million or from $1.2 Billion to $1.0 Billion.

² BC Hydro, 2016/17 Annual Service Report, pp. 80 and 84.