OCCASIONAL PAPER No. 15 GOVERNMENT POLICY

IS THE BC UTILITIES COMMISSION INDEPENDENT?

Following the Liberal government's core reviews of BC Hydro and the Insurance Corporation of British Columbia (ICBC), in 2003 the government delegated regulatory authority over the two public monopolies to the BC Utilities Commission (BCUC). This action was in keeping with common practice where investor-owned utilities which enjoy monopoly pricing power are regulated by and independent agency.

Relying on a third-party to review and set prices, or to approve major capital projects, allows the government to avoid the responsibility of what can often be difficult decisions. However, this theory often breaks down when the appointed regulator makes decisions that may be contrary to the policies or objectives of the party in power. This is especially true when the regulated utility is a Crown corporation, as the finer points of the distribution of authority quickly disappear when the customers are also electors (or corporate donors).

The government was aware of the potential for issues under adjudication of the BCUC to become highly political. The Commission's governing legislation included a provision that allowed the government to issue special directions to ensure that government policy was respected by the Commission. This was most evident when the government began to develop policy and legislation respecting clean energy, and set operating requirements and 'clean' energy targets for BC Hydro.[1] Among other initiatives, the Act required BC Hydro to plan for clean energy generation, enhance conservation and encourage more clean power generation from the private sector.

Economic Recession 2009 to 2010

The economic recession following the world financial crisis of 2008/09 caused a shrinkage in tax revenues, forcing the government to run operating deficits. The government's financial planners looked to the two major Crown corporations to help stabilize government revenue. Cabinet orders in 2008 and 2009 increased BC Hydro's potential surplus and ensured a continuing cash dividend. The prospect of rising electricity rates lead the BCUC, encouraged by the utility and its organized customer groups, to increase the number and value of the BC Hydro's deferral accounts to ease pressure on electricity rates (although this added to the corporation's debt).[2]

[1] The government issued its Energy Plan in 2007 and followed-up with the Clean Energy Act of 2010.

[2] Between 2008/09 and 2010/11 the net value of the deferrals rose from $513 million to approximately $2.1 billion. Deferral accounts transfer the risk of a cost over-run from the shareholder (a reduction in net income) to
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In 2010, the government changed ICBC's legislation to allow it to appropriate "excess" capital accumulated by the highly profitable Optional insurance program. Between 2010 and 2011 the government took $677 million to help defer the government's borrowing requirements.[3] This change did not directly affect the BCUC, as its authority was limited to the regulation of Basic compulsory insurance, although the Commission did encourage ICBC to build a large Basic capital reserve to cushion against potential rate shock.

By 2012, the BCUC had become concerned about the growth in BC Hydro's operating cost deferrals and the resulting debt obligations. Two major reviews of BC Hydro's operations, and its growing reliance on deferral accounts, had highlighted the growing weakness in BC Hydro's underlying financial strength. The BCUC rejected BC Hydro's plan for future generating capacity, and announced a plan to hold oral hearings on the appropriateness of the rate request for 2012 and 2013.

In response. In May 2012, the government issued a directive[4] ordering the commission to approve the requested rates, which were below the level necessary to cover the forecasted expenditures. The government's action ensured that electricity pricing would not become an issue during the 2013 election, and effectively ended the Commission's authority to set BC Hydro prices.[5]

The End of Independence

In November 2013, the government announced a new 10-year financing plan for BC Hydro, including rate increases of 9% for 2014 and 6% for 2015. The Commission would be able to review rate increases for the 2016 to 2018 years, but the government capped the allowed rate increases at 4%, 3.5% and 3% for these years. Essentially, the Commission would be allowed to look but not touch.

The keystone to the 10-year financing plan was a new government ordered 'rate smoothing' revenue deferral account that allows BC Hydro to record unapproved future revenue to ensure that the target amount of annual net income will be achieved.[6] The 2016 to 2018 rate request shows that the deferred revenue in the rate smoothing account rising from $166 million in 2014/15 to almost $1.1 billion by 2018/19.

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the ratepayers (through higher future rates).

[3] By 2015 the appropriation totalled approximately $1.2 billion.

[4] See Appendix I.

[5] BY law the Commission still needed to approve the rate change, and it complied with the cabinet directive.

[6] BC Hydro had also been deferring a significant amount of unapproved and unbilled revenue in the Non-Heritage deferral account.

To emphasize the end of the normal cost of service model of rate-setting, where the utility is given the opportunity to earn an allowed return on equity, in July 2016 cabinet ordered BC Hydro to achieve pre-determined net income levels for the next three rate years, and a dividend amount for 2016/17.[7]

As for auto insurance, the government appeared to believe that it could keep rate increases within a reasonable level by reducing the Basic and Optional capital reserves to cover operating deficits. In March 2013, the government instituted a form of price control (rate smoothing) by ordering the BCUC to set the future year Basic insurance rate increase at no more than 1.5% of the increase approved in the prior year. Unlike the relatively stable cost of hydro power generation, auto insurance claims costs, and especially bodily injury claims, have displayed much more year-over-year volatility. The forecast rate increase required for 2013 was 11.8%, but the government ordered that some $486 million be transferred from the Optional from the Optional program to allow a lower increase in rates.

In 2015, the government again ordered a transfer of $450 million in Optional capital, which allowed ICBC to request a 5.5% increase despite its forecast that an increase of 11.2% was required to cover rising costs and maintain the capital reserve margin.

For 2016, ICBC is again forecasting a large operating deficit in the Basic program. The government has approved ICBC requesting a 4.9% rate increase, despite forecasting a minimum 15.5% increase in costs. Once more the government has directed ICBC to use the highly profitable Optional program to subsidize the Basic insurance rates, although the projected year-end Basic capital is now, after Optional transfers of approximately $1.4 billion since 2012, at the regulatory minimum level. If the recent trends in claims costs continue a massive increase will be required in 2017 Basic rates to preserve the unpaid claims capital reserve.

As a further signal that the BCUC had even less discretion in setting Basic rates, the government has removed the requirement that the Commission approve the target for the Basic capital reserve.[8] Through a 2016 amendment to the Insurance Corporation Act, this authority can now be assumed by cabinet.

Report of the Independent Review Task Force

As part of the 10-year BC Hydro financing plan, the government initiated an independent review of the Commission's role and operations. The report of the task force was released in February 2015, and recommended a restoration of the regulator's

[7] OICs 590/16 and 589/16.
[8] OIC 615/16 of August 2016.

authority to set rates and review major projects. The independent panel also recommended improved process and a strengthening of the capabilities of the BCUC.[9]

The report contained a paper by Rowland Harrison, and expert on regulatory law, which faulted the government for controlling the BCUC through detailed special directions. The use of specific directives "directly contradicts the independence of the Commission, which, rather than making independent decisions in such circumstances, is merely implementing decisions made by cabinet. In addition to contradicting the principle of Commission independence, the practice of issuing prescriptive directions in the context of specific matters before the Commission also begs the question of exactly what the role of the Commission is *vis-à-vis* the provincial cabinet."[10]

Harrison concludes that the BC Utilities Commission is not independent. "The fundamental question is this: Is the BCUC truly intended to be 'an independent regulatory agency…a quasi-judicial tribunal that makes decisions…' or is it an agent that, to a large degree, implements decisions made by cabinet? Currently, the Commission is described as the former, but is closer to being the latter when it is subject to detailed and prescriptive directives issued by the provincial cabinet."[11]

Medium Term Outlook

The government released the report of the independent review after it announced approval of the controversial Site C dam project. This circumvention of the BCUC was in keeping with the government's belief that an independent regulator should not interfere with major government decisions. Energy minister Bennett stated that "a group of unelected bureaucrats and lawyers [should not decide] the future of energy policy in British Columbia…."[12]

This distrust of the potential decisions of an independent regulator has carried forward to the 2016 rate submissions for both BC Hydro and ICBC. In fact, the elimination of the BCUC's authority to approve the Basic insurance capital reserve target further demonstrates that the role of the Commission has been reduced to rubber stamping the government's financial manipulation of the two public utilities.

The government, facing an election in May 2017, has decided that short-term rate suppression is of greater benefit than the longer-term financial stability of these two public utilities.

[9] http://www2.gov.bc.ca/assets/gov/farming-natural-resources-and-industry/electricity-alternative-energy/electricity/bcuc_review_final_report_nov_14_final.pdf

[10] Ibid. See Appendix 4, p. 82.
[11] Ibid., p. 84.
[12] Justine Hunter, *Globe and Mail*, 12 January 2015.

The de-legitimizing of the role of the formally independent regulator may have longer-term consequences for maintaining the public's trust in the decisions of the provincial government.

If the Commission cannot alter the government approved rate adjustments for BC Hydro and ICBC, it still can provide a useful function in analyzing and commenting on the future cost impacts of this government's actions to manipulate the utilities' rates. It remains to be seen if the Commission will take up the challenge.

The writer is a retired senior BC government public servant who's paper on the 40-year financial history of ICBC was published by *BC Studies* in 2013. The same academic journal will be publishing his paper describing the BC government's manipulation of the finances of BC Hydro from 2008 to 2014 in October. He has been an intervener in the BC Utilities Commission's 2014 and 2015 reviews of ICBC's rate requests, and is currently an intervener in the Commission's current reviews of ICBC and BC Hydro rate requests.

APPENDIX I: KEY GOVERNMENT DIRECTIVES RESPECTING BC HYDRO

2008

OICs 27/08 and 28/08 January; rescinded BCUC instruction to rebalance rates, and defined "deemed equity" which increased the net income and dividend.

2009

OIC 74/09 February 2009; orders increase in BCUC benchmark ROE by 1.6% for three years.

2010

Clean Energy Act; exempts some major capital projects from BCUC review and approval (including Site C), integrates the BC Transmission Corporation with BC Hydro, and required BC Hydro to achieve energy conservation targets while encouraging private power generation.

2011

Treasury Board Regulation 146/2011 of July 5, 2011 allowed BC Hydro to adopt the US accounting standard ASC 980 to preserve its regulatory/deferral accounts. The order exempted BC Hydro from the requirement to have an independent third party regulator set the annual rates, thus creating a unique accounting standard for the Crown utility.

2012

OIC 314/12 May 2012; ended BCUC's discretion to set rates for 2011 to 2013 by imposing increases of 8%, 3.91% and 1.44% for the three years which was well below the indicated requirements.

2013

November; government announces new 10-year financial plan for BC Hydro.

2014

OICs 96/14 and 97/14 February; Directive 6 and Directive 7 detail the 10-year plan requirements and provide highly detailed calculation and approval requirements covering 2015 and 2016 rate increases, and cap the BCUC allowed increases from 2016 to 2018; requires the BCUC to approve a new 'rate smoothing' deferral account allowing BC Hydro to record and defer the difference between the required revenue and that generated by the suppressed rates.

2015

OIC 404/15 July 14; requires the BCUC to allow the deferral and recovery of the Thermal-Mechanical Pulping program in future rates.

2016

OIC 123/16 February; BCUC must allow deferral of costs of mining companies rate loan program.

OIC 589/16 July; sets dividend target for 2016/17.

OIC 590/16 July; sets net income (distributable surplus) targets for 2016/17 and next two years confirming that BC Hydro no longer subject to standard cost of service rate model for rate-setting.

APPENDIX II: KEY GOVERNMENT DIRECTIVES RESPECTING BASIC INSURANCE

2005
OIC 734/05 Letter of October 5, 2005 to ICBC directing the transfer of $ 530 million to Basic capital to achieve 100% MCT by FY2005 to enable maintenance of low and stable rates.

OIC 735/05 October 5, 2005 Commission must accept government directives to ICBC

2007
OIC 39/07 Letter of January 31, 2007 to ICBC regarding proposed rate design.

OIC 38/07 Letter of January 24, 2007 to ICBC directing transfer of $ 100 million to Basic capital for FY2006 to complete the balancing of ICBC's capital and achieve 100% MCT.

2010
OIC 222/10 Letter of April 19, 2010 to ICBC; fund the Transformation Program ($ 400 million) from Optional capital.

OIC 287/10 Letter of May 18, 2010 to ICBC; suspends any rebate under the capital management plan to avoid possible rate volatility due to uncertain investment markets and thereby enhance the effectiveness of the capital management plan.

2011
OIC 560/11 Letter of November 25, 2011 to ICBC; moderates the direction of May, 2010, as ICBC should use more Basic capital in the short term:" The government believes that the capital available above the Basic insurance regulatory minimum should be made available to help manage rates." (p. 2) Capital build excluded from the rate request for the next three policy years.

2012
OIC 82/13 Letter of December 13, 2012 to ICBC; transfer all Optional excess capital to Basic for FY2012 to allow MCT to be equal to or above the 100% MCT level.

2013
OIC 152/13 March 2013; amendments to SD IC2; incorporating rate smoothing, a customer renewal credit and annual rate changes; annual rate increases are limited and rates cannot decrease; the Commission to set rates to allow Basic to maintain at least 100% MCT level.

OIC 153/13 March; ICBC directed to seek BCUC approval for a revised capital management plan "to use Basic capital to promote more stable and predictable Basic rates." If the MCT reserve ratio is projected to fall below 100% ICBC must, in conjunction with Treasury Board, develop a plan to restore the capita level.

2014

OIC 15/14 February; transfers balance of excess Optional capital to Basic for 2013 ($113 million).

OIC 56/14 February; changes policy year to November 1st.

2016

Insurance Corporation Act amended to allow ICBC capital reserve targets t be set by cabinet order.

OIC 614/16 August; orders Optional transfer of $300 million of net income and $172 million of capital to allow ICBC to propose a 4.9% rate increase despite a forecast requirement of 15.5%.

OIC 615/16 August; amends Special Direction IC2 deleting all references to Commission approval of the Basic capital reserve target.

OIC 960/16 December; orders the Commission to approve a maximum 4.9% rate increase for PY2016 by January 16, 2017. The government ordered ICBC to conduct an "independent' review of Basic insurance rates.

2017

OIC 326/17 September; orders transfer of $470 million from Optional capital to Basic.

OIC 602/17 December; Orders BCUC to end 2017 rate review by January 12, 2018.

2018

OIC 67/18 February; suspends requirement of BCUC to set Basic rates to ensure a minimum 100% MCT for the years 2018 to 2021.

OIC 456/18 August 9; changes Basic policy year to April-March, with rate application filing by 15 December of prior year.

OIC 457/18 August 9; ICBC ordered to make policy year 2019 rate request by December 15, 2018.

OIC 459/18 August 9; directs BCUC to make a decision on the Basic rate design application within 45 days of filing.