

SOME CONSIDERATIONS ON RESTORING THE BC UTILITIES COMMISSION'S INDEPENDENCE TO REGULATE BC HYDRO

"I do not speak of emancipation at once, but of a decision at once to emancipate gradually." Abraham Lincoln, July 1862.¹

The NDP government agrees with auditor general Carol Bellringer's opinion that the B.C. Hydro's 'prescribed' accounting does not conform to Canadian public sector accounting standards. Finance minister Carole James appears committed to fixing the problem and set aside \$950 million from the 2017/18 surplus as a form of down payment against the eventual cost of bring the B.C. Hydro books into compliance with the national standard.²

The key element is the appropriate use of deferral accounts. Most power utilities in North America use regulatory accounting to defer certain costs for recovery in future customer rates. The regulatory accounting standard requires that the use of deferral accounts is strictly controlled by an independent regulator, which ensures that the corporation does not abuse its monopoly pricing power.

Because the government was directing the B.C. Utilities Commission (BCUC) through prescriptive cabinet orders, Ms Bellringer concluded that B.C. Hydro's use of regulatory accounts did not comply with the accounting standard, and that the regulatory accounts should be wound-up.

No Independence Means No Deferrals

If the BCUC's discretion remains fettered by prescriptive cabinet directives, lifting the auditor general's qualification on the government's financial statements will require the end of regulatory accounting at B.C. Hydro. The outright elimination of regulatory/deferral accounting would come at a stiff price. As of 31 March 2018, B.C. Hydro reported that the net deferred balance (assets less liabilities) was \$5.46 billion. This represented 100% of the equity reported (which was down from the 114% ratio in the previous year).

To comply with the auditor general's opinion the government would need to transfer a further \$4.5 billion (the \$5.46 billion less the \$950 million) to B.C. Hydro, or eliminate all the corporation's equity and reduce B.C. Hydro's debt by approximately \$3.5 to \$4.0 billion.³

¹ Bruce Catton, *A Terrible Swift Sword*, Phoenix Press, 1963, p. 363.

² <https://vancouver.sun.com/opinion/columnists/vaughn-palmer-ndp-makes-impressive-start-managing-b-c-s-finances>

³ Not all the amounts deferred involved actual cash outlays which add to B.C. Hydro's debt.

Conversely, if the government restored the BCUC's discretion to approve the deferral accounts, it is likely that the \$4.5 billion cost to achieve compliance to national accounting standards could be significantly reduced. Using existing criteria and accounting standards (e.g. not counting ethereal revenue) some form of joint B.C. Hydro-BCUC-auditor general review could determine which of the existing deferrals are acceptable.

To satisfy the regulator and the auditor general (who will be B.C. Hydro's external auditor starting in 2019) the additional taxpayer payment – or the reduction in B.C. Hydro's equity – could be as low as \$2.0 billion.⁴

Independent Rate Setting Will Mean Higher Electricity Prices

The previous government used the opportunity presented by regulatory accounting to manipulate the finances at B.C. Hydro to suppress the true price of electricity and yet still enjoy high annual profits.⁵

Is the government prepared to allow the BCUC to set B.C. Hydro's rates to recoup all legitimate costs? If the BCUC set rates based on the cost of service model (without rate smoothing) rates could increase by at least 10% next year.⁶ A 10% increase would place a significant financial burden on many families and businesses. Jock Finlayson of the Business council of British Columbia said that "The reality is, the cost of power is going to be going up in British Columbia, Site C or no Site C. All you have to do is look at Hydro's balance sheet to understand why.... It's a huge dilemma for our elected officials, because they know the public doesn't want to hear that – a lot of my members don't want to hear that, to be candid."⁷

The government could also see a significant reduction in its revenue if the BCUC reduced B.C. Hydro's approved return on equity (profit) to reflect the lower shareholder risk resulting from the large number of deferrals.⁸ Deferrals transfer risk from the shareholders to future customers.

⁴ For example, eliminating the revenue deferrals (Rate Smoothing and Non-Heritage) at \$1.2 billion and the pension deferrals at \$800 million.

⁵ For a summary see https://thetyee.ca/Opinion/2017/05/01/Rate-Increases-BC-Hydro-ICBC/?utm_source=daily&utm_medium=email&utm_campaign=020517

⁶ The current 10-year plan shows the rate smoothing balance increasing by some \$300 million, or some 6.5 %. When added to the planned increase of 2.6% the total is 9.1%. A 10% increase could be a conservative estimate once all the current deferrals are examined.

⁷ <https://www.theglobeandmail.com/news/british-columbia/on-hydro-horgan-borrows-a-trick-from-the-liberal-repertoire/article37027362/>

⁸ Unfortunately, national public sector accounting standards require the net income from self-supporting Crowns to be treated as government revenue, rather than the actual dividend (if any). This distorts the true picture of the government's financial position; for example, the \$1.3 billion loss at ICBC for 2017/18 was not a taxpayer-funded expenditure, and the \$684 million net income from B.C. Hydro was not transferred to the CRF to be available to spend.

Gradual Emancipation?

Auditor General Bellringer has promised to release a report on the regulatory accounting as practiced at the public electrical utility in the next few weeks. Presumably this report will provide a history of the use of regulatory accounting, with the rationale for each of the deferral accounts. It remains to be seen if this report will be designed to assist the government or the BCUC in reconsidering specific deferral approvals, or whether it will just rely on the lack of independent oversight to condemn all the deferrals.

Minister responsible Michelle Mungall stated in June that she has her own review underway to review all aspects of B.C. Hydro to determine how to reduce costs (and presumably the reliance on deferrals), while a second broader review would address how the corporation should be positioned for the 21st century.⁹ Initially she promised that the results of the first review would be made public, but nothing has been heard of this review since June.

Finance minister James was cautious and non-committal about how to find an accommodation between the auditor general's view that no independence for the regulator means no deferrals, and the need to limit the financial impact on taxpayers (higher debt) and/or ratepayers (higher rates).

She hinted that the government might be considering allowing the BCUC more discretion while still limiting the annual allowable rate increase. "They're going to go through their process. They're going to take a look at affordability for ratepayers. That's part of our mandate and it's part of our requirement for Hydro, is to look at both affordability for ratepayers as well as sustainability of Hydro."¹⁰

Can finance minister James find a compromise on the question of unfettering the BCUC's discretion? Will the provincial economy continue to produce budget surpluses that can be transferred to B.C. Hydro to pay down the deferral balances?

Until a mutually agreeable solution can be implemented the resolution of B.C. Hydro's accounting will continue to overhang the government's management of the province's finances.

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The writer is a retired senior BC government public servant whose paper describing the BC government's manipulation of the finances of BC Hydro from 2008 to 2014 was published by *BC Studies* in November 2016. *BC Studies* published his paper on the 40-year financial history of ICBC in 2013. He has been an intervener in the BC Utilities Commission's recent reviews of both ICBC's and BC Hydro's rate requests.

⁹ <https://www.timescolonist.com/opinion/columnists/les-leyne-minister-paints-happy-picture-of-b-c-hydro-1.23324752>

¹⁰ <https://vancouver.sun.com/news/politics/political-directives-have-undermined-b-c-hydro-s-finances-auditor-general-says>

