

**THE QUEBEC GOVERNMENT ‘SIMPLIFIES’ PRICING OF ELECTRICITY BY SIDELINING THE REGULATOR**

In June 2019, the new government in Quebec essentially sidelined the regulator of Hydro Quebec and legislated electricity rates for the next five years. This action was the culmination of a controversy that developed about the fairness of the way that domestic electricity rates were determined. As a result, the public had lost confidence in the rate-setting process which was managed by an independent third-party regulator.

The move by the Legault government to take control of electricity pricing follows the actions of the Clark Liberal government in this province, and the former Liberal government of Ontario. Both governments sought to moderate increases in electricity rates by circumventing the authority of the independent rate-setting bodies in those provinces.

**The Controversy About Over-Charging for Electricity in Quebec**

Thanks to Hydro Quebec’s extensive network of hydroelectric dams and transmission lines the residents and businesses in Quebec have historically enjoyed low-cost and clean electricity. The low-cost electricity produced by the public electricity utility has been a key engine in the development of the Quebec economy, allowing Hydro Quebec to provide significant dividends, taxes and other income to the government each year.<sup>1</sup>

Hydro Quebec’s low production costs allows it to offer electricity at the lowest rates in North America. Yet in the run up to the October 2018 provincial election the then Liberal government was accused of over-charging domestic customers. The higher than planned net income was confirmed by the province’s auditor general who stated that between 2005 and 2017 Hydro Quebec’s cumulative actual net income was \$1.5 billion higher than the level approved by the regulator, allowing the corporation to transfer an additional \$1.1 billion in cumulative dividends to the province.<sup>2</sup>

Francois Legault, who became the premier following the election, said the higher profits were a sly and disguised tax which he would refund if elected.<sup>3</sup> A class action lawsuit was

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<sup>1</sup> For the 2018 fiscal year Hydro-Quebec reported a net income of \$3.19 billion, and a dividend of approximately \$2.4 billion; see <http://www.hydroquebec.com/data/documents-donnees/pdf/annual-report.pdf>

<sup>2</sup> [https://www.vgq.qc.ca/en/en\\_publications/en\\_rapport-annuel/en\\_fichiers/en\\_Rapport2018-2019-Mai2018.pdf](https://www.vgq.qc.ca/en/en_publications/en_rapport-annuel/en_fichiers/en_Rapport2018-2019-Mai2018.pdf) Chapter 8. In this province, between FY2006/07 and FY2016/17 B.C. Hydro paid approximately \$2.4 billion in dividends to the provincial government. Because it recorded negative free cash flow during these years it was forced to borrow the funds to pay the dividends.

<sup>3</sup> Once elected he denied the claim, see <https://montrealgazette.com/news/local-news/petition-calling-for-legault-to-keep-hydro-refund-pledge-hits-56000-signatures>

filed claiming that the province abused Hydro Quebec's monopoly power to help balance the provincial books. Hydro Quebec said the positive revenue variance was not a deliberate government policy.<sup>4</sup>

In February 2019, Hydro Quebec added more credence to the charge of over-charging its provincial customers when it announced a record \$3.2 billion profit (and a \$2.4 billion dividend) for the 2018 fiscal year (although almost \$280 million was the result on a one-time revenue boost).<sup>5</sup> In March 2019, the regulator approved a rate increase of 0.9% (only 0.3% for large industrial users) for the current year.

### **The New Simplified Scheme Practically Eliminates the Independent Regulator for Five Years**

Each year the Régie de l'énergie, the independent third-party regulator, approves rate changes based on the industry standard Cost of Service (COS) model. Expenditures and sales are forecast, and the revenue requirement is set to cover the costs and provide the opportunity to achieve a set return on equity (net income). The regulator was changing the rate-setting model to a more complex benefit sharing scheme designed to incent greater productivity (see Appendix). In March 2019, the regulator approved a rate increase of 0.9% (only 0.3% for large industrial users) for the current year, continuing a trend of annual increases being lower than the increase in inflation.<sup>6</sup>

In response to growing public concern about the complexity and fairness of the price charged for electricity the Legault government confirmed its label as a populist government. In June 2019, it legislatively sidelined the independent regulator for five years by ordering that Hydro Quebec freeze rates for 2020 and increases for 2021 to 2024 would be limited to the increase in the Quebec cost of living. The regulator would also lose its authority to approve longer-term capital expenditures, including generation and transmission projects.<sup>7</sup> The regulator would set the rates for 2025, then the CPI would cap the increase for the next four years.

This "simplified" scheme also eliminates the potential for variances in the profit target because there is no target. The increase in domestic price is capped at the CPI and the Crown's net income will vary depending on its costs and sales.

The government claimed that domestic customers would receive a \$500 million rebates in 2020, while the balance of the \$1.5 billion in earlier over-billings would be made up by the inflation limitation for 2021 to 2024.<sup>8</sup> This claim is impossible to verify. The

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<sup>4</sup> <https://montrealgazette.com/news/local-news/class-action-lawsuit-request-filed-against-hydro-quebec>

<sup>5</sup> <http://www.hydroquebec.com/data/documents-donnees/pdf/annual-report.pdf>

<sup>6</sup> <https://montrealgazette.com/news/local-news/hydro-quebec-rates-to-rise-by-0-9-per-cent-on-april-1>

<sup>7</sup> <http://news.hydroquebec.com/en/press-releases/1510/electricity-rates-adoption-of-a-simplified-approach-that-will-guarantee-low-rates/>

<sup>8</sup> <https://www.cbc.ca/news/canada/montreal/hydro-qu%C3%A9bec-environmentalist-bill-34-1.5172905>

energy minister said a major benefit of the new five-year plan is that it provides customers stable and predictable rates.

The new scheme gives Hydro Quebec much greater autonomy from the regulator, and it would appear that the Crown utility is organizationally now more clearly a department of the government.

The elimination of the rate review process for the next five years will certainly save the staff of Hydro Quebec all the time and effort required to respond to the myriad of information requests from the staff of the regulator and from the interveners in the review. As an example, the current review of B.C. Hydro's rate request for 2019 and 2020 is planned to require over 12 months to complete. Between the application and the responses to two rounds of information requests B.C. Hydro has produced an incredible 9,700 pages of material, with more to come. In many respects the rate review has become an operational audit of all facets of the operation.

A representative of a coalition of Quebec environmental groups called the new model "cut-rate" regulation and was concerned about the loss of outside scrutiny over the costs for the Crown utility. "We're completing a process by which Hydro-Québec gets itself out of being publicly regulated and back into a situation where energy policy and rates are going to be set between cabinet and the public corporation without any proper public oversight.... It's kind of returning to a 'hewers of wood and carriers of water,' kind of [a] Banana Republic approach with no civil society involvement in making the important decisions."<sup>9</sup>

### **Will the New Scheme Conform to Generally Accepted Accounting Principles?**

Hydro Quebec, like B.C. Hydro, uses rate regulated accounting to moderate variances in its costs and the smooth the annual rates charged to domestic customers.<sup>10</sup> As of 31 December 2018, the net regulatory assets totalled almost \$3.3 billion. A fundamental principle of rate regulated accounting is that the deferral accounts must be approved and overseen by an independent third-party regulator. But in recent years the governments of B.C. and Ontario also attempted to gain public popularity by keeping electricity rate increases below what was required.

The provincial governments of B.C. and Ontario circumvented their respective regulators by ordering the use of deferral accounts to mask the true financial state of

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<sup>9</sup> Ibid.

<sup>10</sup> The 2018 ratio of the net balance in Hydro Quebec's deferral accounts to its equity in 2018 was 15.4%. B.C. Hydro's finances are much more dependent on deferring cost variances, and the 2018/19 ratio was about 85%.

their Crown utilities. In B.C. the government used cabinet directives to the B.C. Utilities Commission to set the rates for B.C. Hydro from 2012 to 2018. This resulted (belatedly) in the provincial auditor general qualifying the provinces financial statements for 2016/17 and 2017/18 on the basis that B.C. Hydro was not conforming to public sector accounting standards.

In 2017, the former government of Ontario sought to use deferral accounting to reduce current electricity rates by loading much more debt on future generations of customers. The Ontario auditor general (and the independent finance offer) was clear that this scheme did not conform to standard accounting principles because the new regulator mechanism was not approved by an independent regulator, as required by the national accounting standards.

The B.C. auditor general withdrew her qualification for the 2018/19 public accounts after the NDP government eliminated most of the restrictions placed on the authority of the regulator.<sup>11</sup> The new Progressive Conservative in Ontario also agreed with the Ontario's auditor general's criticism and eliminated the offending deferral scheme.<sup>12</sup>

It remains to be seen if the auditor general of Quebec will follow the lead of her counterparts in B.C. and Ontario and qualify the financial statements of that province because of the lack of an independent third-party regulator to oversee rates and the operation of Hydro Quebec's regulatory accounts.

Another important question raised by the Quebec action is whether it is possible for appointed officials to make decisions on the future finances of Crown monopolies when the affected public targets their criticism at the elected politicians? How is it possible to separate responsibility from ultimate accountability in a public sector setting? Does the elimination of the regulator unduly restrict public accountability? These questions will be explored in a separate paper.

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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 is an intervener in the BC Utilities Commission's current review B.C. Hydro's rate request for 2019 and 2020

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[http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary\\_auditor\\_general\\_removes\\_qualification\\_19\\_july\\_2019/pdf/commentary\\_auditor\\_general\\_removes\\_qualification\\_19\\_july\\_2019.pdf](http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_auditor_general_removes_qualification_19_july_2019/pdf/commentary_auditor_general_removes_qualification_19_july_2019.pdf)

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[http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary\\_ont\\_govt\\_agrees\\_with\\_ag\\_21\\_sept\\_2018/pdf/commentary\\_ont\\_govt\\_agrees\\_with\\_ag\\_21\\_sept\\_2018.pdf](http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_ont_govt_agrees_with_ag_21_sept_2018/pdf/commentary_ont_govt_agrees_with_ag_21_sept_2018.pdf)

## APPENDIX

### SUMMARY OF ELECTRICITY RATE SETTING METHODS IN QUEBEC

The following was prepared by B.C. Hydro in response to a question posed during the current rate review of its 2019 and 2020 rate increase request, see BCUC, B.C. Hydro F20 to F21 RRA, IR2, BCUC 2.286.1, Pdf 768/791;  
[https://www.bcuc.com/Documents/Proceedings/2019/DOC\\_55272\\_B-12-BCH-Response-BCUC-IR2.pdf](https://www.bcuc.com/Documents/Proceedings/2019/DOC_55272_B-12-BCH-Response-BCUC-IR2.pdf)

The Régie de l'énergie has regulated Hydro Quebec Transmission since 1998 and Hydro Quebec Distribution since 2000.

Both Hydro Quebec Transmission and Hydro Quebec Distribution were initially regulated under cost of service regulation. On a yearly basis, they filed a Tariff Request at the Régie using 4 months of actual costs and eight months of projected costs.

Between 2008 (which marked the beginning of the recession in Quebec, at which time electricity demand went down dramatically) and 2014, Hydro-Quebec generated \$1.4 billion in earnings variances, which were referenced by the media as customers being “overcharged”. Hydro-Quebec responded that these amounts were savings associated with productivity increases.

With the election of a new government in 2012, a Bill was introduced to amend *The Régie de l'énergie Act* and add a new requirement for the Régie to establish a performance-based regulatory mechanism for Hydro-Québec in its activities as an electricity power distributor and carrier.

Following this requirement, the Régie launched a multi-year regulatory process to implement PBR.

In 2014, in Decision D-2014-034, the Régie adopted a MTÉR (earning sharing mechanism) which was implemented in 2017. The first 100 basis points of surplus earnings are shared evenly between customers and Hydro-Quebec Distribution. For earnings in excess of 100 basis points, 75 per cent are assigned to customers while Hydro-Quebec Distribution retains 25 per cent.

In 2017, in Decision D-2017-043, the Régie approved a multi-year rate plan for

Hydro-Quebec Distribution featuring a revenue cap with an inflation – X + customer growth formula.

In 2018, in Decision D-2018-067, the Régie used a judgement-based, non-scientific approach to set an X-factor of 0.3 per cent and ordered Hydro-Quebec Distribution to prepare a total factor productivity study to potentially inform the X-factor for the last year of the PBR plan.

The Régie de l'énergie was set to decide on which methodology to adopt to conduct the total factor productivity study this fall. However, with the filing of Bill 34 and its expected adoption, the study may not be required.