MANITOBA PLANS FOR ELECTRICITY RATE INCREASES WHILE B.C. OPTS FOR SHORT-TERM RATE RELIEF

Decisions on the percentage increase for electricity prices for 2019 show a clear difference between the approach adopted by the independent regulator in Manitoba, and by a minority government in British Columbia.

In late May the Manitoba Public Utilities Board (PUB) approved a 2.5% increase in the electricity rates of Manitoba Hydro, effective 1 June 2019.[1] Of particular interest is that all the additional revenue raised will be placed in a deferral account to moderate the impact on future rates of major capital projects that are coming onstream.

B.C. Hydro also has been incurring major capital expenditures, and its customers are facing the operating impact of these projects, including the $10.7 billion for Site C, during the next few years. Rather than follow the Manitoba example of preparing ratepayers for higher operating costs, the B.C. government has decided to keep the short-term rate increases as low as possible.

The Manitoba Decision

Manitoba Hydro ratepayers are facing massive increases to their electricity bills to pay for two large projects approved under the previous NDP government. The Keeyask dam project has faced increased costs and construction delays and is currently estimated to cost $8.7 billion, The Bipole III transmission line was constructed to add reliability to Manitoba Hydro's electricity grid, and to facilitate the transmission of more power to southern markets, including the United States. It came into service last year at a capital cost of $4.8 billion.

Paying the net debt service costs on $13.5 billion will be difficult for the customers of Manitoba Hydro. The original plan to sell the new power in the United States market is now highly unlikely because of the low cost of natural gas and renewal sources to generate electricity in that market. The two projects are obvious examples of stranded assets.

Anticipating the need for a large increase in domestic rates to fund the capital projects, as early as 2013 the PUB ordered that a portion of the subsequent years rate increases

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[1] http://www.pubmanitoba.ca/v1/proceedings-decisions/orders/pubs/2019-orders/69-19.pdf The Crown corporation services approximately 820,000 residential electricity accounts compared to some 1.8 million residential accounts serviced by B.C. Hydro.

be set aside to moderate the impact of Bipole III on the rate base.[2] By the end of FY2017/18, Manitoba Hydro had accumulated $348 million for this purpose. In its 28 May 2019 decision, the PUB ordered that all of the new revenue generated from the 2.5% rate increase be placed in a major capital projects deferral account as a way to smooth the transition to higher rates.

The accumulated deferred revenue is far from sufficient (even with the additional 2.5%) to off-set the anticipated rate increase required to pay the net cost of the two major projects. However, it will help avoid a major rate shock for the customers of Manitoba Hydro, allowing for a more gradual increase in rates.

Proactive Rate Setting

The PUB, like most independent utility regulators, uses the Cost of Service model to establish rates. This method ensures that all prudently incurred costs incurred by the utility are covered in the rates, as well as a reasonable return on equity for the shareholders. This implies that rates are not increased until the cost is incurred, or when a major capital project enters service.

However, the PUB varied the rate setting model to front-load some of the expected increase to smooth the transition to higher rates. It stated that:

> As the known costs of these major new generation and transmission capital projects will form a significant part of Manitoba Hydro's revenue requirement beyond the test year, it is appropriate to take steps today to assist in mitigating future rate increases. This is consistent with the Board's longstanding concern that customer rate changes should be on a stable and predictable basis. Without implementing rate smoothing through a rate increase in the test year, combined with the capital costs of Bipole III ..., the costs associated with Keeyask and the potential for those costs to enter into Manitoba Hydro's 2020/21 revenue requirement could lead to rate shock for consumers.[3]

The PUB also decided that the rates should be adjusted between the three main rate classes (Residential, Commercial and Large Industrial) to move toward the rate revenue from each class equaling the cost of the service. The PUB considers a zone of 95% to 105% to be reasonable.[4] However, it did not seek even more rate revenue to decrease the high debt liability burdening Manitoba hydro's (and by extension the province's) financial statements.

[2] All of the 3.36% revenue increase for both 2017 and 2018 went to the deferral revenue account, see https://www.hydro.mb.ca/corporate/ar/pdf/annual_report_2017_18.pdf p. 92.
[3] http://www.pubmanitoba.ca/v1/proceedings-decisions/orders/pubs/2019-orders/69-19.pdf p. 18.
[4] http://www.pubmanitoba.ca/v1/proceedings-decisions/orders/pubs/2019-orders/69-19.pdf p. 33.

B.C. Government Placates Current Ratepayers

Unlike the situation in Manitoba, where an independent third-party regulator sets the rates for Manitoba Hydro, in this province the provincial government has been directing the B.C. Utilities Commission (BCUC) to set specific rate increases since 2012.[5] The previous Liberal government made extensive use of regulatory accounting to keep rates artificially low by deferring expenditures, and since 2014 by recording unbilled and uncollected revenue to inflate B.C. Hydro's equity and net income (which is recorded as government revenue).[6] This manipulation resulted in a benefit for current ratepayers while increasing the debt liability for future generations of ratepayers.

The NDP condemned the financial manipulation when it was in opposition, as did Auditor General Carol Bellringer when she qualified the province's financial statements for 2016/17 and again for 2017/18. When the NDP formed government, it was aware of the poor finances at B.C. Hydro. Yet the NDP had campaigned on the promise to make life more affordable for the citizens of the province. Ignoring the auditor general's qualification, the government (through the utility) asked the B.C. Utilities Commission to eliminate the 3% rate increase planned for 1 April 2018, and add the foregone $140 million revenue to the rate smoothing deferral account. This was correctly denied by the Commission.

After this initial misstep, the government decided to use some of its surplus to begin to fix the worse example of the financial manipulation. In August 2018, finance minister Carol James announced that $950 million in 2017/18 year-end surplus funds would be set aside as a "prospective adjustment" for addressing the auditor general's concerns with the accounting practices at the public power utility.[7]

In mid-February 2019, energy minister Michelle Mungall announced several decisions respecting B.C. Hydro's financial plan for the next two years, as well as a promise to restore the BCUC's authority to regulate the public monopoly after two years. The provincial budget released days later included further funding to end the practice of recording future unbilled and uncollected revenue, but the other regulatory accounts were still in place to ensure that the government-mandated net income target of $712 million was achieved.[8] The NDP government had rescinded the previous government's

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[5] The government excluded B.C. Hydro from the requirement to have an independent regulator approve the regulatory/deferral accounts; see https://ojs.library.ubc.ca/index.php/bcstudies/article/view/187787/186354

[6] https://thetyee.ca/Opinion/2017/10/24/Will-NDPEnd-BC-Hydro-Wild-West-Accounting/?utm_source=daily&utm_medium=email&utm_campaign=241017

[7] http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_deferral_reversal_31_august_2018/pdf/commentary_deferral_reversal_31_august_2018.pdf

[8] https://www.bchydro.com/content/dam/BCHydro/customer-portal/documents/corporate/regulatory-planning-documents/service-plans/bchydro-service-plan-2019-201902.pdf Even after the elimination of the rate smoothing regulatory account the net balance of the deferred "assets" was equal to the corporation's equity; in other words, if all the accounts were to be closed B.C. Hydro would be insolvent.

highly prescriptive directive to the BCUC, but still restricted the regulator's discretion to set B.C. Hydro's rates or rebalance the rates between classes of ratepayers.[9]

Prefers Short-Term Rate Relief

The NDP government's decision on B.C. Hydro's short-term rate increases was clearly intended to fulfill the election pledge of keeping rate increases as low as possible. While operating costs are expected to rise by approximately 10% during 2019/20 the government announced that rates would increase by only 1.8%.[10] The small rate increase is the result of cancelling a 5% regulatory account retirement surcharge already in the rate base to fund operating costs,[11] and using approximately $330 million (spread over two years) in one-time windfall saving available from an accounting change to keep the rate increase artificially low.

By repurposing the 5% surcharge to cover operating cost increases, and committing the one-time savings to immediate rate relief rather than reducing borrowing requirements, the minority government claimed it was fulfilling its election promise to make life more affordable. Putting a higher priority on rate relief rather than reducing the need for additional debt clearly shows that the government is more concerned with avoiding any public (and corporate) backlash over the rising cost of electricity. The rapid increase in the cost of electricity in Ontario was a major factor in the defeat of the Liberal government in the June 2018 election.

The NDP government had the option of raising rates more rapidly in order to improve the financial health of B.C. Hydro by reducing the growth in debt, and debt servicing costs. Like Manitoba Hydro, B.C. Hydro faces growing debt service costs resulting from major past and planned capital expenditures. It cannot rely on growing domestic sales to generate new income, nor on higher profits from trading or surplus sales. The $10.7 billion Site C project will come on stream in the next four to five years, and could require a 6% to 7% rate increase to cover operating losses during the first decade of operation.[12]

The Manitoba government has not seen fit to interfere with the independence of the PUB. While professing to restore rate making authority to the BCUC the government announced that not only would the BCUC be required to set rates to achieve a high net income target and that all the existing regulatory accounts would continue to be funded.

The government also continued the previous government's prohibition on the BCUC rebalancing rates to better match the revenue by major customer class with the cost of

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[9] B.C. Hydro was required to use Canadian public sector accounting standards beginning in 2018/19. These standards require and independent third-party regulator to approve regulatory (deferral) accounts.

[10] http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_67_bc_hydro_finances_6_march_2019/pdf/occasional_paper_no_67_bc_hydro_finances_6_march_2019.pdf

[11] The Deferral Account Rate Rider was added to the rates to pay down the certain regulatory balances.

[12] Assumes $10.7 billion amortized over 70 years at 4.5%, plus water rental and operating costs, and all power sold at 40% of the cost.

servicing these customers. Currently, large industrial customers are paying 100% of the cost of service, while commercial businesses are paying 123.5%. The 1.8 million residential customers are the big winners as their rates cover only 90.8% of their costs.[13]

The populist approach to rate-setting was clear when the government stated that ”a near-term rebalancing of BC Hydro’s rates could conflict with government’s commitment to keep life affordable for British Columbians. The decision to prohibit rate rebalancing is a matter of public policy.”[14]

Summary

The NDP government’s decision to keep B.C. Hydro’s rate increases low for 2019 and 2020 continues the rate suppression policy of the previous Liberal administration. Even the credit rating agency Moody’s Investor Services has recycled the warning about B.C. Hydro’s debt level that it used with the prior administration.[15]

Instead of using a unique accounting system and a dubious deferral account to record unbilled revenue and keep rate increases below the growth in costs and increasing the corporation’s debt, this government is now committing the 5% debt repayment surcharge and a significant windfall accounting surplus to reduce the indicated rate increase for the next two years. In doing so it has passed up the opportunity to improve the financial health of our public utility by reducing the debt liability faced by future generations of ratepayers.[16] But these future customers are not current voters.

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[13] https://www2.gov.bc.ca/assets/gov/farming-natural-resources-and-industry/electricity-alternative-energy/electricity/bc-hydro-review/final_report_desktop_bc_hydro_review_v04_feb12_237pm-r2.pdf p. 19.

[14] Ibid., p. 20.

[15] https://www2.gov.bc.ca/assets/gov/british-columbians-our-governments/government-finances/debt-management/bc-credit-rating-moodys.pdf See also https://vancouversun.com/opinion/columnists/vaughn-palmer-hydro-icbc-worry-credit-rating-agencies-even-as-they-laud-b-c-finances

[16] The federal bank regulator just increased the capital reserve levels of the national banks to strengthen their balance sheets. The Manitoba regulator has adopted this prudent course, but the B.C. government has not; see https://www.theglobeandmail.com/business/article-regulator-again-raises-banks-capital-buffer-says-risks-remain/