COMMENTARY **B.C. HYDRO**

NEW B.C. HYDRO FINANCING PLAN: SMALL COURSE CORRECTION WITH MORE DISCRETION RESTORED TO REGULATOR

On 14 February 2019, the government released the results of the review of senior officials into the finances of B.C. Hydro.[1] The recommendations were developed by senior government and B.C. Hydro staff and focussed on two key short-term challenges; a) meeting the NDP government's pledge to develop an affordable plan to increase electricity rates, and b) addressing Auditor General Carol Bellringer's objection to the accounting practices at B.C. Hydro (specifically the lack of an independent regulator to approve regulatory accounts as required by generally accepted accounting standards).

The previous day the government released a comprehensive, and in parts controversial, report on the financial impact of the previous government's policy of requiring B.C. Hydro to purchase privately generated electricity from Independent Power Producers (IPPs).[2]

By releasing the two reports almost simultaneously the government was able to link the financial difficulties facing B.C. Hydro to the expensive IPP purchases. As a general statement there is some truth in the association. However, because most of the IPP expenditure is already included in B.C. Hydro's current rates (the rate base) it is not accurate to suggest that all the future financial pressures are due to the IPP contracts.

The senior officials' report was intended to review and revamp the final five years of the current 2014 to 2023 rates plan, and to recommend "enhanced regulatory oversight" of B.C. Hydro.[3] As an integrated power utility B.C. Hydro operates generating stations, transmission lines and retail distribution networks throughout the province, while its trading subsidiary Powerex also adds another dimension of complexity to the operation.

The previous government abused deferral accounts to manipulate the finances to generate profits (net income) and dividends for the government while keeping electricity rates below the cost of service. The result was an increase in the corporation's debt obligation, which was disproportionately placed on future generations of users. The previous government was heavily criticized by the NDP for the abuse of the deferral

[1] 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
[2] https://news.gov.bc.ca/releases/2019EMPR0003-000228
[3] 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. 1.

accounts, especially for recording and deferring future revenue.[4] Once in power it would have been hypercritical, therefore, to perpetuate the accounting practices.

PART I -- The 2019 to 2023 Rate Plan

The last five years of the previous government's rates plan suggested that rates would rise by an average of 2.6% per year, or a cumulative increase of 13.7%. This pre-election plan was unrealistic as it assumed that B.C. Hydro could cover its cost increases to 2023/24, and pay-off approximately $1.5 billion of the Rate Smoothing Regulatory Account (RSRA), with a cumulative rate revenue increase of approximately $700 million.

The government accepted the recommendation that the new five-year rates plan would see rates rise by a cumulative 8.1%, with the 2019 increase set for 1.8%. The government believes that the lower rate increase is achievable because it is providing taxpayer funding to eliminate the RSRA in 2018/19 (using $950 million from 2017/18 funds and a further $190 million for 2018/19 funds[5]), and it will reduce the 5% surcharge (the deferral account rate rider) already incorporated in the rate base to zero for the next five years. This redirection of the surcharge from one-time repayments of the deferral balances to cover ongoing cost increases helps explain the difference in the two approaches.[6]

Some small reductions in the capital expenditure plan were announced, but the government has stated that it will not reduce the $712 million net income requirement for the next two years,[7] and it provided no commitment to reducing the annual water rental expectation of approximately $320 million. Thus, other than the $190 million taxpayer-funded payment for 2018/19, the finance minister has avoided any disruption to the government's fiscal plan (and continues to record B.C. Hydro's net income as revenue when no cash has been transferred).

So, if B.C. Hydro's expenditures are rising as approximately 33%-36% over the five years, and the net income target is fixed (at least for 2019 and 2020), and revenues increase by only 10% (8.1% from the rate increase and 1.9% from additional sales), the repurposing of the regulatory account payment surcharge (a cumulative 27% increase) would appear to balance the ledger.

The government has made the choice to cease paying down the high value of the regulatory balances (mostly debt financed) and re-direct the 5% surcharge to fund

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[4] In 2015/16, for example, the net value of the regulatory assets was 131% of the declared equity; without the deferrals B.C. Hydro would have been insolvent.

[5] We must wait for the 2018/19 annual report to see how the write-off will be recorded on B.C. Hydro's financial statements.

[6] We need to see the detail that will be included in the detailed rate request for 2019 and 2020.

[7] 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. 17.

operating cost increases. This scheme avoids raising rates as quickly as would have been necessary if the surcharge revenue continued to pay down the regulatory balances, but it also means that B.C. Hydro carries a higher debt for a longer period. The debt to equity picture may be brighter, but this will worsen again as Site C comes online.[8]

A more detailed picture of the revenue and expenditure forecast will be soon available when B.C. Hydro files its 2019 and 2020 rate application with the BCUC. This should provide more detail about planned changes to specific deferral accounts.

Moratorium on More Private Power

The government is indefinitely suspending further purchases of electricity from Independent Power Providers, save for minor exceptions. This continues the previous government's policy and it should not reduce current expenditures. In fact, additional IPP costs will be incurred in the medium term as all the currently contracted power comes onstream.[9]

PART II Dealing with the Issue of Regulatory Independence

The previous Liberal government became adept at keeping the façade of an independent regulator while issuing prescriptive cabinet orders to manipulate the finances of B.C. Hydro to suppress short term rates yet still report healthy profits. This cynical approach was evidenced by creating a unique accounting standard to allow the use of deferral (or rate-regulated) accounts without the approval of an independent regulator, extending to recording future unbilled revenue to attain the net income targets regardless of the actual level of revenue less expenditures.

In 2017 Auditor General Bellringer cited the lack of standard public sector accounting at B.C. Hydro as a reason to qualify the province's 2016/17 financial statements. The following year, when she again qualified the 2017/18 statements, the NDP government agreed with her opinion and set aside taxpayer funding to begin to correct the financial excesses at the power utility. In February 2019 the auditor general released her report on the use of regulatory accounting at B.C. Hydro, which provided a useful high-level summary of how the government had stripped the regulator of its discretion to set electricity rates based on the cost of service model. Her sole recommendation was for the government to restore Canadian public sector generally accepted accounting principles (GAAP) to the accounting at B.C. Hydro.[10]

To use public sector GAAP accounting requires the return to an independent regulator overseeing the deferral accounts at B.C. Hydro. The government has promised to restore the BCUC's independence, and has rescinded the prescriptive 2014 Direction 7 and

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[8] The report of the senior officials did not contain a debt forecast for the next five years, but did forecast a debt the equity ratio dropping to 76/24 by 2023/24, see Ibid. p. 22.
[9] Ibid., p. 23.
[10] http://www.bcpolicyperspectives.com/blog/posts/auditor-general-bellringer-details-concerns-with-b

ordered the winding-up the worse rate manipulation scheme – the rate smoothing deferral account.

The requirement that the BCUC set rates to achieve the $712 million net income target for 2019/20 and 2020/21 is clearly contrary to the claim that the government is "re-empowering" the BCUC, as is the two-year prohibition on re-balancing the rates between residential and commercial users.[11] It seems that the government, in promising to reinstitute regulatory independence as required by GAAP, is adhering to St. Augustine's dictum about chastity.

Ordering the BCUC to ensure that the corporation generate a specific net income for the next two years protects the government's revenue target for the next two fiscal years (even though no actual cash is transferred from B.C. Hydro to the government).[12]

Because of B.C. Hydro's central role in the government's economic development agenda (including the promotion of green power) the government has also reserved the option of directing the regulator where issues have implications for government policy. Specific restrictions were listed in a backgrounder to the release of the government's statement.[13]

Finding a balance between regulating the power monopoly to protect the financial interests of the utility and its customers, and still allowing government the mechanism to achieve larger public policy objectives, has sometimes been difficult.[14] It remains to be seen whether the government will have the same degree of confidence in the BCUC after it makes decisions on B.C. Hydro's rates or other matters that are contrary to the government's desires.

Summary

In September I speculated on the possible outcomes of the phase 1 review of B.C. Hydro's rates for the final five years of the rate plan.[15] On balance, the result appears creditable.

The government's revised rate plan relies on the redirection of some $250 million in current revenue intended to pay down deferral balances (or debt in general) to covering

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[11] This was justified because raising residential rates would "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." Ibid. p. 20.

[12] If there is a variance in the net income at year end it is unclear how B.C. Hydro will account for the variance in the absence of the rate smoothing deferral account. Perhaps future revenue will be recorded in the Non-Heritage deferral account as was the practice until this future revenue was recorded in the rate smoothing deferral account.

[13] https://news.gov.bc.ca/releases/2019EMPR0004-000231 Perhaps the most important is the absence of an integrated resource plan for two years, which allows time for the development of the second phase of the B.C. Hydro review.

[14] See the 2014 report of the task force which reviewed the independence of the BCUC; http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_15_bcuc_independence_27_october_2016/pdf/occasional_paper_no_15_bcuc_independence_27_october_2016.pdf

[15] http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_62_23_september_2018/pdf/occasional_paper_no_62_23_september_2018.pdf

operating cost increases. The feasibility of the five-year rate plan, and its impact on the corporation's level of debt, can only be determined when B.C. Hydro files its detailed justification with the BCUC. It may decide that a higher rate increase is necessary to protect future generations from an unequal apportionment of the debt liability.

We will also await the opinion of the auditor general as to whether the government's moves to restore most of the regulatory authority over B.C. Hydro to the BCUC satisfy her requirement respecting the need for regulatory independence.

The NDP government has moved a long way toward a new and more balanced relationship with the BCUC respecting the oversight of the monopoly power utility. It will be interesting to observe how all the parties adjust to their new roles during the years to come. Of particular interest will be the degree of independence that the government will tolerate from the regulator before adopting former energy minister Bill Bennett's belief that "a group of unelected bureaucrats and lawyers" should not be deciding important issues related to energy policy in the province.[16]

   http://www.bcpolicyperspectives.com/

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.

[16] https://www.theglobeandmail.com/news/british-columbia/bc-hydros-site-c-dam-faces-fiscal-regulatory-minefield/article15579932/ See also https://www.timescolonist.com/opinion/columnists/les-leyne-hands-on-then-hands-off-over-and-over-1.23636464 .