

BC HYDRO DRAMATIC DROP IN SALES BUT CLAIMS TO BE IN A STRONG FINANCIAL POSITION

On Monday BC Hydro released a report on how it was responding to the decline in sales resulting from reduction in economic activity caused by the efforts to contain the COVID-19 pandemic.¹ The report, entitled “Demand Dilemma,” stated that the public utility was well positioned to deal with the loss in revenue. “Demand for electricity in the province is a key factor in BC Hydro’s rates—when electricity load falls, it puts upward pressure on future rates to ensure BC Hydro recovers its costs. Despite this uncertainty, BC Hydro is in a financially strong position that will allow it to manage through and emerge from the COVID-19 pandemic”²

Does BC Hydro enjoy a strong financial position? Not according to Moody’s Investor Services, which has been warning for years that BC Hydro has some of the weakest financial metrics of all public energy utilities in Canada. In its July, 2019, report Moody’s continued to express concern about BC Hydro’s high debt levels.³

Part of the explanation for BC Hydro’s high debt load is the large cost of capital expenditures during the last decade. In addition, the large number of regulatory (deferral) accounts, used to moderate rate changes and protect the profit target set by the government, have also increased the debt burden.

Most of BC Hydro’s equity is composed of the net balance in its deferral accounts. As of the third quarter of 2019/20 BC Hydro reported equity of almost \$5.3 billion, but 85% of this was the net assets in the deferral accounts. This ratio is much higher than other utilities in Canada. Because of the decline in interest rates in March, and the drop in the financial markets, it is likely that BC Hydro’s 2019/20 year-end report will show a much higher ratio of deferral assets to total equity.⁴

¹ <https://business.financialpost.com/news/local-news/covid-19-b-c-hydro-sees-steepest-drop-in-energy-demand-since-2008-recession/wcm/22817fb6-5643-4b83-8468-6c70a842a57f>

² The primary focus of the report was on the management (including spilling) of the water reserves. It noted that since mid-March the total domestic demand for electricity had dropped by 10%, a far larger loss than the 5% decline experienced the 2008 recession;
https://www.bchydro.com/content/dam/BCHydro/customer-portal/documents/news-and-features/BC%20Hydro%20Report_COVID19_DemandDilemma.pdf p. 3.

³ <https://vancouversun.com/opinion/columnists/vaughn-palmer-hydro-icbc-worry-credit-rating-agencies-even-as-they-laud-b-c-finances/>

⁴ Pension assets will decline, and the interest rate hedging losses will increase. Both are deferred.

BC Hydro Plans to Replace Lost Sales Revenue with More Debt

The Demand Dilemma document implies that the lost revenue would be recorded as revenue received and deferred in the cost of energy accounts. This will add to the debt faced by future ratepayers, but the report stated that BC Hydro has a high credit rating, implying that this extra debt would be manageable.⁵

While the 11 May 2020 report did not state that the electricity sales losses would be offset by the recording of unearned revenue, BC Hydro was explicit about this issue in a 1 April 2020 filing with the BC Utilities Commission. In response to the COVID-19 revenue decline BC Hydro advised the BCUC that it will be recording the lost revenue to protect the \$712 million profit target:

The extent and duration of the impacts of the pandemic on BC Hydro's revenues and costs are uncertain. However, BC Hydro's regulatory accounts will mitigate much of the uncertainty caused by the pandemic by capturing variances from forecast which can then be returned to or recovered from customers in the next test period in accordance with existing BCUC orders. For example:

- Any impacts to cost of energy or load (e.g., potential declines in the commercial sector load) will be recorded in the Cost of Energy variance accounts.⁶

Why Not Cut the Profit Target?

BC Hydro, acting on orders from the cabinet, is using the deferral accounts to protect the \$712 million profit target from the loss in sales caused by the pandemic. This adds to the already high debt liability faced by future ratepayers. It also employs questionable accounting in recording unearned revenue and creating a regulatory asset on its balance sheet.

In my commentary of 26 April 2020, I suggested that the government should prevent BC Hydro from recording the unearned revenue and allow the revenue to drop, thereby decreasing the net income for 2020/21.⁷ Compared to the deferral approach, reducing the net income will result in less debt liability faced by future ratepayers. It will also provide a more honest representation of the utility's financial position.

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<http://www.bcpolicyperspectives.com/>

⁵ Actually, the province – not BC Hydro – has a high credit rating.

https://www.bchydro.com/content/dam/BCHydro/customer-portal/documents/news-and-features/BC%20Hydro%20Report_COVID19_DemandDilemma.pdf p. 4.

⁶ https://www.bcuc.com/Documents/Arguments/2020/DOC_57721_2020-04-01-BCH-FinalArgument.pdf p. 596.

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http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_bc_hydro_inoculated_from_covid_19_26_april_2020/pdf/commentary_bc_hydro_inoculated_from_covid_19_26_april_2020.pdf

