OCCASIONAL PAPER 31   ONTARIO'S NEW ELECTRICITY PRICE SUBSIDY

ELECTRICITY RATES IN ONTARIO

In the last five years, peak electricity prices in Ontario have increased by approximately 70%, sparking public concern and a drop in the popularity of the Ontario Liberal government.

In response, the government has proposed a 25% reduction in the average electricity bill, beginning in 2017.[1] This will be accomplished through the elimination of the provincial 8% sales tax, and through a smoothing of the revenues through an accounting device like that employed by the BC government to suppress BC Hydro rates.

Ontario's independent budget officer, officially known as the Financial Accountability Office (FAO), analyzed the financial implications of the government's new "Fair Hydro Plan" in a report released on May 24, 2017.[2] BC does not have a similar financial officer to provide independent advice to the elected representatives.

THE FAO REPORT

The FAO costed the government's plan from 2017 to 2045. The planned electricity rate increase for 2017 will be reduced by 25%, and the increases for 2018 to 2021 will be limited to the rate of inflation. From 2021 to 2027, the annual rate increase will be capped at 6.8%. For the remaining years of the plan (2028 to 2045) the FAO estimates that ratepayers will pay 4% more than would have been the case using a status quo approach.

The net cost to Ontario taxpayers of the new financing scheme is $45 billion, and will result in savings of $24 billion to residential and commercial customers.[3]

	Cost to Taxpayers	Cost to Customers
Sales Tax Foregone	$42	($42)
Refinancing Deferral	$0	$21
Rate Relief	$ 3	($ 3)
Total	$45	($24)

[1] http://news.nationalpost.com/full-comment/national-post-view-kathleen-wynnes-liberals-bail-themselves-out-with-public-money-again
[2] http://www.fao-on.org/en/Blog/Publications/Fair_hydro
[3] These two user groups represent some 90% of all electricity customers, but only 50% of the sales or load.

The largest savings to ratepayers results from the elimination of the 8% provincial sales tax (HST) from residential and commercial bills, which will cost the government some $42 billion in foregone tax income.[4],[5]

The refinancing/deferral essentially reduces the rates that would have been charged by 25% for four years, and limits the increase to 6.8% for a further six years. The foregone revenue is accumulated in a new regulatory/deferral account, with the balance (plus interest) paid down until 2045. The three sub-periods are shown in Section 3 of the FAO report.

The FAO notes that while most current customers will see an immediate reduction in their electricity bills, the overall cost is higher due to the interest payments on the deferred revenue, which will be borrowed.

DOES THE SCHEME CONFORM TO ACCOUNTING PRINCIPLES?

The revenue deferral/refinancing scheme involves a complex transfer of borrowing between two public electricity entities that would make a Columbian drug cartel accountant envious.

The plan requires the creation of a regulatory/investment asset account that will produce income in future years (the surcharge on rates from 2028 to 2045). The FAO has expressed doubts that the scheme conforms to generally accepted accounting principles (GAAP), because the entity holding the asset does not provide the electricity (see Appendix C of the report).

The Ontario Auditor General stated that the plan is deceptive but legal.[6]

RATE SMOOTHING AT BC HYDRO

The BC government-directed BC Hydro is an old hand at using the opportunity presented by regulatory/deferral accounting to set electricity prices below the true cost, and turning debt into equity. As early as FY2007/08 BC Hydro began to defer the variance between forecast and actual revenue to its Non-Heritage Deferral Account (NHDA).[7]

[4] http://business.financialpost.com/news/energy/ontario-will-spend-45-billion-to-save-ratepayers-24-billion-on-their-electricity-bills-watchdog-says.

[5] In the 2017/18 budget the government announced that the 7% sales tax on electricity sales to large industrial customers would be eliminated over two years at a cost of $164 million.

[6] http://news.nationalpost.com/news/canada/canadian-politics/david-reevely-ontario-liberals-jiggery-pokery-on-the-hydro-file-means-savings-plan-will-cost-twice-as-much-as-it-saves

[7] By FY2013/14 approximately $520 million had been deferred.

In late 2013, the BC government announced a 10-year financing plan for BC Hydro which relied on a new Rate Smoothing Regularity Account (RSRA) to keep electricity rate increases below the true increases in costs. The BC Utilities Commission, the formally independent regulator, was ordered to approve the RSRA in March 2014 as part of a highly prescriptive set of cabinet orders.

The following summarizes the government approved increases for fiscal years 2013/14 to 2019/20, with the equivalent (2016 dollars) increases that have been, or will be, deferred.

	2014	2015	2016	2017	2018	2019	2020
ALLOWED	9.0	6.0	4.0	3.5	3.0	2.6	2.6
NHDA	3.2	4.8	6.3	--	--	--	--
RSRA	3.9	2.8	4.9	6.7	7.0	9.5	2.3
TOTAL	16.1	13.6	15.2	10.2	10.0	12.1	4.9

Source: BC Hydro F17 to F19 Rate Request, Table 7-2, p. 7-6.

By FY2021/22 the RSRA will have a balance of $1.59 billion, which BC Hydro states will be paid-off within three years, although no mechanism has been identified to accomplish this feat.

DOES BC HYDRO'S APPROACH CONFORM TO GAAP?

The FAO listed three key conditions required to assess whether the recording of a regulatory deferral (the asset) conforms to the US GAAP.[8]

> The entity's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers.

BC Hydro was exempted from this requirement by a 2011 cabinet order.[9] The government has been approving the rate increases since 2012.[10]

> The regulated rates are designed to recover the specific entity's costs of providing the regulated services or products.

[8] Most regulated power utilities in Canada use the American accounting standard.
[9] http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_21_30_january_2017/pdf
[10] http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_15_bcuc_independence_27_october_2016/pdf

BC Hydro's rates do not recover its costs.

> It is reasonable to assume that rates set at levels that will recover the entity's costs can be charged to and collected from customers.

BC Hydro has not identified a recovery mechanism to recover the RSRA balance, and it is unreasonable to expect that the 2.6% average increase indicated for 2019 to 2023 is sufficient to recover the $1.59 billion balance planned for FY2020/21 over the following three years.[11]

In June 2016, Adrian Dix asked Auditor General Carol Bellringer whether BC Hydro's practice of recording future unbilled revenue conformed to generally accepted accounting principles.[12] The Auditor General has not publicly commented on the practice -- even to agree with her Ontario counter-part that it is deceptive.

 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 ICBC's rate requests, and is an intervener in the Commission's current reviews of ICBC and BC Hydro rate requests.

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11 http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_25_12_march_2017/pdf

12 https://thetyee.ca/News/2016/06/10/BC-Hydro-Misleading-Accounting/?utm_source=daily&utm_medium=email&utm_campaign=100616