OCCASIONAL PAPER No. 45 BC HYDRO

GOVERNMENT FREEZES HYDRO RATES FOR 2018: CONTINUED POLITICALIZATION, OR PART OF A LARGER FINANCIAL REFORM AGENDA?

What does the government's announcement that it will not proceed with the planned 3% increase in BC Hydro rates scheduled for 1 April 2018 indicate about its approach to fixing the deteriorating finances of the public's electricity corporation?

At first blush, the decision (subject to approval by the BC Utilities Commission) to add the estimated $150 million revenue shortfall to the Rate Smoothing Regulatory Account (RSRA) contradicts the NDP's criticism of the previous Liberal government's practice of recording and deferring future unbilled revenue.

It also runs counter to the Auditor General's recent opinion that the use of "prescribed" accounting at BC Hydro is contrary to Canadian public sector accounting standards.

AFFORDABILITY

Michelle Mungall, the minister responsible for BC Hydro, stated that the rate freeze fulfills the NDP's election campaign promise to freeze electricity rates, although the government ignored a similar promise when it announced significant increases[1] in ICBC rates, effective 1 November 2017.

Both "self-supporting" Crowns are facing a serious deterioration in their finances caused by the previous government's rate suppression policy; as exhibited by the rapid increase in debt at BC Hydro, and a continuing loss of the capital reserve at ICBC.

Perhaps the new government has a broader agenda as it considers the impact of rising electricity prices on the continuing viability of industrial consumers, especially the financially-stressed pulp and paper companies that consume massive amounts of electricity. The 3% rate freeze will allow the large industrial to avoid some $25 million in additional input costs.[2] The announced phased elimination of the 7% provincial sales tax on electricity purchases will also improve the finances of these firms.

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[1] Basic rates increased 6.4%, while an increase of 9.6% on Optional rates will be phased-in over 12 months; ICBC forecast that a 20% increase in Basic rates was required to keep the capital reserve at the minimum level, but the shortfall will be covered by a $470 million capital transfer from the already under-resourced Optional program.

[2] BC Hydro reported $770 million in revenue from large industrial consumers in 2016/17, see https://www.bchydro.com/content/dam/BCHydro/customer-portal/documents/corporate/accountability-reports/financial-reports/annual-reports/bchydro-2016-17-annual-service-plan-report.pdf p. 22.

The minister stated that foregoing the 3% increase would make life more affordable for BC Hydro's customers.[3] But by adding up to $150 million, plus interest, to BC Hydro's already high debt the government is following the practice of the former Liberal government -- suppressing rate increases for current customers while increasing the debt burden faced by future customers.

AUDITOR GENERAL'S OPINION

In recent years the BC auditor general has disputed the government's interpretation of the national public sector accounting standards related to the timing of revenue recognition of certain transfers. However, this year the auditor general added an important reason to qualify the government's presentation of the 2016/17 financial statements. Auditor General Bellringer found that the regulatory accounting at BC Hydro is not acceptable because of the lack of an independent third-party regulator.[4]

Beginning in 2012, the Liberal government has set BC Hydro's annual electricity rate increases below the level required to match the increase in the utility's costs. In 2014, as part of a highly prescriptive cabinet order, the Crown corporation was required to record and defer unbilled and uncollected revenue in the new rate smoothing account to continue the annual rate subsidy and still produce high net income levels.

This practice also violates a fundamental accounting principle; revenue should be recorded when received. This was one of the criticisms of the Ontario auditor general when she disputed the accounting scheme designed to reduce electricity prices in that province.[5]

PLANNED FINACIAL REVIEW OF BC HYDRO

Minister Mungall stated that the $150 million increase in BC Hydro's debt is likely a short-term problem, as a planned financial review is expected to find cost savings; she said, "we know there are savings to be had there...."[6]

Practically all of BC Hydro's expenditure categories have deferral accounts, therefore any cost reductions will result in a reduction in the net balance outstanding. The low interest rate environment of recent years has resulted in lower than planned expenditures on interest payments on BC Hydro's outstanding debt, but most of the other cost categories have increased (adding to the cost variance deferrals).

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[3] http://vancouversun.com/news/local-news/b-c-government-puts-a-freeze-on-b-c-hydro-rates
[4] http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_44_26_october_2017/pdf

[5] http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_43_22_october_2017/pdf
[6] http://vancouversun.com/news/local-news/b-c-government-puts-a-freeze-on-b-c-hydro-rates

The minister also acknowledged that the existing deferral accounts will be within the scope of the planned financial review. She seemed to down-play the auditor general's qualification, saying that this required the government to "look at those deferral accounts and get them into order."[7]

Unlike a former auditor general's 2011 criticism of the number and size of the accounts, Auditor General Bellringer has stated that the whole scheme is unacceptable because the regulator is not independent. If all the deferral accounts were eliminated, BC Hydro would have negative equity (a polite term for insolvency) and the government would likely face a heightened possibility of downgrade from the credit rating agencies.[8]

TAXPAYER BAILOUT?

Why impose a freeze now, which will further increase BC Hydro's debt? Is there a more comprehensive BC Hydro financing strategy under development?

Justine Hunter reported that the government may be considering transferring the estimated stranded cost of $3.8 billion Site C cost if the government decides to cancel this questionable capital project.[9] Perhaps the government is also planning to reduce a portion of BC Hydro's deferred debt burden by transferring some of the net regulatory account debt from BC Hydro ratepayers to the taxpayer-supported direct debt.

Certainly a recent precedent exists with the NDP government's decision to transfer the Transportation Investment Financing Corporation's Port Mann bridge debt of $3.5 billion to the taxpayer-supported direct debt account.

But what if the government is also contemplating addressing the auditor general's finding that the deferral accounting scheme at BC Hydro is unacceptable because of the lack of an independent regulator?

If the government-mandated deferral accounts, including the RSRA, were wound-up by transferring the debt burden to the taxpayer-supported debt,[10] the government could restore the full rate-setting authority to the BC Utilities Commission (using the cost of service model to set rates), and resolve the auditor general's opinion that the regulator is not independent.

Such a transfer would reduce BC Hydro's assets and debt liabilities and bring its financial statements in line with other regulated power utilities. However, such a move

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[7] Ibid. For example, BC Hydro has yet to advise as to how the forecasted $1.59 billion net balance in the RSRA by fiscal year 2020/21 will be paid down by 31 March 2024, when no funding source has been identified.

[8] Eliminating the regulatory/deferral accounts would have eliminated some $5.9 billion in assets as of year-end 2017/18.

[9] https://beta.theglobeandmail.com/news/british-columbia/bc-hydro-feels-revenue-squeeze-while-ndp-commits-to-rate-freeze/article36889306/

[10] BC Hydro's massive pension solvency shortfall should be included in this transfer.

would not solve the problem that the current rate revenue is far below the amount required by BC Hydro to cover its current and projected costs. For 2018/19, for example, BC Hydro's 3% rate increase assumed that some $300 million (equivalent to a 6% rate increase) in unbilled and uncollected revenue would be recorded as received, and added to the RSRA.

To stabilize BC Hydro's finances the government must limit future cost increases (such as the operating impact of the Site C project), and raise the current rates to cover the public utility's forecasted costs.

Abandoning the already low 3% rate increase planned for April 2018, without other major structural changes, will add millions more to the debt liability faced by future generations of customers.

MEDIA REPORTS

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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 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 review BC Hydro's rate request.