

SUBSIDIZING ELECTRICITY RATES IN ONTARIO AND BRITISH COLUMBIA

The growing cost of electricity has become a major political issue in Ontario. On Monday, September 12th, the Ontario government announced a new 8% subsidy for residential electricity consumers, which a number of commenters have suggested is an attempt to dampen growing public anger over steep recent rate increases.¹ The new subsidy, which is estimated to cost taxpayers approximately \$1.0 billion annually, replaces a 10% subsidy which was in effect from 2011 to 2015. Rural residents will also receive an addition 20% discount, with the estimated \$285 million to be funded by urban ratepayers.

The rising price of electricity in Ontario has been attributed to growing fixed costs, longer-term lucrative contracts signed with private power suppliers, the cost of major capital expenditures, the move to “green” power generation, and falling demand for electricity.²

All of these cost drivers are being faced by BC Hydro, but the Liberal provincial in this province has not had to face the same degree of public opposition to rising electricity costs because the government in this province has chosen a different mechanism to suppress the true costs from current ratepayers.

Comparing The Two Provincial Approaches

The Ontario government has two Crown corporations that provide electricity. The Ontario Power Generation (OPG) corporation is responsible for the hydro dams, nuclear power and other forms of generation, which is sold to Hydro One (HO) which provides transmission and distribution to residents and businesses. In BC, these roles are combined within BC Hydro, which provides electricity to about 95% of BC residents and businesses.

In recent years both governments have been promoting “green” energy. Ontario has been closing coal-fired generation and relying on long-term contracts with private firms to supply new power generation. The BC government ordered BC Hydro to close the Burrard thermal power station, and has also required BC Hydro to sign long-term CPI-adjusted contracts with private power producers.

¹ <http://news.nationalpost.com/news/canada/canadian-politics/david-reevely-ontario-voters-get-electricity-bill-relief-as-kathleen-wynne-looks-for-self-preservation>
<http://www.theglobeandmail.com/news/national/ontario-liberals-promise-tax-break-on-hydro-bills/article31826751/>

² <http://www.theglobeandmail.com/news/national/ontario-liberals-expected-to-reveal-electricity-cuts-as-election-looms/article31821311/>

The Ontario government is in the process of privatizing part of Hydro One and using the sale proceeds to expand infrastructure. One important feature of the privation is that it has forced Hydro One to clean-up its finances to present a more favourable picture to potential private investors.³

The following comparison of certain aspects of the combined HO and OPG financial reports for the 2015 fiscal year to the 2015/16 BC Hydro results is illuminating.

As regulated power utilities all three use deferral accounting (also called regulatory accounting) to smooth year over year rate volatility. All three have their rates, in theory, regulated by an independent regulator. However, it is clear that the Ontario corporations have more healthy finances compared to BC Hydro.

	<u>2014</u>	<u>2015</u>
Net Deferral to Equity		
Ontario Combined	59.5%	43.3%
BC Hydro	130.3%	131.3%
Debt as Ratio of Equity		
Ontario Combined	82.9%	70.9%
BC Hydro	404.8%	404.7%

In Ontario, the 2015 net deferral balance of \$8.6 billion was \$1.5 billion lower than in the prior year mainly because the pension shortfall declined by \$1.2 billion, for a solvency ratio of approximately 86%, compared to 80.6% in 2014. For BC Hydro, the net deferral balance grew by almost \$480 million, and its pension solvency ratio was 75.5%.

Deferral accounting allows deferred costs to be recorded as assets which are included in the equity. In 2014, the BC government ordered BC Hydro to defer the difference between the forecast revenue required to cover costs (and generate the required net income), and the revenue produced by the lower rate increase. The total unapproved future revenue deferred for 2014/15 and 2015/16 totalled approximately \$790 million.

In 2015, the combined HO and OPG debt was approximately \$14.1 billion, while the equity recorded (including deferrals) was \$19.9 billion. For 2015/16, the equity for BC Hydro was \$4.5 billion (including deferrals) while the debt was \$18.2 billion. Little wonder that Moody's Financial raised concerns about the weak financial picture at BC Hydro.⁴

³ This may impair the ability of the OPG to use the HO dividends to pay its debt costs.

⁴ <http://vancouversun.com/opinion/columnists/vaughn-palmer-credit-report-sounds-alarm-over-bc-hydro-debt>, Moody's Financial said BC Hydro could raise rates, but now that the government is forcing BC Hydro to count future unapproved revenue to meet the net income targets why bother?

What Ontario Could Learn from the BC Approach

Unlike in Ontario, the BC government has kept the rising cost of electricity from becoming a source of public concern. Instead of passing on the true cost of electricity in the rates, the Liberal government in BC has enthusiastically exploited the opportunities created by the deferral accounting provisions and deferred to some future generation of ratepayers the true cost. When the demand (load) began to fall below the forecast levels, which threatened BC Hydro's net income used to calculate the government revenue and surplus, the government became more creative and ordered that the missing revenue be counted anyway.

Had the Liberal government in Ontario adopted the accounting practices used in this province it could have subsidized its ratepayers without adding to its direct debt. It could pretend that its electrical Crown corporations were generating high profits, while deferring costs and creating revenue. It would have resulted in a much higher debt burden for future electrical customers, but the public's power corporations are supposed to be self-supporting. That's what Moody's Financial believes anyway.

It is questionable that the Ontario Auditor General would have sanctioned such accounting measures.

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The writer is a retired senior BC government public servant who's paper on the 40-year financial history of ICBC was published by *BC Studies* in 2013. The same academic journal will be publishing his paper describing the BC government's manipulation of the finances of BC Hydro from 2008 to 2014 in the fall. He has been an intervener in the BC Utilities Commission's 2014 and 2015 reviews of ICBC's rate requests.