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Once over lightly for BChydro

A 'Review of BChydro' has been prepared by a panel of three of BC's top civil servants in response to the government's concerns about politically unacceptable increases in electricity rates, which would have amounted to 32.1% over the next three years. Completed in June, the report has just been released and the Premier has now decreed that the proposed rate increase be halved.

The review panel consisted of John Dyble, Deputy Minister to Premier Christy Clark; Peter Milburn, Deputy Minister to Finance Minister Kevin Falcon; and Cheryl Wenezenki-Yolland, former Provincial Comptroller-General.

The report is a lightweight piece of work that tiptoes carefully around the government's primary role in creating BChydro's problems. Granted, it would not have been easy to produce a comprehensive analysis of BChydro's extensive activities in such a short time. It's not surprising that the resultant report is uneven in emphasis, cautiously worded, and inadequately explained in many areas. But credit must be given for some insights, most of which need considerable further exploration.

Government-owned BChydro has a virtual monopoly on the supply and distribution of electricity in the province. It is regulated by the BC Utilities Commission (BCUC) through an annual review of its planned projects and its proposed customer rates.

Incremental Thinking

The review notes that BChydro budgets incrementally, rather than zero-based; focusing on cost increases over the previous year. All that seems to matter is the proposed increase in electricity rates. It takes no risks because it must not be seen to make any mistakes; it must obey the government's wishes, no matter what impact they may have on its primary function of supplying electricity reliably and economically.

As well as these responsibilities, BChydro must provide a constant stream of revenue to the government. In return,

as a Crown corporation, it does have the privilege of borrowing at the preferential rates enjoyed by the government.

Build New! Maintain The Old?

Two of BChydro's proposed projects, the building of the Site-C dam on the Peace River, and the system upgrades described as the Smart Meter Initiative, have been excused by the 2010 *Clean Energy Act* from BCUC oversight, which suggests that the government felt that their justification would not stand up to careful analysis (see also Editorial, page 4). The review is careful not to make any meaningful comment on them.

It does, however, note that BChydro's 'forced outage' numbers are too high, and that this may indicate aging infrastructure. But despite BChydro's insistence that its proposed rate increases relate to the need to maintain and upgrade its existing assets, the panel did not analyse the costs and manpower involved.

Government Energy Policy

The main task of an electrical utility is to ensure that the amount of power available exactly matches the amount of power demanded by customers at any time, and of course there are wide variations in demand: hourly, daily, seasonally and regionally. BChydro has many tools to do this; in addition to its heritage hydroelectric dams (which generate large and controllable amounts of electricity, and can be used as energy storage facilities), it can trade power with neighbouring states and provinces, and utilize wind and run-of-river generation.

BChydro is more fortunate than most utilities in its flexibility, both in sources and prices. This has been a major factor in BC's low electricity prices in the past 50 years. However, over the past eight years, the government has interfered mightily in BChydro's planning. Through the 2007 *BC Energy Plan* and the 2010 *Clean Energy Act*, the government has required that BChydro be 'self-sufficient' in power generation by 2016, and further that

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this self-sufficiency be achieved in the worst possible circumstances, a record low-water year. In addition, generating capacity for a further 3,000GWh must be built in BC as 'insurance'.

Legislation also requires that all new power be 'clean' and renewable. And, finally, that BChydro be barred from undertaking any new generation projects of its own, but that the additional power required be purchased from privately owned 'Independent Power Producers' (IPPs).

In a normal year, BChydro is virtually self-sufficient, but these requirements dictate a further 15% (7000-8000GWh) in generating capacity be available, and in high water years, as much as 14,000GWh could be surplus.

BChydro's Response

BChydro's reaction to these policies has been to build up its engineering staff, and negotiate 'take or pay' contracts with IPPs for power from wind and run-of-river generation sources. ('Take or pay' means that BChydro has to pay for the power generated by the IPPs, whether it is needed or not. Much of this electricity is generated at spring runoff, when it is not needed.) This has had the immediate effect of cost increases for electricity, since IPP power costs substantially more than either power from BChydro's heritage facilities or power purchased on the open market. (The latest estimate for purchased IPP power is \$124 per GWh, although only \$64 goes to the IPPs; the rest is BChydro's cost of connecting them. Current market prices for power range widely, from \$4.34 to \$52.43 per GWh.)

These provincial policies were legislated by the BCLiberal government, and are still in effect. The report, in an excess of timidity, does not go so far as to recommend that the policies be rescinded, but only that BChydro and the provincial government: 'Evaluate alternative definitions and timelines for government's self-sufficiency policy that meet the needs of the province and ratepayers in a way that is sustainable for the long term.'

Timidity rules again on IPP electricity purchases. The panel's recommendations call for 'weighted and defined evaluation criteria for bids on electricity purchase agreements are disclosed within competitive bid documents, to improve transparency, promote consistency and enhance vendor relationships', and that the financial viability of bidders be evaluated (30% of accepted bids are never executed). BChydro takes the lion's share of project risks, says the report, and recommends that BChydro 'Review the process for risk

allocation to ensure that risks are being transferred to those IPPs which are best able to manage risks at the least cost, while serving the public interest.' The implication is that the IPPs don't take risks, but get paid for them anyway.

Balancing The Books

These softly worded recommendations are typical of the report's weak approach to the big issues. Finance is another one. The report notes that 85% of BChydro's net profit is supposed to be paid to the provincial government (currently \$589 million) provided that this does not cause the debt-equity ratio to exceed 80:20. But for the last three years, this limit has been reached and the allowable Return on Equity has been missed (like BCFerries), and the proceeds to the province have been reduced.

Clearly, with multi-billion dollar projects mandated for BChydro under the *Clean Energy Act*, something must be done, but what? The panel recommends: 'Determine collaboratively, as the economy improves, a capital structure to support the desired debt to equity ratio and dividend payout policy that balances the needs of the province and the utility.' This recommendation has enough holes in it to drive the Legislature building through.

Paying For Regulatory Accounts

The panel did comment on the growth of what BChydro terms 'regulatory accounts' which accumulate spending that, if paid for out of current revenues, would result in a net loss in the current year. Instead, these costs are recorded as assets, on the basis that they can be paid for out of future revenues (after all, BChydro is a monopoly); of course, this will increase future rates but avoid some increases in present ones; it also avoids BCUC scrutiny.

In some cases, says the report, there is no plan to pay them out at all. It recommends that BChydro 'Work with the province to perform a more in-depth review of the growth of regulatory accounts and determine a more sustainable approach to utilizing them over the long term'.

The report also criticizes provincial water use taxes charged to BChydro, saying that they are much higher than other provinces, and also BChydro is charged more than other electricity generators in BC. Another hidden tax, also to be tackled 'collaboratively, as the economy improves'.

Managing Contracts

Procedures, policies, and attitudes around contract and capital project management are important too, since these have big implications for costs. Here the report comes face

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to face with BChydro's controlling, risk-averse 'culture'. This may be described as a mindset which means BChydro staff supervise all contracts very closely, in most cases doing all the detailed design work and resulting in many 'change orders' as the work progresses; and, of course, assuming responsibility for all the risks. This is all covered by generous, even excessive, budgeted contingency allowances and reserves (up to 20% of project costs), and systems that allow project surpluses to be transferred, thus ensuring that nothing goes over budget, ever.

While praising BChydro's high standards, the report expresses concern that they may amount to a 'gold-plated' attitude, since BChydro always expects, through current or future revenues, to be able to recover its costs.

The report makes numerous recommendations, among them: BChydro should use performance-based contracts to allow contractors more choice in how they do the work; BChydro should accelerate a changeover from manual contract management procedures to a computer-based information and tracking system; contingencies and reserves should be reduced; cost expectations should be set before detailed estimates are made.

With respect to purchasing, recommendations tend to parallel the above. Also, BChydro should make better use of longer term contracts for products and services, and make use of the provincial government systems Shared Services BC and BC Bid to ensure better prices on common items.

Budgeting and Costs

The most important recommendation here attacks the 'incremental' mindset in BChydro's budget. Both BCUC and BChydro typically review operating cost and revenue figures by comparing them with previous years, taking into account the usual explanations for increases: inflation, customer growth, maintenance costs, economic forecasts, safety improvements, etc. This approach does not encourage consideration of alternative ways of doing things or paying for them, or even considering whether they should be done at all.

The panel recommends that BChydro 'improve its budgeting and forecasting processes by periodically undertaking a zero-based budgeting exercise to obtain a better understanding of their incremental costs and improve overall cost effectiveness.' Zero-based budgeting reviews total costs, not just the increase over last year.

Several other recommendations encourage management to improve controls on all discretionary expenses, including contracting for professional services. Questions were also raised as to whether the rates charged for Residential, Commercial, and Industrial customers were proportional to the cost of serving them.

Job Cuts

The report recommends that staff be reduced by some 1200 (20%), but provides no detail as to where and how in the organization this should be done. It only says that the Ministry of Highways, with a similar capital budget, doesn't seem to need as many engineers. This is a facile and simplistic comparison, and does not appear to consider what actual work there is to do.

BChydro's personnel numbers have undergone many changes in the past eight years, with the splitting off and recent reintegration of the BC Transmission Company and the Accenture 'back office' contract (which expires soon). It would have been helpful if the report had provided more detail of proposed cuts, in view of the potential disruption which could result.

The report also notes that virtually all company employees earn 'performance bonuses'. This is taken as a possible indication that the standards against which performance is measured may be too generous.

Management and Directors

The report has little to say about the board and management who have presided over BChydro's deficiencies over the past few years. It recommends only that they report on how Premier Clark's anticipated savings are to be accomplished. She didn't say how, so presumably they will be achieved—incrementally. ☞