

TO: CITY MANAGER 2004 January 21
FROM: DIRECTOR FINANCE File: B66-2
SUBJECT: B.C. HYDRO RATE INCREASE APPLICATION

PURPOSE: To provide Council with background information on B.C. Hydro's recent application for a rate increase.

RECOMMENDATION:

1. THAT this report be received for information.

REPORT

At its meeting of 2004 January 12 Council received correspondence from B.C Hydro regarding their application to the B.C. Utilities Commission for a rate increase. Out of the discussion Council requested clarification on the need for an increase and whether it could be phased in over a longer period of time.

RATE INCREASE

On December 15, 2003 B.C. Hydro filed an application, with the B.C. Utilities Commission, for its first rate increase in 10 years. Hydro has requested a 7.23% increase effective as of 2004 April 01 and a further 2.00% increase effective as of 2005 April 01.

The new rates will likely be put in place temporarily under a BCUC interim order adopted by the end of January, pending the outcome of the full BCUC rate application review.

The rate increases are needed to: *"...meet the cornerstone objectives* of the Energy Plan, and in particular will allow BC Hydro to maintain system reliability; and to responsibly manage environmental and social impacts. At the same time they will allow BC Hydro to maintain and improve service levels in line with customer expectations. Finally, the applied for increases are required to permit BC Hydro an opportunity to earn its allowed rate of return on equity"*.

* The cornerstone objectives of the Energy Plan are:
 Low electricity rates and public ownership of BC Hydro
 Secure, reliable supply
 More private sector opportunities
 Environmental responsibility and no nuclear power sources

In November 2002 the provincial government adopted a new energy policy under a document entitled "Energy for Our Future: A Plan for BC" (the Energy Plan). In addition to the four cornerstone objectives stated above the Energy Plan prescribes a number of specific policy actions:

- B.C. Hydro is required to continue to deliver energy at cost based rates under a "Heritage Contract".
- the rate freeze will not be extended beyond 2003 March 31 and once again B.C. Hydro will be subject to rate regulation by the B.C. Utilities Commission.

The basis that the B.C. Utilities Commission must use to establish electricity rates is defined by Heritage Special Direction No. HC2, namely that the rates must enable B.C. Hydro to:

- provide reliable electricity service
- pay its debts & other obligations
- comply with government policy directives
- achieve a specified annual rate of return on equity

The current forecasted rate of return on equity for fiscal 2004 is 6.13%, which is significantly below the allowed rate of return of 14.33%. In order to avoid a further shortfall in fiscal year 2005 the new electricity rates must be implemented by 2004 April 01. The 7.23% rate increase (and a further 2.00% increase in 2005), proposed by B.C. Hydro in the revenue application, is calculated to provide B.C. Hydro an opportunity to earn its allowed rate of return.

10 YEAR RATE FREEZE

Electrical rates in British Columbia have been frozen for ten years. In 1994, when the rate freeze was enacted, B.C. Hydro had excess generating capacity from within its system (the "Heritage Resources"). In the ensuing years demand for electricity steadily increased and was met by utilizing the excess generating capacity. The revenue from the sale of the additional electricity allowed Hydro to finance the increasing inflationary costs over the ten year period. This excess capacity, and therefore the ability to sell additional electricity, is no longer available:

(GWh)	<u>1994</u>	<u>2003</u>
Total Domestic Sales	42,018	48,677
Line Losses and System Use	<u>4,315</u>	<u>4,689</u>
Gross Energy Requirements	<u>46,333</u>	<u>53,366</u>

In an average year the Heritage Resources, which supply the cheapest electrical energy, can only provide about 49,000 Gwh., the resulting supply deficit precludes additional revenue being realized from excess capacity and points to the coming need to meet rising cost challenges through rate increases.

The energy generation deficit is intended to be covered by PowerSmart initiatives (B.C. Hydro's energy conservation program), increasing capacity at existing facilities (which creates additional cost issues) and, as dictated by the Heritage Contract, new energy sources being furnished by the private sector.

In addition to the above, funds from B.C. Hydro's Rate Stabilization Account have been virtually exhausted meeting cost increases over the last several years.

PAYMENT TO THE PROVINCE

The requested rate increases are needed to fund Hydro's infrastructure maintenance and upgrade requirements. It should be noted that in accordance with the Heritage Special Directive No. HC1, B.C. Hydro is obligated to transfer 85% of its surplus (net income less capitalized finance charges) each year to the consolidated revenue fund of the provincial government. The concept of this type of payment is consistent with royalties or dividends paid by other resource extraction or utilization companies operating in the Province. The annual payment, after the implementation of the rate increase, is estimated to be \$344 million per year (\$128 million for fiscal 2003/04). Therefore, the rates being set based on the return on equity has the effect of generating a defined level of net income, 85% of which is transferred to the Province as a royalty or dividend equivalent.

IMPACT ON BURNABY

In 2003 electrical energy cost the City of Burnaby \$2.4 million, a 7.23% rate increase will cost the city about \$175,000 per year. This increase will be mitigated, to some degree, by the work of the energy efficiency project that is currently underway.

SUMMARY

An electrical rate increase is needed for infrastructure maintenance and upgrades that can no longer be funded by the sale of electricity generated by B.C. Hydro through the employment of excess capacity.

The magnitude and timing of the increase is dictated by a legislated Return On Equity that creates a defined level of net income, 85% of which is transferred to the Province in a form equivalent to a royalty.



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