

## The Role of IPP Energy Costs in the BC Hydro Rate Increase Backgrounder

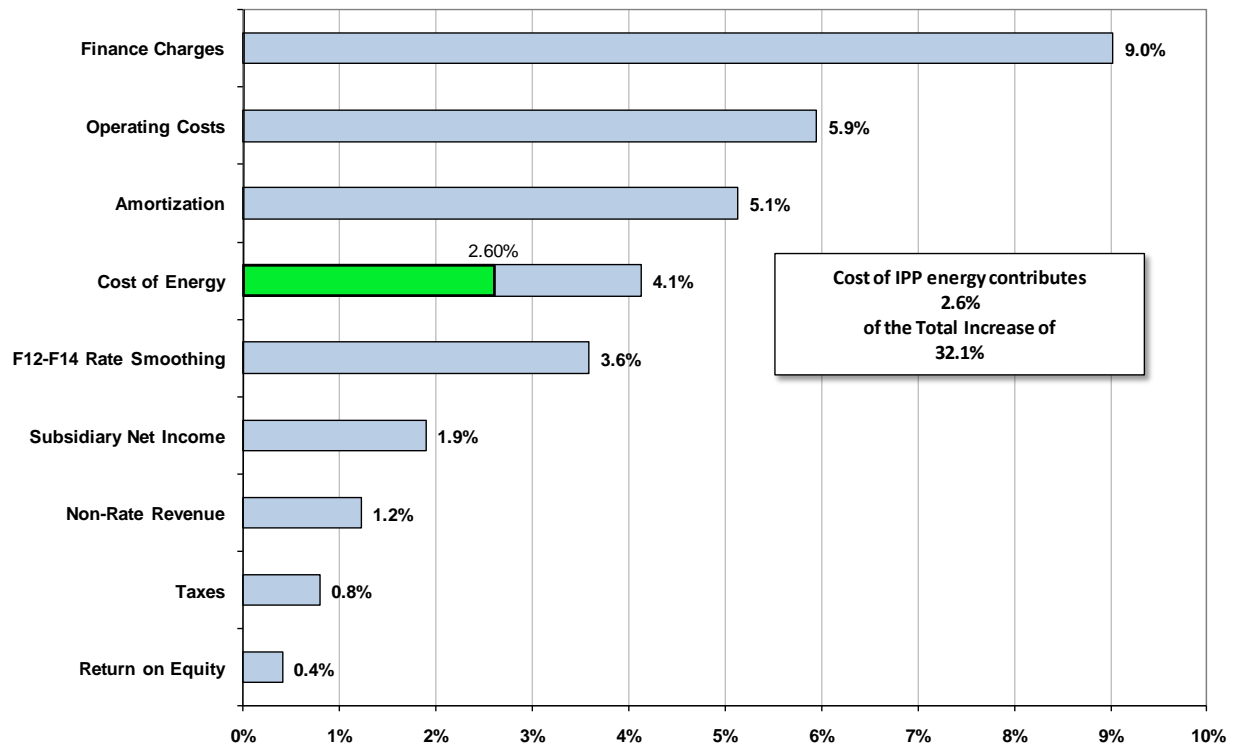
In its current revenue requirements application (“Application”) before the B.C. Utilities Commission (“BCUC”) covering the years F2012 to F2014, BC Hydro (“BCH”) requests a rate increase of 9.73% in each year, which compounds to a 32.1% increase over the 3-year period.

The critics of independent energy production have tried to blame independent power producers (“IPPs”) for BCH’s proposed increases – but the Application tells a very different story. The primary driver for the large increases is the cost of renewing and enhancing the publicly-owned assets in the generation, transmission, and distribution systems.

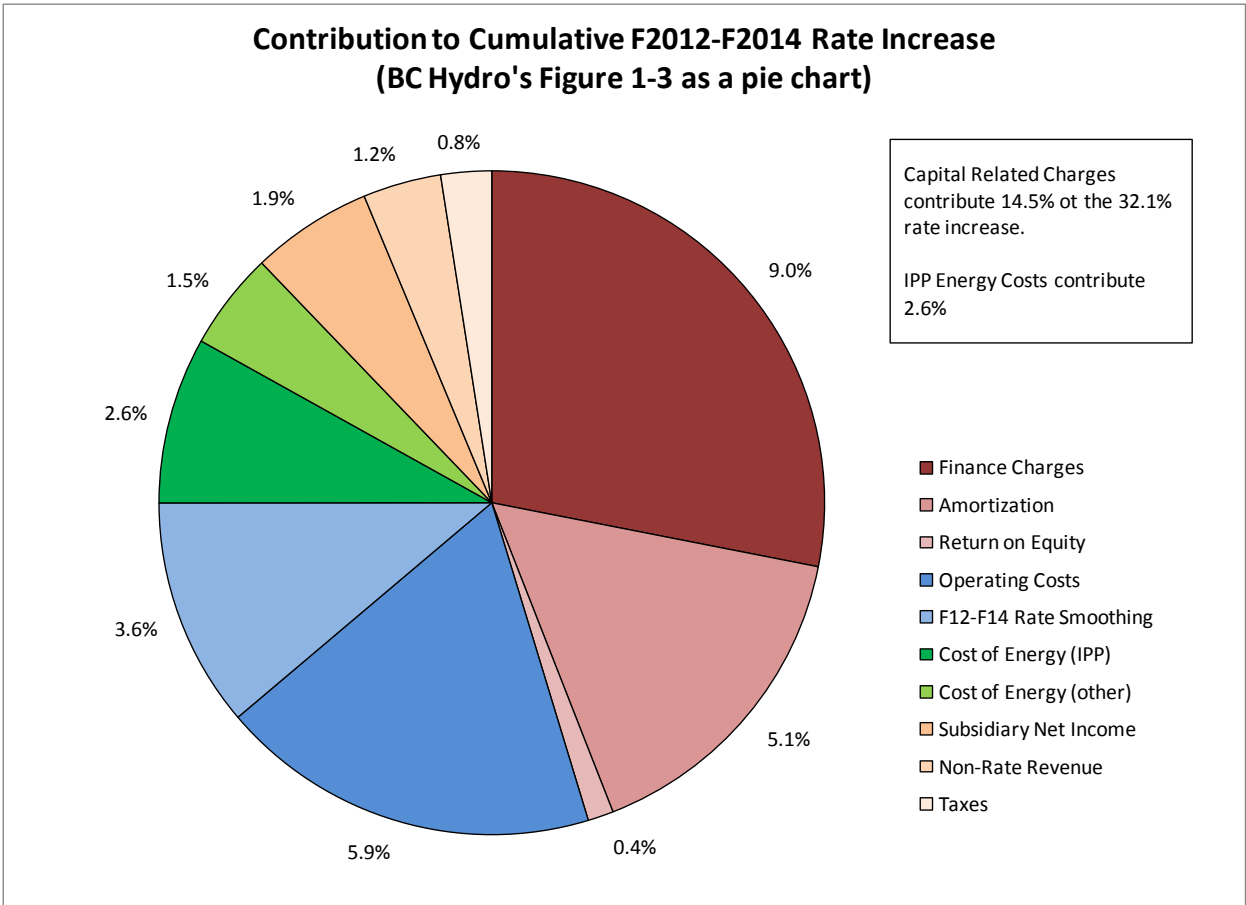
In Chapter 1 of the Application, BCH provides the following chart, which shows the relative contribution to the rate increase due to different cost components. The green bar has been overlain to represent the portion of energy cost that could be attributed to IPP energy.

From this chart it is evident that the increase attributable to IPP energy represents only a 2.6% rate increase over the 3-year Application period, out of the total requested increase of 32.1%. That means that an increase of 29.5% is due to other factors than IPP energy costs.

**Figure 1-3 Contribution to Cumulative F2012-F2014 Rate Increase**



When presented as a pie chart, this same information can be viewed as follows:



From this chart, the relative magnitude of the different components is readily apparent. By far the largest contribution comes from the capital related charges – namely finance charges, amortization and return on equity. The second most significant contribution stems from BCH’s own internal operating costs, and the third comes from BCH’s attempt to “smooth out” the rate increase by deferring part of the increase from F2012 into F2014, which then incurs additional carrying charges for interest and return on equity.

It’s useful to understand that the definition of IPP energy used by BCH includes purchases from Alcan, whose primary business isn’t electricity production, and certain public entities such as Columbia Power and Columbia Basin Trust. The largest producers of electricity, including these organizations, account for almost half of the total “independent” production and include the 5 generators shown in the following table<sup>1</sup>:

<sup>1</sup> Appendix 1, as attached.

2.0 Reference: Exhibit B-1, Chapter 4, Cost of Energy, and Appendix A, Schedule 4.0, Cost of Energy

1.2.5 How much of the 10,145 GWh shown in F2011 for "IPPs and long-term commitments" represents the generation from each of Alcan, Keenleyside, Brilliant, Island Cogen, and McMahon?

**RESPONSE:**

The generation in GWh from the sources indicated for F2011 is as follows:

Alcan	3,329
Keenleyside	767
Brilliant Expansion	429
Island Cogeneration	45
McMahon	840
	<hr/>
	5,410

BC Hydro explains, also in Chapter 1, that there are two IPP-related elements contributing to the increase in the cost of energy<sup>2</sup>:

*"2. An increase in the cost of purchases from IPPs of \$196 million... Offset by: ...*

*7. A change in the accounting treatment of certain electricity purchase agreements with IPPs which reduces the cost of energy by \$102 million."*

Of all the cost increases over the 3-year period, there is only \$94 million that is attributable to the cost of IPP energy.

Of all the cost components depicted in Figure 1-3, by far the most significant portion of the rate increase is due to the capital related costs consisting of finance charges, amortization, and return on equity. The increases in these capital related charges require a 14.5% rate increase over the 3-year period, and the increases in these charges are due mainly to the fact that BCH has been investing heavily in its own infrastructure assets – and will continue to do so over the 3 year period of the Application.

Since F2008, BC Hydro has spent \$7.0 billion on its capital asset infrastructure and demand side management or Power Smart measures, and it plans to spend a further \$6.5 billion over the next 3 years.<sup>3</sup> That is a huge investment in capital for a company whose total property, plant and equipment was valued at \$10 billion at the beginning of F2008 – it represents more than doubling the size of the company over a 7-year period.

It is very important to note that this enormous expenditure is not intended to serve any additional customer load. The expenditure is for renewal, not for growth. The domestic energy sales in F2008 were reported as 53.3 million MWh, while the forecast for F2014 is only 52.2 million MWh.<sup>4</sup> BCH is actually forecasting a decline in its residential and commercial customer sales.

---

<sup>2</sup> BCH F12-F14 RRA, Exhibit B-1, page 1-15.

<sup>3</sup> BCH F12-F14 RRA, Exhibit B-1, Appendix A, Schedule 13.0, line 14.

<sup>4</sup> Ibid. Schedule 14.0, line 9.

When the asset investment more than doubles, to serve the same or lower customer demand, rate increases are inevitable.

The second most significant cause of the required rate increase is BCH's own operating costs, but much of this increase is due to changes in accounting policies which require BCH to charge items to operating costs that were previously being capitalized or expensed elsewhere.

The net result is that operating costs rise by \$214 million over the period and are responsible for 5.9% of the 32.1% rate increase.

Over the past 4 years, BCH has had very significant increases in staffing levels and also salary levels, but some of the additional compensation costs appear to have been capitalized, They will appear in future rate increases, once the new capital assets are put into service but this is not to say that any cuts in staffing levels won't result in any reduction in rates.

BCH's full time equivalent or "FTE" staffing level at March 31, 2007 was reported as 4,670<sup>5</sup>. The Application reports that the number of FTE's is expected to reach 6,895 as of March 31, 2011<sup>6</sup>. That represents a 48% increase in staffing levels over a 4-year period.

Salary levels have also been escalating at a significant rate. Between yearend 2006 and yearend 2009, the number of employees making more than \$100,000 per year increased 95.5%, and the number making more than \$200,000 per year increased by a similar 95.1%<sup>7</sup>.

### **Conclusion**

It is clear that the proposed 32% rate increase has little to do with the cost of IPP energy, and everything to do with the cost of renewing the publicly-owned infrastructure. It is simply about updating the costs for the generation, transmission, and distribution assets BCH's customers have all been taking for granted for the past 40 or 50 years, and bringing these costs into the 21<sup>st</sup> Century.

---

<sup>5</sup> F2011BCH RRA, Exhibit B-1, Appendix A, Schedule 16.0.

<sup>6</sup> F12-F14 BCH RRA, Exhibit B-1, Appendix A, Schedule 16.0.

<sup>7</sup> F2011 RRA, Exhibit B-11, response to CECBC IR 2.7.4.