

GUTTING A POWER HOUSE

BC Hydro
and the new
Energy Plan

by Marjorie Griffin Cohen

APRIL 2003



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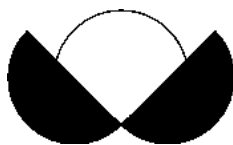
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Gutting a Power House

BC Hydro and the new Energy Plan

By Marjorie Griffin Cohen

THIS PAPER IS A CRITIQUE OF THE BC ENERGY PLAN'S PROPOSALS FOR CHANGING the provision of electricity in BC. The BC government claims that the changes to BC Hydro under the new energy plan are relatively minor. They are nothing of the sort. The changes will radically and irrevocably change the nature of BC Hydro and critically undermine its strength as a public provider of electricity.

The objectives of the new electricity plan are completely different from those that currently exist, and the entity that is called BC Hydro will bear little resemblance to the utility that has served the needs of British Columbia so well.

The new BC Energy Plan changes the provision of electricity in the following ways:

- The new electricity plan will break up BC Hydro through a variety of different mechanisms, so that the integrated nature of the utility will no longer exist. All four major components of the system—generation, transmission, distribution, and administrative and customer services—will be separated into distinct and separate companies, some of which have already been privatized. The result will be a less efficient system, with higher prices for the residential and industrial consumers of BC power, undermining what has been a clear advantage for the BC economy.

Administration and Services

- The private company Accenture is now responsible for most of the service activities of BC Hydro, including customer services, information technology, financial services, human resources, and procurement services. These are activities that accounted for about one-third of the BC Hydro workforce. Shifting these service activities to the private sector takes away the responsibility for customers and employees from BC Hydro and off-loads these responsibilities to the private sector. At no point has the public seen a business case for this radical change in the nature of the company. The governance structure of Accenture Business Services of BC lacks public oversight and could pose conflict-of-interest problems down the road.

Transmission

- Transmission will no longer be part of BC Hydro, but will be a completely separate legal entity. BC Hydro will have no say in its activities. The operation and control of the system will be turned over to a U.S. organization, RTO West (a fundamental change about which there has been virtually no public discussion). BC Hydro Transmission Corporation will own the transmission lines and will collect rents associated with the ownership, but that is virtually all it will do. RTO West will not only decide who has access to the transmission system, but will also decide all prices paid on the system and the nature of all future investment.

Generation

- In the BC Energy Plan, new generation of electricity is to be the preserve of the private sector. BC Hydro's new generation is restricted to improvements on existing facilities. BC Hydro will not be able to initiate new investments in areas such as wind or tidal energy, nor will it be able to build any new gas or hydro facilities. BC Hydro will progressively account for a smaller and smaller proportion of the total electricity generated in the province.
- The expanded role for private producers of electricity will involve considerable risks for the public. The public will continue to invest heavily in electricity, although this will not be for the benefit of the accumulation of *public* assets, but rather to subsidize and encourage private sector ownership of power generation. The main risk associated with relying on the private sector for new electricity is to the security of supply—unless prices rise considerably, there is no reason to assume the private sector will adequately invest in new generation for BC's future needs. This was aptly demonstrated in the Ontario experience. The failure of the private sector in Ontario to bring to market sufficient electricity to meet domestic demand resulted in a huge surge in prices, a surge that was not politically sustainable. The result was a rate freeze for customers that was subsidized by the government and will cost taxpayers over \$1 billion.

- As this study shows, one of the major changes is the decision to re-orient the BC electricity system toward export to the U.S. market. The new plan aims to encourage private production of electricity for export. This expansion, coupled with a transmission system that is increasingly geared toward exports, will set in motion a continental system of market prices that will be considerably higher than the existing system.
- The new energy plan will have significant negative environmental consequences. The plan's overall outcome is to increase electricity production and to use dirtier forms of fuel in the production process. A major new initiative will be the encouragement of the use of gas and coal by the private sector. Coal production will be much cheaper than any other less polluting forms of electricity generation and is, therefore, likely to displace the more expensive fuels when decisions are mainly market-based.

A massive redesign of the whole BC electricity system is occurring in order to meet U.S. and private energy producers' interests—not the collective interests of the people of BC. Radical changes will occur as a result of the new energy policy that will place the future of electricity in BC in the hands of the private sector. BC Hydro will become less and less significant over time and all of the disadvantages of a privately controlled electricity industry are likely to play out in BC in the future. These changes are occurring without clear and detailed public information or meaningful consultation.

Introduction

LATE IN NOVEMBER OF 2002 THE BC GOVERNMENT RELEASED ITS NEW ENERGY POLICY, *Energy for Our Future: A Plan for BC*.¹ It is a policy that attempts to convey the notion that massive changes in BC Hydro will not occur: it asserts that “BC is not ready for, or in need of, large-scale electricity reform.”² This is a position that reflects the public’s perception of the significance of BC Hydro’s role in the

province and its unwillingness to entertain massive change in the electricity sector. A year earlier the *Task Force on Energy Policy* provided an interim report with policy suggestions that received a great deal of heated criticism, primarily because of the demands for a radical change in the electricity sector in BC. It recommended changes that would lead to a fully market-based price system, open access for private generation, private sector building for export, and a system that had the potential to mirror all of the disadvantages that had been associated with market reforms and the privatization of electricity elsewhere.³

Criticism of the Task Force’s interim proposals came from virtually all quarters, including business, the public at large and academic researchers.⁴ While the final report of the Task Force backed away from some of the hotly contested issues (specifically a rapid move to market prices), the public has never had an opportunity to discuss its other recommendations to change the objectives and nature of the electricity system.⁵ Rather, the final report’s recommendations were released at the same time

as the government’s new energy policy, a policy based on the recommendations of the final report that will be put into place without public review.⁶

This paper is a critique of the BC Energy Plan’s main proposals for changing the provision of electricity in BC. The BC government’s assertion that its new policy is not large-scale electricity reform can only be characterized as massively disingenuous. The changes that are about to occur will radically and irrevocably change the nature of BC Hydro and critically undermine its strength as a public provider of electricity. They will also seriously diminish the role of the public sector in electricity production in BC. While everything about the rhetoric of the energy plan implies the changes being instituted are relatively minor (such as the reference to the plan as providing “a measured response to continue improving our power market”)⁷ the objectives of the electricity plan are completely different from those that currently exist, and the entity that is called BC Hydro will bear little resemblance to the utility that has served the needs of British Columbia so well.

Breaking up BC Hydro

THE NEW ELECTRICITY POLICY WILL BREAK UP BC Hydro through a variety of different mechanisms so that the integrated nature of the utility will no longer exist. All four major components of the system—generation, transmission, distribution, and administrative and customer services—will be separated into distinct and separate companies, some of which will be privatized. Both transmission and distribution will be separated from generation into distinct companies, changes that are so significant and serious to the operations of the company that they will require some changes to the BC Hydro Act and a literal disintegration of the way the company operates and makes decisions.

Administration and Services

A private corporation with head offices located in Bermuda, Accenture, now runs (and, it appears, will ultimately own) the major service activities of BC Hydro, activities that accounted for about one-third of the BC Hydro workforce. These service activities include customer services, information technology, financial services, human resources, and procurement services. Shifting these service activities to the private sector shifts the responsibility for customers and employees away from BC Hydro to the private sector. It is a radical change that isolates the business of BC Hydro from both those who provide what the company produces (employees) and those who need these services (customers). At no point has the public seen a business case for this radical change in the nature of the company. This is important because, in all measures of efficiencies for public utilities, the administrative services of BC Hydro have had extremely good performance records and are more efficient than most utilities in North America in carrying out these functions.⁸ The shift to the private sector for services is not confined to those already identified—the new energy plan also indicates that more services will be outsourced in the future.⁹

Moving such vital components of BC Hydro to the private sector seriously undermines the integrity and efficiency of the corporation, as does the choosing of Accenture as the company to take over these functions.

Accenture has become well known in Canada because of its work in the privatization of social services in Ontario, for which it was paid over \$250 million. This is a project that did not turn out well, according to Ontario Auditor General Erik Peters:

At the time of our audit, the system contained significant flaws... We concluded that the taxpayer took virtually all the financial and performance risks of this project and Accenture reaped a disproportionately large share of the financial rewards.¹⁰

The Ontario case is not an isolated instance of problems associated with Accenture's performance in public sector projects. Serious problems have arisen in other jurisdictions, including Florida, Ohio, New York, New Brunswick, Texas, Nebraska and Virginia.¹¹ California's state treasurer refuses to do business with Accenture because it locates its head offices in a foreign country that he alleges shelters the company from U.S. law.¹²

The takeover of BC Hydro's services occurred on April 1, 2003, with the reported cost of setting up the new company at \$60 million. Accenture Business Services of British Columbia is run by a board of directors that includes current and former BC Hydro executives (including Chair and CEO, Larry Bell), and executives from Accenture. There are no outside members on this board, the recommended 'best practice' for board compositions since the debacle of Enron. Since this is now a private company, there will be no public scrutiny, as there was when these activities were carried out under a Crown Corporation. The ethical principles that apply to Crown Corporations (including conflict-of-interest guidelines for directors of Crown Corporations) are substantially different and considerably more strict than those that generally apply to a private corporation. The practical implications of a board that includes BC Hydro executives is that these executives will be in the position of judging the decisions they made as board members of Accenture when Accenture's performance is being assessed by BC Hydro. The interests of the public are not represented on the new Accenture board and it is impossible to see how Accenture's promise to save BC Hydro \$250 million over 10 years will be assessed adequately in the future.

It is a radical change that isolates the business of BC Hydro from both those who provide what the company produces (employees) and those who need these services (customers).

Transmission

Transmission will no longer be part of BC Hydro, but will be separated into either a new crown corporation, *BC Hydro Transmission Corporation*, or a private corporation whose shares will be owned by the BC government.¹³ The proposed name, *BC Hydro Transmission Corporation*, is misleading because while the company will still retain the name BC Hydro, it will be a completely separate legal entity and BC Hydro will have no say in its activities. The stated point of doing this, according to the Energy Plan, is because the U.S. regulator, the Federal Energy Regulatory Commission (FERC), requires a separate entity for transmission in order for U.S. based companies to have access to the BC system.¹⁴

The government has drawn little attention to what will happen to this new Crown Corporation once it is established. Policy Action #15 in the energy plan states, specifically, “BC Hydro Transmission Corporation will be responsible for planning, operating, and managing BC Hydro’s transmission system.” This statement misleads because while this will occur as an interim measure, by 2006 the transmission system will be totally operated by a U.S. based entity. BC Hydro Transmission Corporation will own the transmission lines and will collect rents associated with the ownership, but that is virtually all that it will do. All of the operations of the system will be turned over to a new entity that is being set up in the U.S. by FERC. This new entity controlling all transmission in the Pacific West will be called RTO West (Regional Transmission Organization West).¹⁵ According to the new energy policy document, “RTO West will operate U.S. transmission systems on behalf of their owners, as well as the region’s wholesale power market.”¹⁶ What it does not say is that RTO West will also operate and control the entire BC Hydro transmission system.

Here is how it will work: in completely running the BC Hydro transmission system, RTO West will not only decide who has access to the transmission system, but also it will decide all prices paid on the system and the nature of all future investment. RTO West will begin in

the fall of 2004 and will completely run the system by 2006. BC Hydro Transmission Corporation will receive the income from the use of the transmission lines, but will have no other significant role. It will not be responsible for planning, operating or managing the BC Hydro transmission system because this will be the responsibility of RTO West. RTO West, in turn, appears to be expecting the private sector to actually manage and run the new amalgamated transmission system.

The first step in the plans for the transmission system has been laid out by the energy plan, but the subsequent steps, while alluded to, have not been clearly presented, although the BC government has been closely involved in the design of RTO West. Some people in the industry are aware of these plans to turn over the operations of BC Transmission Corporation to RTO West through information presented by FERC, BC Hydro, and the BC Utilities Commission (BCUC) in a workshop in Vancouver in December 2002. But the implications of these plans for the control and future of the transmission system have been omitted from discussion in the energy plan.

Turning over the transmission system to the U.S. entity RTO West has serious implications for the future of electricity in BC. FERC’s intention, in setting up regional transmission organizations to run transmission systems, is to ensure that private companies have access to the existing grids and that electricity export markets expand. As decisions about the future development of the transmission grid in BC will now be made by RTO West, all expansions of the transmission system will be made with these objectives in mind. These decisions may not be based on the best service to people within the province.

One of the main features of the RTO West design is to include a market-based access system with tradable rights for transmission. This feature will force the abandonment of the current cost-based system of pricing, and will adopt a system that allows prices to change to reflect whatever the market will bear. It is the kind of system that is very susceptible to market manipulation.

In regions in the U.S. that have already restructured their electricity markets, there is support for the new

By 2006 the transmission system will be totally operated by a U.S. based entity. BC Hydro Transmission Corporation will own the transmission lines and will collect rents associated with the ownership, but that is virtually all that it will do.

FERC electricity designs. However, in regions that are served by integrated public utilities, opposition to the FERC design is substantial.¹⁷ This is particularly true in the Pacific Northwest, an area dominated by hydro-based electricity production. One of the main arguments against using a standard market design, such as FERC is proposing, all over North America is that it is highly inappropriate for a hydro-based system.¹⁸ The new system was designed to integrate and privatize fossil fuel and nuclear-based systems and cannot take into account the variability of water flows and the large variety of different kinds of objectives that a hydro-based system must meet. For example, the City of Seattle, in a formal submission to FERC, shows how the requirement that “hydro generators must offer to the Independent Transmission Provider ‘all available capacity’ at hydro projects, to clear congestion,” could have serious repercussions.¹⁹ The implication is that RTO West could not only control transmission, but could also, if it deemed necessary, command the resources of both turbines and reservoirs. As the City of Seattle points out in its FERC submission, hydro-based systems are complex entities that are not well suited to manipulation by pure market mechanisms. They are subject to numerous and often conflicting operational requirements associated with issues such as Aboriginal treaties, environmental law, flood control, endangered species considerations, in addition to the requirement to provide service to domestic customers.

While the system design itself is a problem for hydro-based systems, the other objections within the U.S. are based on two main issues. The first is the lack of confidence in both FERC’s competence and intention to protect regions, such as the Pacific Northwest, from harm. This relates to the costly implications for the states in this region resulting from the California crisis in 2000-2001.²⁰ The second objection relates to issues of jurisdiction. As the City of Seattle points out, FERC does not have jurisdiction for the areas that would be affected by the new proposals. FERC only has jurisdiction over investor-owned utilities, not the public utilities owned by states

or municipalities. It should be noticed that while there is considerable opposition to the FERC model by public utilities in the U.S., the BC government, through BC Hydro, is actively involved in creating the new system.

Handing over the transmission system to RTO West will fundamentally alter the nature of BC Hydro. It will shift prices from a cost-based system to a market-based system, it will jeopardize the security of supply of electricity within BC and it will have serious repercussions on the intricate balancing of the objectives of a hydro-based system.

Generation

The shift of one of the most basic components of the BC Hydro system, transmission, to a separate corporation that is controlled by an entity in the U.S. will have enormous repercussions on the operations of the electricity system. BC Hydro will become primarily a generation and distribution system. The generation company will be required to sell its power to new, separate distribution systems that will be able to buy power from both BC Hydro and anyone else selling on the market. But it will be a generation system with a major handicap: its ability to invest in new generation is restricted to improvements at existing facilities. It will not be able to initiate new investments in areas such as wind or tidal energy, nor will it be able to build any new gas facilities.

In the BC Energy Plan, most new investments are understood to be the preserve of the private sector. This is a provision designed to enable private electricity companies to gain a foothold in the market. Even if new, very large hydro projects occur, such as the development of Site C on the Peace River, it is likely that this will be a private sector initiative.²¹ This is because a public sector development of the magnitude of a new dam would undermine the private sector by injecting huge amounts of electricity on the market, something that would make it impossible for the private sector to compete.

With the existence of BC Hydro, and the very low-cost

energy embedded in its hydro-based system, private power producers will be induced to invest in new generation facilities only if the advantages that are inherent to BC Hydro are eliminated. *This nullification of BC Hydro's efficiencies is the over-riding objective of the new energy policy.* Private energy corporations would not be able to compete with BC Hydro as it currently exists. This is because it operates at extremely low costs, is efficient, and has the investment potential to out-perform all competitors in the future. These advantages are inherent in the system because it is a public entity with access to low-cost capital and because it has efficiency advantages as an integrated system. Only by eliminating all of the advantages of the BC Hydro system can circumstances be created so that private producers can be induced to enter the market.

Independent Power Producers (IPPs) have always had a role in BC, but it has been fairly limited and has historically accounted for about 3 per cent of the total of BC Hydro's production. In the current system IPPs sell electricity to BC Hydro and a few very large producers (like Alcan) export to the U.S. IPPs have not had a larger role in BC because their costs of production have been considerably higher than most new electricity BC Hydro could bring on line. The policy of using IPPs' power only when it made economic sense is now being undermined by a policy that gives new generation rights almost exclusively to the IPPs, even when it would be cheaper for

BC Hydro to provide the power.

The main risk associated with relying on the private sector for new electricity is to the security of supply, as the Ontario experience demonstrates. The failure of the private sector in Ontario to bring to market sufficient electricity to meet domestic demand resulted in a huge surge in prices, a surge that was not politically sustainable. The result was a rate freeze for customers subsidized by the government that will cost taxpayers over \$1 billion. While consumers have paid only 4.3 cents per kilowatt hour, the market price averaged a record 8.86 cents a kilowatt hour in February: generators are paid the market price, with the province providing the difference and, at the same time, running up its debt to finance the price freeze.²² Since the ratepayers are the same people as the electricity customers, the shift from a large electricity bill to a large tax bill will not make a difference to most households ultimately.

But most disturbing about the rate freeze is the implications this has for the investment climate in electricity. Private generators have indicated that they are unlikely to invest more money in Ontario as long as the price freeze is in effect.²³ Clearly the price freeze will cause further problems in Ontario and not least because the artificially low prices are causing excessive use of electricity. The lesson for BC is that without long-term planning, the security of electricity supply cannot be guaranteed and prices at reasonable levels certainly cannot be sustained.

The Public Subsidizes Private Risk

In designing the new energy policy the issue of risk for the private sector was a critical factor to be addressed. One of the most difficult aspects of trying to combine a public and a private system, particularly one that is relying on the private sector for new electricity, is creating a sufficiently lucrative environment to encourage private investment. Getting the private sector to ensure that there is enough electricity supply in the future is particularly difficult if one of the objectives of the state is to try to keep consumer prices from rising too rapidly. (When governments want to stay in office, rapidly rising electricity prices tend to dampen the public's enthusiasm for those in charge.) Achieving adequate private investment has been at the heart of the difficulties of the most spectacular failures of restructured electricity markets, such as California, Alberta and Ontario. Usually prices rise dra-

matically, forcing the state to intervene either by giving rebates to customers or underwriting the cost of new private investment itself.

The management of risk and who assumes it is one of the most misleading aspects of the new BC energy policy. The stated reasons for encouraging private investment in electricity production in BC are that the private sector has better access to capital resources and that the private sector will assume the 'risks' of new investments.²⁴ The energy plan specifically states "new power development by the private sector will protect them (taxpayers) from the financial risks of building new generation."²⁵ The assumption is that private companies will invest—that is, they will spend their own money—in new generation capacity and this will eliminate the need for increased public investment.

In a blending of the worst of all possible worlds, the public will continue to invest heavily in electricity, but to support and encourage private sector ownership of power generation.

The new energy plan seems to be proceeding, in its encouragement of private electricity production, in an astonishing way. In a blending of the worst of all possible worlds, the public will continue to invest heavily in electricity, although this will not be for the benefit of the accumulation of public assets, but to support and encourage private sector ownership of power generation. The most recent example is the extremely large investment BC Hydro is making to allow Weyerhaeuser to get into the power generation business. Under the *Power Smart* initiative, BC Hydro is giving Weyerhaeuser \$18 million (of a total project cost of \$28 million) to build a new 30 MW facility. This will be a power plant large enough to provide the power needs of 15,000 homes.²⁶ The purported reason for doing this is to forestall a need for BC Hydro to build new generation capacity.²⁷

This *Power Smart* program for Weyerhaeuser is at least 10 times larger than any previous *Power Smart* undertaking. And its sheer size should be cause for concern. *Power Smart*, rather than being used as a conservation program, which was its original intention, has now become a program to fund private sector investment: BC Hydro will be losing customers and paying a great deal to do so. If the intent is to institute a competitive market, then requiring the one public player (BC Hydro) to finance the investment of its competitors certainly undermines the whole excuse for the exercise—eliminating the need for the public to both borrow money and to take any risk on new investment.

BC Hydro intends to expand its efforts to finance very significant amounts of private sector investment. According to Ben Van Ruyven, senior vice-president of distribution for BC Hydro, “We are going to be approaching all the other customers who are able to do similar projects.”²⁸ This means that BC Hydro appears to be ready to underwrite a large proportion of the investment of the private sector in the future. With these kinds of programs, BC Hydro will become the major uncompetitive player in the market—it will be bled dry. The real losers will be the people of BC. Not only will they have higher electricity prices, but they will also be assuming many of the costs associated with private sector investment—not the private corporations.

Under conditions where the public sector underwrites the investment of private sector generation (particularly at the rate of two-thirds of the total, as is happening with Weyerhaeuser), it is highly likely that the private sector will find the BC market very attractive indeed and BC will be flooded with large international corporations ready to take funds from the public purse. Under these kinds of conditions they may even be prepared to take on the development of Site C, the kind of project that normally has payouts too far into the future to be attractive to the private sector.

When the public sector invested very large sums of money to develop the BC Hydro system, its primary objectives were to provide secure and reliable power to the people and industries of BC at reasonable rates. The collective investment was necessary because the private sector did not want to take the risk involved in the massive outlay of investment funds that were necessary to build the system. The result has been a system that is extraordinarily successful and has passed on its success to the people of the province both by having lower prices and a secure system, but also by having a system of electricity generation that does not contribute to greenhouse gases.²⁹ The public owned the assets of the system and the public reaped the benefit. The irony in the new energy policy is that the people will continue to assume the costs of much of the new investment, but will not accumulate any assets in the process. The assets will be the property of private corporations.

The government makes a point of saying that “public ownership of BC Hydro” is a cornerstone of its energy plan. In a very narrow sense this is true, but it is quite different from maintaining public ownership of electricity in BC. BC Hydro will progressively account for a smaller and smaller proportion of the total electricity generated in the province, and the privatization of specific assets of the corporation (that have conveniently been defined as “non-core assets”) make the public ownership less able to meet the electricity needs of the province than it had been in the past.

Putting Export Goals Ahead of Domestic Needs

The new energy plan's focus on electricity production for export is a radical change in the direction of electricity policy in BC. BC Hydro has, in the past, operated for the sole benefit of the people of BC, and while exports occurred, these were confined to 'surplus' energy. When new hydroelectric projects brought huge amounts of electricity on the market that exceeded, for a time, the amounts needed for domestic consumption, large amounts were exported. But, as the energy requirements of BC have grown, these surpluses have diminished. In recent years Powerex, BC Hydro's export corporation, has not relied solely on electricity generation by BC Hydro to sell into the U.S. market. Instead, it has used the large BC Hydro reservoir system to buy power from other jurisdictions when it is cheap. This has enabled it to store water that otherwise would have been used for electricity production and use the stored water to generate electricity for export when market conditions justified it. This has been profitable and has contributed to maintaining low-cost electricity in BC. It has worked well because BC Hydro controlled all the elements of the system (the dams, generation and transmission) and could calculate the best use of these integrated resources.³⁰

The new energy policy claims that "electricity trade helps ensure low power rates and reliability for domestic consumers."³¹ This is certainly true under the existing conditions of exporting electricity. However, under the conditions of the new energy plan, a plan that encourages private production of electricity for export, the export market will be a major driver in the increase in prices for consumers in BC. This is because the government intends to rely on the private sector for virtually all new electricity generation. Since the major private sector producers have demanded the redesign of the transmission system to allow access for exports and the new energy plan encourages this, in the future consumers in BC will be competing with customers in the U.S. for this power. The very existence of the export market, coupled with a transmission system that is increasingly geared toward exports, will set in motion a continental system of market prices that will be considerably higher than the existing system. Expanding the electricity market will bring substantial benefits for private energy producers, but unless prices rise considerably within BC, the security of

electricity supply will be in jeopardy. If the prices in BC do not rise, the possibility of electricity shortages would be very real, since private producers would have other more lucrative markets.

The focus on building for exports is directly related to handing over the transmission system to U.S. control. According to the BC government, "the transmission grid was designed with the mandate to serve domestic customers and not with trade as the primary consideration."³² Trade now appears to have become the 'primary consideration' for the expansion of the grid. When RTO West runs the transmission system the needs of private exports will be the focus for new investment decisions. And, since BC Hydro's generation is not to grow, the prime beneficiary of increased trade with the U.S. will be the private sector.

The BC government maintains that the U.S. redesign of its system requires that BC's system change as well in order to meet U.S. requirements. So far FERC has urged the voluntary separation of transmission from generation entities so that private electricity producers can have access to the transmission grid. BC has done this and private producers now have complete access to the transmission system. The new Standard Market Design (SMD) proposals of FERC, that insist on the separation of transmission from generation utilities as the first stage of a uniform North American market, are still at the discussion stage. But events are rapidly proceeding and will result in the deep integration of electricity markets and the control by a U.S. entity over all transmission systems. This is something that many groups in the U.S. oppose because it is particularly risky for consumers in jurisdictions that already have low-cost electricity.³³ The point is that the proposals for 'standard market design' are still proposals—yet the BC government is behaving as though they are a requirement for massive changes in BC.

But even if the U.S. did, in the future, change the nature of its electricity system, there is no requirement in international law that any entity in Canada has to change its system in order to export into the U.S. This is a fundamental protection that is given each country under NAFTA. According to the NAFTA Commission for Environmental Cooperation in its assessment of the cross-border electricity trade:

Under the conditions of the new plan, one that encourages private production of electricity for export, the export market will be a major driver in the increase in prices for consumers in BC.

The demand for reciprocity from U.S. producers has already become a prominent issue relating to cross-border trade. Under NAFTA, a Party is not required to provide reciprocity, but only national treatment for the goods of another Party. Market participants in Canada, such as BC Hydro, have for the time being chosen to agree to reciprocity voluntarily rather than insist on their rights...³⁴ (my emphasis)

The BC government is behaving as though ‘reciprocity’—or mirroring U.S. policy—is required in Canada in order to export into the U.S. As the Commission on Environmental Cooperation shows, under NAFTA no country is required to have exactly the same type of organiza-

tion of its market or industry as exists in the country into which it exports. Rather, each country must grant ‘national treatment’ to foreign firms. What this means is that as long as a province treats domestic and foreign firms in the same way, it is not contravening NAFTA. In treating FERC proposals for standard market design as something that compels significant change in BC, the BC government is giving up a significant right that NAFTA guarantees each country.

The government’s claim that “increasing energy trade can improve domestic reliability, enhance continental energy security, and create economic benefits for British Columbians”³⁵ certainly misinforms the public and masks the considerable dangers that exist in establishing an integrated international market.

Higher Prices

Lower prices are not the objective of the restructuring of the electricity sector in BC, something that has normally been the objective of undertaking complex restructuring in other jurisdictions.³⁶ Most shifts to competitive markets from regulated public and private utilities are undertaken because of problems with high prices of electricity, with the hope that by introducing competition into the market, prices will be forced down. In BC the opposite appears to be the intent of restructuring: electricity rates have been low and the government is promising higher rates. The justifications for a policy to increase prices are to both increase government revenues and to encourage more energy conservation.

Prices to consumers will no longer be based on the costs of producing electricity, as has historically been the basis for setting BC Hydro prices, but will be restructured to accommodate, in a separate way, the distinct costs of bringing new private electricity on the market. BC Hydro’s current price for customers is a blended rate that includes all costs, including low costs from hydro projects, high costs of IPP purchases, and any costs associated with imported power. This way of determining prices will be shifted to a new system that will separate the specifically BC Hydro generated electricity (called the ‘heritage’ price)

from the new costs of electricity developed by the private sector.

This means a certain, as yet unspecified, amount of BC Hydro generated electricity will be available for use by customers at the ‘heritage price.’ Above this amount customers will pay the full cost of new generation. The government did not specify in the new energy policy how much electricity would be available at the heritage price, but two factors would indicate that it would need to be low enough not to include the entire energy use of most customers. The amount available at the heritage price will have to be small enough to give new power producers an incentive to invest. Also, since BC Hydro wants to continue to export power, a significant amount for this purpose will need to be removed from the pool of heritage electricity. This dual pricing structure is to last for 10 years only, with the likelihood that after this period BC will shift to full market pricing.

One problem with the proposed pricing structure is that it will raise the price of electricity in BC, despite the government’s clear indication that low-cost electricity is beneficial to the BC economy. The new electricity being brought to the market by private power producers will be considerably more expensive than that which could

have been generated by BC Hydro. Since the new energy plan is silent on the proportions of new and 'heritage' power available to consumers, there is no clear way to estimate the exact effect on average households of the new pricing structure.

The only significant reason to institute this two-tier electricity-pricing scheme is to provide a sufficient incentive, through high prices, for the private sector to gen-

Environmental Impacts

Few people would dispute the need to encourage energy conservation through the pricing system. This goal can be accomplished within a relatively contained system controlled by a public monopoly. But there is an internal inconsistency in the energy plan that would negate these conservation efforts. The energy plan asserts that as much as 10 per cent of total electricity demand could be 'saved' by 2015 through increased conservation and energy efficiency. While a pricing scheme that encourages conservation is laudable, this will do little to reduce the total amount of electricity produced in BC because of the government's decision to encourage private production for export.

People in BC may very well respond in the desired way to price signals and reduce their consumption of electricity, but this will not 'defer the need for new supply'³⁷ as the report asserts. Just because people within BC consume less does not mean less will be produced or used. Rather, consumers in BC (including businesses) will be encouraged to use less electricity, but more will be produced for sale outside the province.

The new energy plan's overall design is to increase electricity production and to use dirtier forms of fuel in the production process. The major new initiatives will be the encouragement of the use of gas and coal by the private sector. BC Hydro has one major gas-fired burner (Burrard Thermal) that already contributes significantly to greenhouse gas effects. Encouraging further private sector electricity production through gas will most likely occur near areas that are already experiencing high degrees of air pollution. But the most devastating effect of new pro-

duce electricity in BC. The government's assertion that this two-tier pricing scheme is needed to curtail electricity consumption would be a reasonable approach were it not for the fact that the government is encouraging the production of electricity for exports. As will be seen below, this feature of the new energy plan has introduced a contradiction that offsets its supposed environmental objectives.

duction on the environment will come from coal.

The new energy plan pitches its changes as environmentally responsible and holds out the spectre of new small-power energy that is more environmentally friendly.³⁸ Small power plants that serve local communities are a vision for the future often offered by people who feel market restructuring will improve environmental problems associated with large-scale electricity production. This is mainly because local production and distribution eliminates the necessity of large, long-distance transmission systems (characteristic of large-scale hydro generation) that are very hard on the environment. However, while the new energy plan extols the benefits of private combined cycle gas turbines and small hydro plants,³⁹ most new production will not be geared toward local distribution networks, but will be encouraged to trade through the wider North American market.

The main point is that the new system is not being restructured to eliminate the necessity for a new extensive and environmentally damaging transmission system, but rather it requires a much more extensive system in order to allow private power to achieve its objective. Also, the focus on private production, particularly the enthusiasm for using coal for electricity generation, will shift electricity generation increasingly toward production that has very serious repercussions for greenhouse gases. Coal is the main source of greenhouse gas emissions in the electricity industry. In the U.S., for example, coal accounts for 89 per cent of all greenhouse gas emissions in the electricity industry.⁴⁰ However, coal production will be much cheaper than any other less polluting forms of electricity

The new energy plan's overall design is to increase electricity production and to use cheaper and dirtier forms of fuel – gas and coal – in the production process.

A massive redesign of the whole BC electricity system is occurring to meet U.S. and private producers' interests—not the collective interests of the people of BC. The BC government is misleading people when it claims that changes are not radical.

generation and is, therefore, likely to displace the more expensive fuels when decisions are mainly market-based. And since all private electricity generating companies will be allowed, under the new system, to sell directly to industrial users, the acceleration of electricity generation from coal is likely to be one of the most dominant forms of new energy. According to the NAFTA Commission for Environmental Cooperation, coal consumption by utilities in the U.S. and Canada will increase by as much as 30 per cent as a direct result of restructuring in the electric power industry.⁴¹

New environmental regulatory changes to make the system more 'results-based' in order to provide 'flexibility' is necessary to make the electricity system accessible to lower-cost electricity generators, particularly those in the coal and gas sectors. The new energy plan maintains that a more efficient regulatory process can "reduce development costs for projects that are considered prudent."⁴² While the exact nature of 'results-based regulation' is not spelled out, all environmental assessment reviews, air emissions permissions, and oil and gas development approvals will be shifted to this new method that "allows flexibility for finding the most economical means" to meeting environmental requirements. Generally terms like 'flexibility' and 'results-based' mask lower standards and, in a plan that intentionally wants to shift to cheaper and dirtier ways of producing electricity, this change in regulatory approval procedures will allow dirty fuels onto the market very quickly. Coal production will be expanded by the adoption of "emission guidelines for coal-fired power plants that will allow BC to compete for investment with neighbouring jurisdictions."⁴³ This eas-

ing of regulations, coupled with the 'voluntary' nature of clean energy targets for distribution company purchases, is an indication that the province intends to treat environmental issues rather casually.

Conclusion

The government is redesigning the electricity system in BC for the wrong reasons. According to Energy Minister Richard Neufeld, it is necessary in order "to appease independent power producers who want to generate their own power and sell it on the open market." He also maintains that it is important "to satisfy the U.S. Federal Energy Regulatory Commission, which has been pressing utilities in North America to separate the transmission from the generation components of their businesses."⁴⁴ A massive redesign of the whole BC electricity system is occurring in order to meet U.S. and private energy producers' interests—not the collective interests of the people of BC.

The BC government is misleading people when it claims that the changes to the electricity system are not radical. It has very carefully crafted its message by saying, for example, that "public ownership of BC Hydro's generation, transmission and distribution assets will continue" in order to reassure the public that the public utility that has served them so well will remain.⁴⁵ But radical changes will indeed ensue from the new energy policy, and they will place the future of electricity in BC in the hands of the private sector. BC Hydro will become less and less significant over time and all of the disadvantages of a privately controlled electricity industry are likely to play out in BC in the future.

The changes that are occurring in the electricity industry are massive, and they are proceeding without clear and detailed public information about the implications of the changes and without the opportunity for public discussion. What is presented as minor changes in a system that works well is a serious misrepresentation of the magnitude of what is about to occur.

Looking for more information about BC Hydro and what you can do to protect public power? Contact BC Citizens for Public Power...

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Notes

- ¹ British Columbia, Ministry of Energy and Mines, *Energy for Our Future: A Plan for BC*. (Victoria: Ministry of Energy and Mines, November 2002).
- ² *Energy for our Future*, p. 16.
- ³ British Columbia, *Strategic Considerations for a New British Columbia Energy Policy: Interim Report of the Task Force on Energy Policy*, November 30, 2001.
- ⁴ See, for example, Pierre-Olivier Pineau, Peter Ostrowski, Anil Hira, Lynda Gagné, Arne Elias, *Concerns on the Interim Report of the Task Force on Energy Policy: Strategic Considerations for a New British Columbia Energy Policy*, Report of Workshop on Task Force on Energy Policy, School of Public Administration of the University of Victoria, January 18, 2002; Ian Mulgrew, “Energy task force report ‘a dangerous piece of work,’” *The Vancouver Sun*, January 14, 2002; Marjorie Griffin Cohen, *Public Power and the Political Economy of Electricity Competition: The Case of BC Hydro* (Vancouver: CCPA, 2002). www.policyalternatives.ca
- ⁵ British Columbia, *Strategic Considerations for a New British Columbia Energy Policy: Final Report of the Task Force on Energy Policy* (Victoria, March 15, 2002), released Nov. 2002.
- ⁶ The Final Report of the Task Force is dated March 15, 2002, yet it was not released until the end of November when the government also made public its new energy policy.
- ⁷ *Energy for our Future*, p. 16.
- ⁸ The Canadian Electrical Association, an organization of 15 major Canadian electric utilities, measures the relative efficiency of the utilities. BC Hydro has consistently outperformed most other utilities in costs for operations, maintenance and administration (OMA). Similar results occur in comparisons with electrical utilities throughout North America.
- ⁹ *Energy for Our Future*, p. 36.
- ¹⁰ Eric Peters, *Vancouver Sun*, Jan 11, 2003. This was a letter to the editor by the Ontario auditor in response to an article in the business section of the *Vancouver Sun* by Harvey Enchin, “The other side of the BC Hydro story.” (Jan 2, 2003) The auditor felt he had been misrepresented in Enchin’s article on Accenture’s performance in Ontario.
- ¹¹ Nancy Cool Lauer, *Tallahassee Democrat*, Jan. 29, and Feb. 12, 2002; “State Probes \$26 million no-bid deal,” *Cleveland Plain Dealer*, Jan. 26, 2001; “Welfare Ripoffs Outlined by NDP,” James Wallace and Antonella Artuso, *Toronto Sun*, Nov. 5, 1998; Wendy McCann, “Consulting Company has a track record of boosting billing,” *Canadian Press Newswire*, Nov. 4, 1998.
- ¹² News Release, California State Treasurer’s Office, Thursday July 25, 2002.
- ¹³ The Energy Plan states that it will be a Crown Corporation, however subsequent developments indicate that the preferred structure is a private company with shares owned by the government. This would be similar to the structure for the new BC Ferries company. The main advantage to the government of this type of ownership structure, over a crown corporation, is that the records of the company are not public and, therefore, are not subject to public scrutiny.
- ¹⁴ *Energy for our Future*, p.19.
- ¹⁵ For a full analysis of RTO West see Marjorie Griffin Cohen, *High Tension: BC Hydro’s Deep Integration with the U.S. through RTO West* (Vancouver: Citizens for Public Power, 2003), pp. 31. www.citizensforpublicpower.ca
- ¹⁶ *Energy for our Future*, p. 20.
- ¹⁷ States opposing FERC’s initiative, through a joint statement signed July 30, 2002, are Arkansas, California, Georgia, Idaho, Kentucky, Louisiana, Mississippi, North Carolina, Oregon, South Dakota, Washington and Wyoming.
- ¹⁸ For an analysis of the problems with FERC’s restructuring proposals see Ellen Lapson, Lina Santoro, Philip Smyth, “FERC Standard Market Design,” *Fitch Ratings: Global Power North America Special Report*, October 11, 2002.

- ¹⁹ FERC, Docket No. RM01-12-00, *Comments of the City of Seattle Opposing the Proposed Rules, Recommending that they be Withdrawn, and Recommending Alternative Actions*, January 10, 2003.
- ²⁰ Several investor-owned utilities in the Pacific Northwest were compelled to enter into expensive power purchase contracts to avoid reliance on spot market prices to meet their energy supply needs. This occurred because FERC was too slow to intervene in the abuse of the wholesale market.
- ²¹ *Energy for our Future*, p. 30.
- ²² John Spears, "Ontario's Hydro Bill Soars to \$1 Billion," *Toronto Star*, March 14, 2003.
- ²³ *Ibid.*
- ²⁴ According to the energy plan, "the private sector is well positioned for power development, given its ability to find entrepreneurial capital, efficiently build and operate facilities, and take on the associated risks" (p. 30). It should be pointed out that many of the companies currently operating in BC, such as Aquila (formerly West Kootenay Power), have credit ratings that are at or near junk bond status. BC Hydro's credit rating, at AA2 is excellent, enabling it to borrow at much lower rates than the private sector.
- ²⁵ *Energy for Our Future*, p. 37.
- ²⁶ Scott Simpson, "Weyco, Hydro sign deal on private generation," *Vancouver Sun*, January 16, 2003.
- ²⁷ BC Hydro claims that it is immediately saving money because it can use the power it would have sold to Weyerhaeuser to sell on the open market at higher prices than Weyerhaeuser would have paid. This is an odd form of accounting that seems to completely set aside the enormous cost (\$18 million) of acquiring this power.
- ²⁸ Simpson, *op. cit.*
- ²⁹ As noted elsewhere, all electricity production has negative environmental impacts and this is especially true of large dams. (See Marjorie Griffin Cohen, *Public Power and the Political Economy of Electricity Competition*, *op. cit.*) However, once these dams are in place, hydro certainly ranks as more environmentally benign than fossil fuel generated electricity.
- ³⁰ BC Powerex's trading has not been without controversy, however. BC Powerex has been accused by California of manipulating the power market in order to achieve excessive returns. FERC has already determined that Powerex must refund \$279 million to California and a further \$163 million could be lost, according to BC Hydro's annual report. The potential loss could be as high as \$1.3 billion if all of California's arguments are accepted by FERC. (Scott Simpson, "Powerex chief to face U.S. investigators," *Vancouver Sun*, Jan. 24, 2003.)
- ³¹ *Energy for Our Future*, p.14.
- ³² BC Hydro, "A Briefing on BC Hydro's Transmission Capacity Requirements," Sept. 2002.
- ³³ See, for example, press release of the Consumer Federation of America and Consumers Union, November 14, 2002.
- ³⁴ Commission for Environmental Cooperation (CEC), *Electricity in North America: Some Environmental Implications of the North American Free Trade Agreement (NAFTA)*, March 1999, p. 290.
- ³⁵ *Energy for Our Future*, p. 22.
- ³⁶ The new energy plan notes this by saying, "in general, reforms are intended to reduce costs by making electricity markets more competitive." (p. 16).
- ³⁷ *Energy for Our Future*, p. 20.
- ³⁸ *Energy for Our Future*, p. 22.
- ³⁹ *Energy for Our Future*, p. 19.
- ⁴⁰ "Greenhouse Gases, Global Climate Change and Energy," National Energy Information Centre, Washington, D.C., December 3, 2002. <http://www.eia.doe.gov/oiaf>
- ⁴¹ CEC, 1999, p. 313
- ⁴² *Energy for Our Future*, p. 24.
- ⁴³ *Energy for Our Future*, p. 35.
- ⁴⁴ *Globe and Mail*, November 13, 2002.
- ⁴⁵ Policy Action #3.

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