Preliminary 2010 Revenue Requirements

Tab 3

Revenue Requirements

Table of Contents

3.0 Overview

As presented in Table 3.0 on page 3 of this Tab, FortisBC is forecasting 2010 Revenue Requirements deficiency at 2009 rates of approximately $11.0 million, requiring a forecast rate increase of 4.6 percent effective January 1, 2010. A summary of the 2010 Revenue Requirements drivers is as follows:

i. **Power Supply**: Increases in Power Supply Costs due to load growth, price increases and provincial water fees is forecast to require a 2.0 percent rate increase or $6.9 million of increased Revenue Requirements;

ii. **Operating**: O&M Expense net of capitalized overhead plus wheeling expense and other income are forecast to require a 0.4 percent increase or $1.2 million of increased Revenue Requirements;

iii. **Taxes**: Increases in property taxes, offset by a reduction in income tax results in a $0.4 million increase in Revenue Requirements or a 0.1 percent rate increase;

iv. **Financing**: Financing the Company's ongoing investment in new and upgraded infrastructure continues to be a primary rate driver, resulting in a 2.4 percent rate increase or $8.5 million in Revenue Requirements;

v. **Incentive and Other Adjustments**: Incentive sharing (including the 2008 incentive true-up) and flow-through adjustments reduce Revenue Requirements by $0.9 million, a 0.3 percent rate decrease.

Each of these components is discussed in detail in this Tab. All 2009 forecast operating and capital amounts including the Incentive Adjustment are based on July 31, 2009 financial statements with a forecast for the August to December results. A full set of financial schedules supporting the Revenue Requirements calculations can be found in Tab 4 of this Application. On or before November 2, 2009, FortisBC will file updates to the 2009 and 2010 forecasts incorporating actual results to September 30, 2009.

Table 3.0: Overview of Revenue Requirements

		Approved 2009	Increase or (Decrease)	Forecast 2010
			($000s)	
1	Sales Volume (GWh)	3,107		3,174
2	Rate Base	907,977		975,827
3	Return on Rate Base	7.38%		7.28%
4				
5	**REVENUE DEFICIENCY**			
6				
7	**POWER SUPPLY**			
8	Power Purchases	70,944	6,280	77,224
9	Water Fees	8,480	584	9,064
10		79,424	6,864	86,288
11	**OPERATING**			
12	O&M Expense	46,573	1,310	47,883
13	Capitalized Overhead	(9,315)	(262)	(9,577)
14	Wheeling	4,010	139	4,149
15	Other Income	(4,915)	61	(4,855)
16		36,353	1,248	37,601
17	**TAXES**			
18	Property Taxes	11,561	987	12,548
19	Income Taxes	4,354	(596)	3,758
20		15,915	391	16,306
21	**FINANCING**			
22	Cost of Debt	34,803	1,981	36,784
23	Cost of Equity	32,215	2,056	34,271
24	Depreciation and Amortization	37,504	4,475	41,978
25		104,522	8,512	113,034
26				
27	Prior Year Incentive True Up	173	(495)	(322)
28	Flow Through Adjustments	(435)	(497)	(933)
29	ROE Sharing Incentives	(1,181)	87	(1,095)
30		(1,443)	(906)	(2,349)
31				
32	**TOTAL REVENUE REQUIREMENT**	234,771	16,108	250,879
33				
34	Carrying Cost on Rate Base Deferral Account	(8)	8	-
35	ADJUSTED REVENUE REQUIREMENT	234,763	16,116	250,879
36	**LESS: REVENUE AT APPROVED RATES**			239,873
37	**REVENUE DEFICIENCY for Rate Setting**			11,006
38				
39	**RATE INCREASE**			**4.60%**

3.1 Power Supply

3.1.1 Power Purchase Expense

Power Purchase expense is forecast to be $77.2 million in 2010, an increase of 10.0 percent over the 2009 forecast amount as summarized in Table 3.1.1 below. The increase is primarily due to an increase in forecast load, greater use of the BC Hydro Power Purchase Agreement, and BC Hydro and Brilliant Plant rate increases, partially offset by reduced market requirements. The details of the 2010 Power Purchase forecast are discussed in Tab 6 of this Application.

Table 3.1.1: Power Purchase Expense

		Actual 2008	Forecast 2009	Forecast 2010
			(GWh)	
1	FortisBC	1,610	1,552	1,593
2	DSM	-	11	30
3	Power Purchases (net of surplus sales)	1,791	1,884	1,889
4	Total System Load (before DSM savings)	3,401	3,447	3,512
5	Less DSM	-	(11)	(30)
6	Total System Load (including DSM savings)	3,401	3,436	3,482
			($000s)	
7	Expense - Energy	53,540	59,022	63,467
8	Expense - Capacity	12,624	12,255	13,881
9	Capital Projects, Accounting & Other Adjustments	(154)	(1,076)	(125)
10	Total Power Purchase Expense	66,010	70,201	77,224

3.1.2 Water Fees

Water fees are assessed by the Province based on FortisBC's generation in the previous year and the rate is indexed to BC Hydro rate increases in the previous year.

An increase in the provincial rate is responsible for the $0.5 million increase in water fees in 2010, as shown in Table 3.1.2 below.

Table 3.1.2: Water Fees

		Actual 2008	Forecast 2009	Forecast 2010
1	Plant Entitlement Use (GWh) in previous year	1,498	1,608	1,552
2	Water Fees ($000s)	7,878	8,563	9,064

3.2 Operating

3.2.1 2010 Operating and Maintenance ("Gross O&M") Expense

Gross O&M Expense is primarily determined by formula under the PBR mechanism, with the addition of a small number of cost items that are forecast on an annual basis. The formula-driven portion of Base O&M is calculated as follows, and the components are defined below:

Base O&M	=	Base O&M per Customer
	x	[1 + (BC CPI – PIF)]
	x	Average Number of Customers

i. Base O&M Cost per Customer is defined as the 2006 Gross O&M Expense excluding Pension, Post Retirement Benefits, and the Trail Office lease costs divided by the Average Number of Customers in 2006, as adjusted annually for inflation and productivity.

The Base O&M Cost per Customer for the purposes of calculating Revenue Requirements under PBR is $382.48 in 2009, as approved by Commission Order G-193-08.

ii. The BC Consumer Price Index ("CPI") for 2010 has been forecast at 2.1 percent based on the following sources:

Toronto Dominion Bank - July 16, 2009	1.5%
Conference Board of Canada - July 15, 2009	2.6%
BC Ministry of Finance - September 1, 2009	2.1%
Average (rounded)	**2.1%**

(FortisBC previously included a forecast by the Royal Bank in its CPI forecast for Revenue Requirements. The Royal Bank no longer forecasts BC CPI.)

iii. The 2010 Productivity Improvement Factor is 1.5 percent when CPI is less than 3 percent, pursuant to the 2009 NSA.

The calculation of the 2010 Gross O&M Expense is presented in Table 3.2.1 below.

Table 3.2.1: 2010 Gross O&M Expense

		Approved 2009	Forecast 2010
1	O&M, Formula-Driven		
2	Base O&M Cost per Customer	$ 382.48	379.04
3	Consumer Price Index (British Columbia)	2.1%	2.1%
4	Productivity Improvement Factor	-3.0%	-1.5%
5	O&M per Customer, Escalated	$ 379.04	381.31
6	Average Number of Customers (Line 17)	110,921	112,051
		($000s)	
7	Base O&M (Line 5 times Line 6)	42,043	42,726
8	Pension and Post-Retirement Benefits (Note 1)	3,318	3,945
9	Trail Office Lease (Note 1)	1,212	1,212
10	Mandatory Reliability Standards	-	-
11	Total Operating and Maintenance Expense for Base O&M	46,573	47,883
12	Capitalized Overhead	(9,315)	(9,577)
13	Net Operating & Maintenance Expense	37,258	38,307
14	Number of Customers		
15	Opening Count	109,928	111,190
16	Ending Count	111,913	112,911
17	Average Number of Customers	110,921	112,051

Note 1:

Under the terms of the PBR mechanism, Pension and Post-Retirement Benefits and the Trail Office Lease Costs are excluded from the formula in calculating Base O&M.

3.2.2 Mandatory Reliability Standards

On June 4, 2009 the Commission, by Order G-67-09, adopted Mandatory Reliability Standards ("MRS") developed by the North American Electric Reliability Corporation ("NERC") and the Western Electricity Coordinating Council ("WECC") for British Columbia, and ordered utilities to file by December 31, 2009 a Mitigation Plan outlining their plans to bring themselves into compliance with applicable reliability standards.

The requirements of MRS compliance meet the definition of a “Z” Factor under the terms of the PBR mechanism as defined in the 2006 NSA:

> “A “Z” factor provision is proposed to permit recovery or refund of extraordinary costs outside of the “steady state” operations as determined by the formula described for Base O&M expenses. “Z” factor circumstances limited to the following:
>
> - Directives of the BCUC or other competent regulatory agencies;
> - Acts of legislation or regulation of government;
> - Changes due to Generally Accepted Accounting Principles;
> - Changes to actuarial evaluations;
> - Force Majeure events;
> - Other extraordinary events as agreed to by the parties in the Negotiated Settlement Process.”

Order G-67-09 sets out an expected date of compliance of November 1, 2010. FortisBC is in the process of determining its O&M requirements for MRS compliance for 2011 and future years and expects to apply for “Z” factor treatment in its 2011 Revenue Requirements Application.

The one-time setup costs and capital costs of compliance are discussed in Section 3.7.2 of this Tab.

3.2.3 Capitalized Overheads

As presented in Table 3.2.1 above, Capitalized Overhead has been set at 20 percent of Gross O&M for the term of the PBR Plan (Orders G-58-06 and G-193-08).

3.2.4 Wheeling

Wheeling expense is forecast to increase in 2010 due to increased wheeling nominations at the Okanagan Interconnection Point. The expense includes wheeling service provided by BCTC under the General Wheeling Agreement ("GWA") and the Open Access Transmission Tariff ("OATT"), as well as payments to Teck Metals Ltd. ("Teck") for the use of its 71 Line.

Wheeling expense is summarized in Table 3.2.4 below and further discussed in Tab 6.

Table 3.2.4: Wheeling Expense

		Actual 2008	Forecast 2009	Forecast 2010
1	**Wheeling Nomination**		(MW)	
2	Okanagan	1,965	2,115	2,160
3	Creston	402	420	420
4	**Expense**		($000s)	
5	Okanagan	3,223	3,529	3,661
6	Creston	425	457	464
7	Other	7	28	24
8	Total Wheeling Expense	3,655	4,013	4,149

Note: Differences due to rounding.

3.2.5 Other Income

Other income is revenue, other than income from the sale of electricity, and is derived from apparatus and facilities rentals (primarily pole rentals), contract work performed for third parties and miscellaneous revenue.

Waneta and Brilliant Management Fees associated with non-routine O&M and capital work varies from year to year, as can be seen in Table 3.2.5 below.

Table 3.2.5: Other Income

		Actual 2008	Forecast 2009	Forecast 2010
			($000s)	
1	Apparatus and Facilities Rental			
2	Electric Apparatus Rental	2,281	2,875	2,288
3	Lease Revenue	169	169	136
4		2,450	3,044	2,424
5	Contract Revenue			
6	Waneta Management Fee	368	311	265
7	Waneta Management Fee Capital	170	2	106
8	Waneta Carrying Costs	94	94	94
9				
10	Brilliant Management Fee	139	194	259
11	Brilliant Management Fee Capital	314	327	228
12				
13	Fortis Pacific Holdings Inc.	516	534	572
14		1,601	1,461	1,524
15	Miscellaneous Revenue			
16	Connection Charges	469	531	495
17	NSF Cheque Charges	9	11	9
18	Sundry Revenue	175	176	182
19		652	718	686
20				
21	Investment Income	333	219	220
22				
23	Total	**5,035**	**5,441**	**4,855**

3.3 Taxes

3.3.1 Property Tax

Property tax for 2010 is based on the Company's forecasts of the assessed value of taxable assets, municipal mill rates, and taxes from revenues earned from electricity consumed within the Municipalities. The growth in assessed values is due to annual plant additions and is forecast to increase over the next several years. Overall, municipal mill rates increased in 2009, and are expected to increase again in 2010.

Table 3.3.1 below summarizes Property Tax by plant type for the years 2008 through 2010.

Table 3.3.1: Property Tax

		Actual 2008	Forecast 2009	Forecast 2010
			($000s)	
1	Generating Plant	2,459	2,548	2,760
2	Transmission and Distribution	5,209	5,405	5,651
3	Substation Equipment	2,855	3,000	3,535
4	Land and Buildings	513	524	602
5	**Total Property Tax**	**11,036**	**11,477**	**12,548**

3.3.2 Income Tax

Income Tax is forecast to decrease by $0.4 million or 8.8 percent from the 2009 forecast. The decrease is primarily attributable to increasing Capital Cost Allowance ("CCA") deductions as a result of the Company's capital expenditures as well as a 1.5 percent reduction in the statutory income tax rate from 2009 to 2010. The change in CCA rates, effective July 1, 2009, also resulted in a decrease of $0.1 million in 2009, which is included in the Flow-through Adjustments to 2010 rates, as shown in Section 3.5.

Table 3.3.2 below summarizes the impact of the tax timing differences and tax rate.

Table 3.3.2: Summary of Income Tax Expense

		Actual 2008	Forecast 2009	Forecast 2010
			($000s)	
1	UTILITY INCOME BEFORE TAX	67,032	71,179	74,813
2	Deduct:			
3	Interest Expense	30,163	33,747	36,784
4				
5	ACCOUNTING INCOME	36,869	37,432	38,029
6				
7	Deductions			
8	Capital Cost Allowance	42,886	50,466	54,530
9	Capitalized Overhead	9,062	9,315	9,577
10	Incentive & Revenue Deferrals	(654)	(584)	2,349
11	Financing Fees	922	912	681
12	Other	611	138	436
13		52,827	60,247	67,573
14				
15	Additions			
16	Amortization of Deferred Charges	2,539	2,521	3,730
17	Depreciation	31,477	34,858	38,249
18		34,016	37,379	41,979
19				
20	TAXABLE INCOME	18,058	14,563	12,435
21				
22	Tax Rate	31.0%	30.0%	28.5%
23				
24	Taxes Payable	5,598	4,369	3,544
25	Prior Years' Overprovisions/(Underprovisions)	87	(487)	-
26	Deferred Charges Tax Effect	184	239	214
27				
28	REGULATORY TAX PROVISION	5,869	4,121	3,758

3.3.3 Harmonized Sales Tax ("HST")

On July 23, 2009, the province of British Columbia announced a proposal to harmonize the provincial sales tax ("PST") of 7 percent with the federal goods and services tax ("GST") of 5 percent to create an HST with a combined rate of 12 percent effective July 1, 2010. The federal and provincial governments expect to enter into a new Canada-British Columbia Comprehensive Integrated Tax Co-ordination Agreement by September 30, 2009 in order to transition to HST. The Company has not recognized the impacts of transition to HST in the 2010 Revenue Requirements because the large business restrictions and transitional rules have not yet been finalized and the changes required to accounting and information systems cannot be reasonably determined for FortisBC at this time. The implementation of the HST meets the definition of a "Z" factor under the PBR mechanism. FortisBC will defer the impact of the harmonized tax and apply for disposition in a subsequent application to the Commission. Additional information, if available, will be provided in the November 2, 2009 Revenue Requirements Update.

3.4 Financing Costs

FortisBC's financing costs for the purpose of Revenue Requirements are based on a deemed capital structure of 60 percent debt and 40 percent equity, as confirmed by Commission Order G-58-06. The Company's capital structure and Return on Capital is summarized in Table 3.4 below.

Table 3.4: Return on Capital

		Actual 2008	Forecast 2009	Forecast 2010
			($000s)	
1	CAPITALIZATION			
2	Debt	467,835	523,439	585,496
3	Common Equity	334,039	348,960	390,331
4		801,875	872,399	975,827
5				
6	Equity as % of Total	42%	40%	40%
7				
8	EARNED RETURN			
9	Interest Expense	30,163	33,747	36,784
10	Net Earnings	31,001	33,310	34,271
11		61,164	67,057	71,055
12	RETURN ON CAPITAL			
13	Weighted Average Cost of Debt	6.45%	6.45%	6.28%
14	Return on Equity	9.28%	9.55%	8.78%
15	Weighted Average Cost of Capital	7.63%	7.69%	7.28%

3.4.1 Cost of Debt

Approximately 95 percent of FortisBC's 2010 interest expense is associated with embedded long-term debt. The Company expects to issue approximately $100 million of senior unsecured Medium Term Note ("MTN") debentures in 2010 in order to pay down the operating credit facility that it has been using to finance the Company's capital expenditure program. The debt is expected to be issued in the second half of 2010. The MTN debentures will be issued pursuant to Commission Order G-51-09 approving FortisBC's application to issue up to $300 million from time to time, according to the terms of a Shelf Prospectus, until June 11, 2011.

On April 30, 2009, the Company amended its operating credit facility. The amended operating credit facility is comprised of a $50.0 million, three-year revolving facility maturing on May 9, 2012 and a $100.0 million, 364-day revolving facility maturing on May 6, 2010.

The average balance of revolving debt outstanding for 2010 is forecast to be $24.5 million. The estimated average cost of revolving debt for 2010 is based on a combination of prime rate borrowings, Bankers Acceptance rate borrowings, and bank charges and fees.

Table 3.4.1 summarizes FortisBC's annual weighted debt balances and cost of debt for 2009 and 2010.

Table 3.4.1: Weighted Average Cost of Debt

			2009 Forecast			2010 Forecast		
			Weighted Average Balance	Interest Expense	Weighted Average Cost of Debt	Weighted Average Balance	Interest Expense	Weighted Average Cost of Debt
			($000s)			($000s)		
1	Long Term Debt							
2	Series E	11.00%	3,591	395		-	-	
3	Series F	9.65%	15,000	1,448		15,000	1,448	
4	Series G	8.80%	25,000	2,200		25,000	2,200	
5	Series H	8.77%	25,000	2,193		25,000	2,193	
6	Series I	7.81%	25,000	1,953		25,000	1,953	
7	Series J	6.75%	31,164	2,104		-	-	
8	Series 1 - 04	5.48%	140,000	7,672		140,000	7,672	
9	Series 1 - 05	5.60%	100,000	5,600		100,000	5,600	
10	Series 1 - 07	5.90%	105,000	6,195		105,000	6,195	
11	MTN - 09	6.10%	57,247	3,492		105,000	6,405	
12	MTN - 10	5.80%	-	-		20,959	1,215	
13			527,002	33,250	6.31%	560,959	34,880	6.22%
14								
15	Short Term Debt		(3,563)	497	-13.95%	24,537	1,904	7.76%
16								
17	Total Debt		523,439	33,747	6.45%	585,496	36,784	6.28%

Interest expense in 2009 is forecast to be approximately $1.1 million lower than the amount approved in rates and, under the terms of the PBR mechanism, is included as a flow-through reduction to 2010 rates as described in Section 3.5 of this Tab.

3.4.2 Cost of Equity

The Company expects to issue, subject to Commission approval, an additional $30 million of common share equity in 2010 in order to maintain its deemed capital structure of 60 percent debt and 40 percent equity.

The 2010 Allowed Return on Equity has been forecast using the August 2009 Consensus Economics forecast, in accordance with the BCUC’s Automatic Adjustment Mechanism, as shown below. FortisBC’s risk premium of 40 basis points was confirmed by Commission Order G-58-06. Final ROE under the Automatic Adjustment Mechanism will be based on the November Consensus Economics forecast.

Table 3.4.2: Return on Equity

		Approved 2009	Forecast 2010
1	Bond Yield per:	(%)	
2	10 year Government of Canada Bond Yield	3.850	3.700
3	Premium from 30 Year Bond Yield	0.504	0.529
4			
5	Forecast 30 Year Bond Yield	4.354	4.229
6	Add/Subtract 25% of yield under 5.25%	0.224	0.255
7	Adjusted Yield	4.578	4.484
8	Premium for Low Risk Utilities	3.895	3.895
9	BCUC Benchmark Forecast	8.473	8.379
10	Rounded Benchmark ROE	8.470	8.380
11	FortisBC Risk Premium	0.400	0.400
12	FortisBC Allowed ROE	**8.870**	**8.780**
13			
14	Rate Base ($000s)		975,827
15	Equity Ratio		40%
16	Allowed ROE		8.78%
17	Net Earnings ($000s)		34,271

FortisBC notes that the Terasen Utilities’ application of May 15, 2009 requests that the Commission eliminate the use of an ROE automatic adjustment mechanism in the determination of the ROE for the Terasen Utilities, and that an Oral Hearing into this application is in progress as of the filing date of this Preliminary Revenue Requirements Application. The outcome of the Terasen Utilities’ application will impact FortisBC’s allowed ROE because Terasen Gas

Inc. is the benchmark low-risk utility for purposes of applying FortisBC's risk premium.

Any impact of a Commission decision concerning the Terasen Utilities' application, if issued prior to the final determination of FortisBC's 2010 Revenue Requirements, will be incorporated into rates at that time. Otherwise FortisBC would expect to implement any resulting change to 2010 Revenue Requirements and rates by way of a flow-through adjustment at the time of the decision.

3.4.3 Depreciation and Amortization

Depreciation and Amortization expense consists of Depreciation on Plant and Equipment, and the Amortization of Deferred Charges. Depreciation Expense for 2010 has been calculated according to the rates agreed to in the 2006 NSA. The detailed calculations can be found in Tab 4 of this Application. Details on the Amortization of Deferred Charges can be found in Section 3.7.2 of this Tab and in Tab 4.

Table 3.4.3 summarizes Depreciation and Amortization Expense for the years 2008 to 2010.

Table 3.4.3: Depreciation and Amortization Expense

		Actual 2008	Forecast 2009	Forecast 2010
			($000s)	
1	Depreciation of Plant & Equipment	31,477	34,858	38,249
2				
3	Amortization of Deferred Charges	2,539	2,521	3,730
4				
5	Depreciation & Amortization Expense	34,016	37,379	41,979

3.4.4 Allowance for Funds Used During Construction ("AFUDC")

On March 9, 2007 Commission Order G-20-07 directed the Company to exclude Construction Work in Progress ("CWIP") subject to AFUDC from Rate Base for the purpose of determining Revenue Requirements.

During construction, the Company applies AFUDC to projects that are greater than $100,000 and more than three months in duration. The AFUDC rate is equal to the weighted Return on Equity plus the after tax cost of debt. The estimated AFUDC rate for 2010 is 6.2 percent (rounded), as calculated in Table 3.4.4 below.

Table 3.4.4: Calculation of AFUDC Rate for 2010

		Approved 2008	Approved 2009	Forecast 2010
1	Proportion of Debt	60.00%	60.00%	60.00%
2	Weighted Average Cost of Debt	6.43%	6.39%	6.28%
3	Income Tax Rate	32.50%	30.00%	28.50%
4	Tax-Effected Debt Component	2.60%	2.68%	2.70%
5	Proportion of Equity	40.00%	40.00%	40.00%
6	Return on Equity	9.02%	8.87%	8.78%
7	Equity Component	3.61%	3.55%	3.51%
8	AFUDC Rate (rounded)	6.20%	6.20%	6.20%

Table 3.4.5 below shows actual and forecast capital expenditures and AFUDC for 2008 through 2010.

Table 3.4.5: AFUDC

		Actual 2008	Forecast 2009	Forecast 2010
			($000)	
1	Capital Expenditures	111,579	113,953	162,670
2	AFUDC Rate	6.20%	6.20%	6.20%
3	AFUDC	3,009	3,200	4,887

3.5 Flow-through Adjustments

Flow-through adjustments (including a 2008 incentive true-up) are forecast to decrease 2010 Revenue Requirements. The flow-through adjustments are shown in Table 3.5.1 below:

a. A flow-through decrease to 2010 of $322,000 to recognize a true-up from the forecast to actual 2008 incentive;

b. A flow-through decrease to 2010 of approximately $739,000 to reflect lower Interest Expense than approved in 2009 rates;

c. A flow-through decrease to 2010 of approximately $109,000 as a result of a Capital Cost Allowance tax change for computer hardware effective July 1, 2009. This change to income tax meets the definition of "Z" factor (see page 9 of this Tab);

d. A flow-through increase, pursuant to the 2009 NSA of approximately $18,000 to recognize lower sales to the City of Nelson, following the Commission's decision in Order G-48-09 regarding BC Hydro's application to amend Section 2.1 of the FortisBC – BC Hydro Power Purchase Agreement; and,

e. A flow-through decrease to 2010 of approximately $103,000 representing lower actual Pension Expense than approved in 2009 rates.

Table 3.5.1: True Up and Flow-through Adjustments

		Approved	Forecast	Variance	Income Tax Shield	Customer Share	Flow Through Adjustment
				($000s)			
1	2008 Incentive True Up	1,443	1,765	(322)	-	100%	(322)
2	Interest Expense	34,803	33,747	(1,056)	(317)	100%	(739)
3	CCA Change for Computer Hardware	-	(109)	(109)	-	100%	(109)
4	Nelson Hydro Export Sales	-	26	26	8	100%	18
5	Pension Expense	3,318	3,171	(147)	(44)	100%	(103)
6	Flow Through Adjustment						(933)

3.6 ROE Sharing Mechanism Adjustment

The ROE Sharing Mechanism Adjustment provides for equal sharing, after the flow-through adjustments listed above, of any variance within a 2 percent band above or below the approved return on equity. The forecast ROE Sharing Mechanism Adjustment reduces the 2010 Revenue Requirements by approximately $1.1 million. The calculation of the incentive is shown in Table 3.6.1 below.

Table 3.6.1: ROE Sharing Mechanism Adjustments

		Approved	Forecast	Variance	Customer Share	ROE Incentive Adjustment
				($000s)		
1	Net Income for ROE Incentive	32,215	34,404	2,189	50.00%	(1,095)
2	Common Equity	363,191	348,960			
3	Allowed ROE	8.87%	9.86%	0.99%	50.00%	0.49%

3.7 Rate Base

Mid-Year Utility Rate Base is forecast to be approximately $975.8 million in 2010, a $103.4 million or 11.9 percent increase over the 2009/10 forecast. The increase in Rate Base is necessary to ensure the continued safe, reliable delivery of power to the Company's growing customer base. The most significant areas of expenditure are those required to expand and upgrade the bulk transmission and distribution ("T&D") system to keep pace with load growth, and to continue the Upgrade and Life Extension ("ULE") program at FortisBC's generating plants.

Table 3.7: Rate Base

		Actual 2008	Forecast 2009	Forecast 2010
			($000s)	
1	Net Additions	103,387	113,826	154,588
2	Mid-Year Utility Rate Base	802,566	872,399	975,827

3.7.1 Capital Expenditures

FortisBC received approval for its 2009–2010 Capital Expenditure Plan Application on February 27, 2009 by Commission Order G-11-09. The 2009/10 Capital Plan is focused on safety, customer service, reliability, productivity, and the environment. Capital Expenditures for 2009 and 2010 are forecast to be $110.0 and $157.1 million respectively net of customer contributions, and are described in Tab 7 of this Application.

Table 3.7.1: Summary of Capital Expenditures

		Actual 2008	Forecast 2009	Forecast 2010
			($000s)	
1	GENERATION			
2	Growth	-	-	-
3	Sustaining	16,195	20,225	19,103
4		**16,195**	**20,225**	**19,103**
5	TRANSMISSION & STATIONS			
6	Growth	38,320	44,382	81,653
7	Sustaining	8,641	7,638	10,174
8		**46,961**	**52,020**	**91,827**
9	DISTRIBUTION			
10	Growth	27,113	17,954	23,344
11	Sustaining	9,379	11,651	14,525
12		**36,492**	**29,605**	**37,869**
13	TELECOM, SCADA, PROTECTION & CONTROL			
14	Growth	1,108	2,066	1,664
15	Sustaining	1,764	800	619
16		**2,872**	**2,866**	**2,283**
17				
18	GENERAL PLANT	**9,058**	**9,237**	**11,588**
19				
20	TOTAL (as in Tab 4)	**111,579**	**113,953**	**162,670**
21				
22	RECONCILIATION TO CAPITAL ADDITIONS			
23	Demand Side Management Additions	1,634	2,513	2,826
24	Less: Contributions in Aid of Construction	(11,736)	(6,500)	(8,400)
25				
26	TOTAL (as in Tab 7)	**101,477**	**109,966**	**157,096**

3.7.2 Deferred Charges

Pursuant to Commission Order G-52-05 deferred charges are recorded net of income tax. Incentive adjustments do not impact Income Tax Expense and are therefore not recorded net of tax. Similarly, Preliminary and Investigative Charges are either charged to capital or expensed and are not tax-effected. Deferred charges are summarized below:

Table 3.7.2: Deferred Charges (Net of Tax)

		Balance at Dec. 31, 2008	Balance at Dec. 31, 2009	Additions and Transfers 2010	Amort./Transf. to Other Accts	Amortization 2010	Balance at Dec. 31, 2010
				($000s)			
1	Demand Side Management	6,654	8,233	2,826	-	(2,349)	8,710
2	Preliminary and Investigative Charges	664	1,083	2,240	(2,996)	-	327
3	Deferred Regulatory Expense	(1,352)	(1,546)	341	2,349	(59)	1,086
4	Other Deferred Charges and Credits	6,611	6,057	(529)	(50)	(987)	4,491
5	Deferred Debt Issue Costs	3,651	4,058	941	-	(335)	4,663
6	TOTAL DEFERRED CHARGES	**16,227**	**17,885**	**5,818**	**(696)**	**(3,730)**	**19,277**

In the following description of the deferred charges, with the exceptions noted above, costs are after the effect of income tax. The tax rate applicable to 2009 and 2010 deferred charge additions are 30.0 percent and 28.5 percent respectively. Please refer to Tables 1-B (2009) and 1-B (2010) in Tab 4 for detailed deferred charges schedules.

Demand Side Management

DSM expenditures of $2.8 million ($4.0 million before tax) forecast in 2010 were approved under Order G-11-09 as part of the Company’s 2009/10 Capital Plan Application. The approved 2010 spending level is required for the continuation of the Company’s existing DSM programs.

Preliminary and Investigative Charges

Expenses incurred in this category are due to investigation into potential capital projects. Upon conclusion of these studies and subsequent approval of these projects by the Commission, the costs incurred will be transferred to the approved Capital Projects.

Deferred Regulatory Expense

i. Flow-through and ROE Sharing Mechanism Adjustments

Flow-through and ROE Sharing Mechanism Adjustments in the amounts of $0.3 million (2008 true-up) and $2.0 million ($0.9 million for 2009 flow-through and $1.1 million 2009 ROE Sharing) serve to reduce 2010 Revenue Requirements by $2.3 million.

ii. 2009 Revenue Requirements

Costs for the 2009 Revenue Requirements Application, PBR Extension, and Negotiated Settlement Process totalled $30,000 ($43,000 before tax) in 2009. The Company requests approval to amortize this amount in 2010.

iii. 2010 Revenue Requirements

Costs for the 2010 Revenue Requirements Application, forecast to be $35,000 ($50,000 before tax), are being deferred as agreed in the 2009 NSA. Upon completion of the regulatory process the Company will apply for disposition of the deferred amounts.

iv. 2011 Revenue Requirements

The Company requests approval to defer the costs for the 2011 Revenue Requirements Application, forecast to be $36,000 ($50,000 before tax) in 2010. Upon completion of the regulatory process the Company will apply for disposition of the deferred amounts.

v. Cost of Service Analysis ("COSA") and Rate Design Application ("RDA")

On June 30, 2009, FortisBC submitted its draft COSA, and on or before October 30, 2009 the Company will submit is final COSA and RDA. At this time the Company anticipates the Application will be disposed of by way of an oral public hearing during 2010. Upon completion of the regulatory process the Company will apply for disposition of the deferred amounts, forecast to be approximately $533,000 ($760,000 before tax).

vi. BC Hydro Application to Amend Rate Schedule 3808

On September 16, 2008, BC Hydro filed an application requesting the Commission to amend Section 2.1 of the PPA between BC Hydro and FortisBC (BC Hydro Rate Schedule 3808). The proposed amendment would prevent FortisBC from selling electricity purchased under the PPA to a self-generating customer that intends to export its own generation. Following a written public hearing, the Commission approved BC Hydro's proposed amendment to the PPA on May 6, 2009.

Costs associated with the BC Hydro hearing are approximately $87,000 ($125,000 before tax). In 2009 the deferral account was approved as a non-rate base, non-interest bearing account. FortisBC requests approval to transfer this account to rate base, consistent with the treatment of other regulatory proceeding costs, and to amortize the deferred amounts over a period of three years beginning in 2010.

vii. Section 5 Provincial Transmission Inquiry

Section 5(4) of the Utilities Commission Act, requires a Commission inquiry into the Province's electricity transmission infrastructure and capacity needs for a 30-year period. The expected regulatory timetable includes a series of regional hearings throughout the Province in 2009 and an oral phase in January 2010.

FortisBC requests approval to defer the costs associated with its participation in the inquiry, currently forecast to be approximately

$141,000 ($200,000 before tax). Upon completion of the regulatory process the Company will apply for disposition of the deferred amounts.

viii. Renewal of BC Hydro Power Purchase Agreement

FortisBC's PPA with BC Hydro expires in 2013. FortisBC has been attempting to negotiate a renewal of the PPA since October 2005 and determined that a negotiated solution is not achievable. Recognizing the need to gain certainty on the future availability of this key resource, on June 18, 2009 FortisBC filed an Application for a renewal of the 3808 Power Purchase Agreement with BC Hydro. The Company expects this regulatory process to conclude in early 2010 and will apply for disposition of the deferred amounts at a future time.

ix. BC Hydro Waneta Transaction Application

BC Hydro has filed an application to acquire a one-third interest from Teck Metals Ltd. in the Waneta Dam. FortisBC and its customers have an interest in this transaction for a number of reasons including the potential rate impact of the acquisition. In addition, there are numerous agreements governing various aspects of existing inter-relationships among FortisBC, BC Hydro, and Teck, that may be affected, including the Waneta Management Agreement under which FortisBC operates the Waneta Dam.

The Company requests approval to defer the costs of this proceeding, estimated to be $88,000 ($125,000 before tax), and will apply for disposition of the deferred amounts upon completion of the regulatory process.

x. Terasen Utilities Return on Equity and Capital Structure Application

The Terasen Utilities filed an application for review of their respective ROEs and capital structures on May 15, 2009. Terasen Gas Inc. is considered the low-risk benchmark utility in British Columbia, and FortisBC's ROE is based on the allowed ROE for the low-risk benchmark utility plus an additional risk premium. As the outcome of this application has future implications for FortisBC's ROE, the Company is participating in the regulatory process related to this application.

The Company requests approval to defer the costs of participating in this proceeding, forecast to be approximately $42,000 ($60,000 before tax). Upon completion of the regulatory process, the Company requests approval to defer the associated costs. FortisBC will apply for disposition of the deferred amounts.

Other Deferred Charges and Credits

i. Prepaid Pension Costs

Generally Accepted Accounting Principles ("GAAP") requires that companies recognize and accrue future liabilities associated with pension benefits provided to retirees. The Company is forecasting a $1.5 million ($2.1 million before tax) decrease to this account in 2010.

ii. Post-Retirement Benefits

GAAP requires that companies recognize and accrue future liabilities associated with providing certain benefits to retirees. The Company includes the full accrued expense and the portion of accounting expense that is not paid out in cash is recorded in Deferred Charges and credited to Rate Base. The treatment is consistent with the accounting for Pension Benefits. The Company is forecasting a $1.4 million ($1.9 million before tax) increase to this account in 2010.

iii. 2008 System Development Plan (SDP) Update

The Company updated its System Development Plan in conjunction with the 2009/10 Capital Plan Application. The cost of updating the SDP, $0.8 million ($1.1 million before tax), is being amortized in 2009 and 2010 as previously approved.

iv. Advanced Metering Infrastructure ("AMI")

As directed by the Commission in Order No. G-168-08, the costs of the AMI program development are held in a deferral account pending a CPCN application which is expected to be filed in 2010.

v. 2009 Resource Plan Update

The 2009 Resource Plan is FortisBC's strategic plan for identifying existing power generation capability, forecasting long term customer load requirements, and developing solutions for meeting the supply gap over the period 2009 – 2028. The recommended solution seeks to balance the complex issues of environment, public policy, economics and stakeholder concerns. The 2009 Resource Plan was filed with the BCUC on May 29, 2009, and is currently awaiting the establishment of a regulatory schedule. Development of the 2009 Resource Plan is expected to cost approximately $0.7 million after tax ($1.0 million before tax). It is expected that the 2009 Resource Plan regulatory process will be complete in 2010, and the Company will apply for disposition of the costs when the Resource Plan is approved.

vi. Revenue Protection

In accordance with Commission Order G-58-06 the Company is directed to report annually on the costs and tangible benefits of the Revenue Protection program.

Forecast expenditures for 2009 are $220,000, which will yield approximately $444,000 in present value benefits as shown below. Consistent with past treatment, the Company has deferred the expenditures and is proposing to amortize the costs the following year.

2009 Activity	Approved Cost	Forecast Cost	Forecast Annual Savings	NPV Savings *
Power Diversion Inspections	$195,000	$190,000	$82,000	$327,000
Third Party Contracts	$30,000	$30,000	$117,000	$117,000
Total	**$225,000**	**$220,000**	**$199,000**	**$444,000**

**Discounted Savings at 8% over five years*

The primary activities undertaken in 2009 are:

Power Diversion Inspections

This is the core activity of the Revenue Protection program. The identification and correction of electrical power diversions is important for several reasons:

- Public and employee safety - Power diversions require physical changes to the electric service infrastructure that are not properly inspected. This creates a potential safety hazard for both the public and employees;
- Power purchase costs - When power is diverted, power purchase costs for all ratepayers increase. The quantifiable benefits of power diversion inspections are based solely upon power purchase savings; and
- General deterrence - Power theft investigations and the criminal charges that often accompany detection send a clear message in the service area that FortisBC is committed in its mandate to deliver electricity safely at the lowest possible cost to customers.

Third Party Contracts

Joint training sessions for the FortisBC operations group and pole licensees was a key area of focus during 2009. These sessions highlighted the obligations of the parties and introduced new electronic processes to ensure that FortisBC ratepayers continue to receive maximum benefit from these agreements.

Revenue Protection expenditures in 2010 are forecast to be $230,000.

vii. International Financial Reporting Standards

In 2008 the Canadian Accounting Standards Board ("AcSB") adopted a resolution that replaces GAAP with International Financial Reporting Standards ("IFRS") as of January 1, 2011. Further, in order to provide comparative data for 2011, companies will need to be able to collect accounting information according to IFRS standards for 2010 as well, resulting in an effective IFRS transition date of January 1, 2010 for the Company. Further details on the Company's transition to IFRS are included in Appendix B.

The Company is requesting approval to defer the costs of approximately $210,000 ($300,000 before tax) in 2009 and $159,000 ($223,000 before tax) in 2010 associated with the conversion to IFRS including research, education, training and changes to existing processes. The Company is proposing to amortize the costs in the year subsequent to the costs being incurred until fully amortized.

viii. Right-of-Way ("RoW") Encroachment Litigation

The Company is expecting to defer approximately $84,000 ($120,000 before tax) of legal costs incurred by the end of 2010 associated with an ongoing litigation matter with a land developer in relation to certain encroachments made by the developer on one of the Company's statutory right of ways in Kelowna, British Columbia. Upon resolution of the dispute, recovered cost will be recorded to the deferral account and the residual will be amortized into the Company's rates as agreed to in the 2009 NSA.

ix. 2011 – 2030 Integrated System Plan

The Company expects to incur approximately $0.9 million ($1.2 million before tax) in developing a Long Term (20-year) Integrated System Plan. The plan will provide a new 20-year Plan incorporating the Company's Resource Plan, DSM Plan, Transmission & Distribution, Generation, and General Plant Expenditures. The Company is requesting approval to defer the costs of the study and will apply for disposition of the costs in a subsequent regulatory process.

x. Demand Side Management Study

In December 2008 the Company filed the Strategic DSM Report which outlined the objectives to be addressed in the next DSM business plan. The Company is planning to develop and file the 2011 DSM 10-year plan in 2010.

In its 2009 Revenue Requirements Application, the Company applied for and received approval for expenditures of approximately $70,000 ($100,000 before tax), which are being used for the Residential and Commercial End-Use Surveys. The balance is allocated to a Conservation and Demand Potential Review and the Company is hereby applying for an additional $118,000 ($165,000 before tax) in 2010 to complete this work.

FortisBC is requesting approval to defer these additional DSM Study costs and will apply for disposition of the total DSM Study deferred costs in a subsequent regulatory process.

xi. Joint Pole Use Audit

Under the provisions of the various joint pole use contracts, the parties to the agreements are required to perform an audit of the joint use pole contacts once every five years. Any unreported contacts identified during the audit result in penalty billing ranging from 3 - 5 years and sustainable revenues over the succeeding 5 years. The audit resulted in a collection of $407,000 in penalty revenue.

FortisBC's portion of the audit costs were $109,000 ($155,000 before tax) in 2009, and are deferred to be amortized over 5 years beginning in 2009.

xii. Mandatory Reliability Standards ("MRS") Project

FortisBC expects to incur capital costs in addition to setup and ongoing operating costs to become and remain compliant with the newly adopted Mandatory Reliability Standards. The capital costs for the MRS Project are presently being carried as deferred Investigative costs and will be charged to the Capital Project once approved.

The one time setup (O&M) costs for the MRC work, presently estimated at approximately $0.8 million ($1.1 million before tax), is expected to be completed by November 2010. The costs associated with this project meet the definition of a "Z" factor under the PBR mechanism. FortisBC will apply for the disposition of these costs in a subsequent application to the Commission.

Deferred Debt Issue Costs

i. Medium Term Note Debenture

On May 7, 2009, the Commission approved an application by FortisBC to issue, from time to time over a period to June 11, 2011, up to $300 million of Medium Term Note Debentures, according to the provisions of a Shelf Prospectus. The Company expects to issue $100 million in senior unsecured MTN debentures in 2010 in order to finance the Company's capital expenditure program. FortisBC requests approval to defer the issue costs, estimated at $1.1 million, and to amortize the costs over the term of the debt issue.

3.8 Non Rate Base Deferred Accounts

Appendix B of this Application discusses the developments and implementation of accounting guidance under Canadian GAAP and IFRS, and notes that although FortisBC will be required to apply IFRS in full beginning January 1, 2011, financial statements for the year ended December 31, 2010, including opening balances as at January 1, 2010, will require restatement for comparative purposes.

The most significant difference currently identified by the Company between GAAP and IFRS relates to the treatment of regulatory assets and liabilities. The Company requests acknowledgement and approval by the Commission of certain non-rate base deferral accounts at this time in order to permit this comparative reporting. As these deferral accounts are excluded from rate base, they do not have an impact on customer rates for 2010. The request for approval includes the following deferral accounts (please refer to Appendix B for detail):

Table 3.8: Non Rate Base Deferred Accounts

		BCUC Order (Note 1)	Forecast 2010 Regulatory Asset / (Regulatory Liability)
			($000s)
1	Capitalization of Depreciation on Assets Used in Construction		(3,700)
2	Property, Plant and Equipment - Gains and Losses on Disposal of Assets		2,000
3	Customer Contributions Amortization Rate and Timing		(510)
4	Depreciation Changes for Property, Plant & Equipment		7,500
5	Depreciation of Major Inspections		160
6	Deferred Income Taxes	G-37-84 & G-193-08	92,050
7	Pension and Employee Future Benefit Costs - Cumulative Unamortized Actuarial Gains and Losses, Past Service Costs, and Change in Measurement Date Upon Transition		29,890
8	Brilliant Terminal Station Capital Lease	G-2-04 & G-193-08	5,090
9	Other Post-Retirement Benefits	G-52-05 & G-193-08	3,536
10	Trail Office Building Lease	G-41-93 & G-193-08	1,249
11			**137,265**

The inclusion of Non Rate Base assets in the 2010 Revenue Requirements is discussed further in Appendix B.

Note 1: Deferral recognition has been approved through the Orders listed above.

3.9 Contingent Liabilities

The Provincial Ministry has alleged breaches of the Forest Practices Code and negligence relating to a forest fire near Vaseux Lake and has filed and served a Writ and Statement of Claim against FortisBC. In addition, private land owners have filed a separate Writ and Statement of Claim in relation to the same matter. FortisBC is communicating with its insurers and has filed a Statement of Defence in relation to both of the actions. The outcome cannot be reasonably determined and estimated at this time. Accordingly no amount has been accrued in the financial statements. Costs to date have been covered under insurance provisions for the Company. The Company received approval in its 2009 Revenue Requirements to defer future costs not covered under the Company's insurance coverage. Disposal of those amounts would be the subject of a subsequent regulatory application.