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March 17, 2011

British Columbia Public Interest Advocacy Centre
Suite 209 – 1090 West Pender Street
Vancouver, BC
V6E 2N7

Attention: Mr. James L. Quail, Executive Director

Dear Mr. Quail:

Re: FortisBC Energy Inc.[1] ("FEI")
Application for Approval of a Service Agreement for Compressed Natural Gas ("CNG") Service and for Approval of General Terms and Conditions ("GT&Cs") for CNG and Liquified Natural Gas ("LNG") Service (the "Application")

Response to the British Columbia Public Interest Advocacy Centre on behalf of the British Columbia Old Age Pensioners Organization et al ("BCOAPO") Information Request ("IR") No. 3

On December 1, 2010, FEI filed the Application as referenced above. In accordance with Commission Order No. G-181-10 setting out the Regulatory Timetable for the review of the Application, FEI respectfully submits the attached response to BCOAPO IR No. 3.

If you have any questions or require further information related to this Application, please do not hesitate to contact Shawn Hill at (604) 592-7840.

Yours very truly,

FORTISBC ENERGY INC.

Original signed by Shawn Hill:

For: Diane Roy

Attachment

cc (e-mail only): Erica Hamilton, Commission Secretary
Registered Parties

[1] Formerly Terasen Gas Inc.

1.0 Reference: Exhibit B-1, page 2

BCOAPO 2.1.1

BCOAPO 2.3.1

CEC IR 2.1

CEC 2.9.1

Preamble: *The evidence states that "TGI has previously offered a regulated NGV service. The Company's past NGV initiatives, which ultimately failed to gain lasting traction, included NGV fueling stations and targeted lightduty NGV vehicles served by a public refueling network."*

1.1 Does TGI agree that one difference between the previously offered regulated NGV service and the services previously and currently offered to new residential gas users is that, in the former case, if the service fails to "gain lasting traction" there is the possibility of stranded assets; in the latter case, while there may be a temporary incremental bad debt cost (in the case of non-payment), in the long term the residential gas distribution assets are far more likely to remain used and useful?

Response:

It is accurate to say that the Company's past NGV initiatives did not gain lasting traction because Rate Schedule 6 NGV volumes initially ramped up to 1.1 million GJ per year in 1998, but then subsequently declined to 75,000 GJ by 2009. There was also a loss on disposal of station assets of $2.13 million that was associated with the sale of the Company's fueling stations (Exhibit A2). However, during the period from 1988 to 2009, the Company delivered 10.9 million GJs under the Rate Schedule 6 tariff and, this incremental volume has generated benefits for all non-bypass customers. That is, all else equal, without the incremental volume from Rate Schedule 6 customers the delivery rates for non-bypass customers would have been higher. FEI believes it is appropriate to consider the larger picture including the financial and non-financial costs and benefits when evaluating the impact of the previous NGV initiatives on ratepayers.

In the event that the new proposed NGV refueling Service fails to gain lasting traction, in the sense that it fails to meet growth projections, the investments in each fuel station asset will still be backed by long-term "take-or-pay" commitments that recover the incremental forecast cost of service occurring during the contract term. Each of these investments will provide benefits to existing customers through increased throughput over the duration of the contract term. If a customer does not continue to take service for the life of the fueling assets, which FEI believes will normally be unlikely, then there will be stranded assets, however small.

In the case of a main extension, bad debt may be an issue if customers take service and do not pay for it. But also, the volume risk rests entirely with existing customers. If the load fails to gain lasting traction in the sense that it does not meet the load projections used in the MX Test, the assets might or might not be stranded. If every customer on the extension ceases to take service altogether, the assets would be stranded. However, the assets might well still remain used and useful but underutilized. In that case, it will have turned out to be been an unprofitable extension. The assets would then remain in rate base, as (under) used and useful assets.

1.2 Is TGI aware that in a recent gas distribution rate case in Ontario (OEB File Number EB-2010-0018, Natural Resource Gas Limited 2011 rates case) even more onerous credit requirements than TGI is proposing here have been placed by the utility on a new customer – in the form of requiring the customer to provide an irrevocable letter of credit in the amount of the net book value of the assets required to serve the customer – when there is a concern about a shutdown or ceasing operations that would lead to significant costs being recovered from other customers?

Response:

FEI is aware of this ruling by the Ontario Energy Board which required a specific customer of a small utility, Natural Resource Gas Limited, to post a letter of credit in exchange for the utility investing in a capital project required to serve them. FEI believes that the proposed "take-or-pay" model is more appropriate because it provides a similar level of mitigation against the risk of under recovery while requiring a lower financial burden be placed on the customer in the immediate term than a letter of credit might represent.

1.3 Is it TGI's view that to mitigate the risk of default in the initial term, requiring a letter of credit in the amount of the net book value of assets would be overly onerous and serve as a barrier to entry?

Response:

FEI believes that stranded asset risk associated with the NGV refueling projects as proposed is comparable to other areas of core gas distribution business. As such, imposing additional barriers to commercial relationships with potential NGV customers, particularly where FEI's proposed rate design already contractually allocates more risk to the new CNG/LNG Service customer (through long-term take or pay contracts) than is allocated to new customers under the MX Test , are unnecessary and counter-productive to the goal of maximizing the opportunity for all customers to benefit from the expansion of the NGV refueling business. FEI believes that requiring a letter of credit on top of undertaking the creditworthiness assessment, as discussed in our response to CEC IR 2.9.1, would be shortsighted from the perspective of existing customers.

1.4 Does TGI agree that "take or pay" or minimum contract demand arrangements are fairly common in cases where firm capacity is being reserved on existing assets (e.g., for shippers on pipelines) and where long-term assets need to be constructed to serve a new customer class or use where the long-term viability is, to some degree, in question?

Response:

Yes, long-term "take or pay" contracts are often required for pipeline construction; however, the analogy to a residential or commercial customer addition under the MX Test is more apt. Pipeline construction can be expected to represent a very significant capital addition to rate base in relation to the total assets of the pipeline company. By contrast, the addition of a new CNG/LNG Service customer requires a very small investment relative to the utility rate base, just as is typically the case with heating customer additions as part of residential or commercial main extensions. There is always risk with any customer addition, regardless of end use, and the viability of an extension to add new customers is the consideration in applying the MX Test. FEI does not believe that there is substantial risk of long term assets becoming stranded in the proposed business model, however, it is exactly because we want to give existing customers comfort that their interests are being protected that we have proposed this business model in such a way that take-or-pay contracts will move additional risk on to NGV customers.

2.0 Reference: CEC IR 2.4.1

2.1 Does TGI currently have any gas delivery customers who have dual fuel capability e.g., customers who can switch to diesel fuel from natural gas, or vice versa, when the price spread between the alternate fuels makes such a switch advantageous?

Response:

FEI does have customers that have the ability to switch fuels. Examples would include:

DES Customers (e.g. Central Heat) – This major customer runs a district heating system in downtown Vancouver. Central Heat's boilers are normally fuelled with natural gas, but the customer does have the capability to use distillate products depending on fuel price levels and environmental considerations.

Greenhouse Operators (e.g. Windset) – FEI provides natural gas service to many greenhouses in BC. Some of these customers have the capability to run their operations on biomass fuels depending on economics and environmental considerations.

Industrial Accounts (e.g. Teck) – Coal drying operations in S.E. BC have the ability to switch fuel from natural gas to coal.

Residential Accounts – At the individual household level some customers have the ability to switch to electric baseboard or plug in heaters and others may switch back and forth to biomass heating through wood or pellet stoves.

In contrast to these accounts, NGV customers are generally committed to using NG for the life of the vehicle once the NGV is purchased. Hence the ability to switch back and forth is limited.

3.0 Reference: BCOAPO IR 2.2.1

BCUC IR 2.1.9

Preamble: *The second response referenced contains the following passage: "As in the case of any expenditure undertaken by the utility, the allocation of cost risk is as follows:*

• prudently incurred costs of service are recoverable in rates; and

• the shareholder bears the risk that expenditures will be disallowed if they have been imprudently incurred."

3.1 Does TGI regard the shareholder cost risk to be a real and significant risk faced by the utility in this case? If so, please provide TGI's view as to what would be required to demonstrate to the BCUC that expenditures had been imprudently incurred after the fact. Please provide illustrative examples.

Response:

FEI believes that the potential for a prudence review resulting in disallowance of FEI's investment in fueling assets is limited for two reasons.

- First, the risk that CNG/LNG fueling assets will become stranded is reasonable in light of the nature of the assets (re-deployable) and the proposed rate design (long-term "take-or-pay" contract based on cost of service rate).
- Second, the construction costs are largely subject to fixed price contracts, thus limiting the potential variability from estimates.

Although the risk of a disallowance is limited, there is also risk associated with any investment in utility assets as a result of business risk affecting the utility as a whole. The shareholder's return on equity compensates for both types of risk.

3.2 Please provide all recent cases in which TGI has received prior regulatory approval for a project but later, and after the fact, had costs disallowed due to being imprudently incurred. For each such case, please provide the initial amount or estimate for the project in the application that was approved, the actual amount spent, and the amount disallowed for recovery from ratepayers.

<u>Response:</u>

FEI (or TGI) has not incurred an instance where the Commission disallowed costs after receiving prior regulatory approval for a CPCN in the last 10 years.

The only instance in which the Commission disallowed costs of one of the FortisBC Energy Utilities in recent years was when as part of FortisBC Energy (Whistler) Inc. 2010-2011 Revenue Requirements Application, the Commission, in its Decision Order No. G-138-10, approved Conversion project costs to be included in rate base for recovery from customers to be limited to $11.03 million (as opposed to the $11.869 million proposed in the application) and therefore the total disallowance was $839K.

4.0 Reference: BCUC IR 2.33

BCSEA 2.20

4.1 Please confirm that the expected benefits to other customer classes of the proposal, as described in this application and assuming TGI does not receive any proceeds from carbon credit sales, are net of the amount of EEC initiative amounts that are proposed to be used. If unable to so confirm, please explain fully.

Response:

Confirmed, the expected benefit as calculated in the cost benefit analysis in Appendix A-1 of the Application is net of the forecast EEC incentives.

FEI has been experiencing a trend towards lower use per customer in recent years, which results in upward pressure on delivery rates, all else equal. In the FEI Utilities 2010 Long Term Resource Plan, this trend was forecast to continue, resulting in average FEI Residential use rate declines of approximately 1% per year for 2012-2030.[1] As discussed on page 22 of the CNG & LNG Service for Vehicles Application, the NGV load will serve to mitigate some of the delivery rate pressure that existing customers may face in years to come as natural gas demand for heating declines.

The table below illustrates the significance of the forecast NGV load to FEI's existing non-bypass customers - the forecast NGV load minimizes delivery rate increases that would otherwise occur in the case of a 1% decline in Residential use rates and results in a net delivery rate decrease by the year 2025. As demonstrated in the response to CEC IR 2.11.1, a 1% decline in Residential use rates results in a forecast increase to delivery rates of $39 million, or 7.2%, in 2030. The expected benefit of the NGV load, as determined in Appendix A-1 of the Application and net of EEC costs, is a forecast reduction to delivery rates of $82.5 million, or 15.2%, in 2030, more than offsetting the delivery rate pressure of a 1% decline in Residential use rates and resulting in a net delivery rate decrease of $42.4 million, or 8.0%, in 2030.

[1] Sourced from the FortisBC Energy Utilities, Long Term Resource Plan, BCUC IR 1.53.3, Attachment 53.3

Impact to Existing Natural Gas Customers: 1% Decline in FEI Residential Customer Use Rates offset by CNG and LNG Service Benefits	**2012**	**2015**	**2020**	**2025**	**2030**
Forecast Revenue (Deficiency), $000's					
Reference Case Scenario, Decrease to Revenue Requirement	384	2,285	12,501	39,829	82,451
1% Annual Decline in Residential Use Rate, Increase to Revenue Requirement	(2,245)	(8,848)	(19,419)	(29,472)	(39,032)
Net Impact	(1,861)	(6,563)	(6,918)	10,357	43,419
Approximate Annual Delivery Rate Increase, %					
Reference Case Scenario, Decrease to Rates	-0.07%	-0.42%	-2.31%	-7.36%	-15.24%
1% Annual Decline in Residential Use Rate, Increase to Rates	0.42%	1.64%	3.59%	5.45%	7.21%
Net Impact	0.34%	1.21%	1.28%	-1.91%	-8.03%
Annual Volume Impact (TJs)					
Reference Case Scenario, Volume Increase	264	1,236	6,024	15,764	29,549
1% Annual Decline in Residential Use Rate, Volume Decrease	(686)	(2,702)	(5,929)	(8,999)	(11,918)
Net Impact	(421)	(1,465)	95	6,765	17,631