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British Columbia Utilities Commission
Sixth Floor, 900 Howe Street
Vancouver, BC V6Z 2N3

**Attention: Ms. Erica M. Hamilton,
Commission Secretary**

Dear Sirs/Mesdames:

**Re: FortisBC Energy Utilities, Project No. 3698652
Common Rates, Amalgamation and Rate Design Application**

In accordance with the Regulatory Timetable set for this proceeding by Order No. G-106-12, the FortisBC Energy Utilities are filing the attached Rebuttal Evidence in response to the Intervenor Evidence filed by Mr. Randolph Robinson and the Fort Nelson and District Chamber of Commerce.

The Rebuttal Evidence consists of the Rebuttal Evidence of the FEU, as well as the Rebuttal Expert Testimony of Mr. Gary Saleba and Ms. Kathy McShane.

Twelve hard copies of the Rebuttal Evidence will follow by courier.

Yours truly,

FASKEN MARTINEAU DuMOULIN LLP

[Original signed by Christopher Bystrom]

Christopher Bystrom

CRB/ccm
Encl.

**FortisBC Energy Utilities Common Rates, Amalgamation and
Rate Design Application**

**Rebuttal Evidence of
FortisBC Energy Utilities**

September 7, 2012

1 **Q1: What is the purpose of this Rebuttal Evidence?**

2

3 A1: The purpose of this Rebuttal Evidence is to respond to the evidence of Mr. Randolph
4 Robinson (Exhibits C11-4 and C11-5) and Fort Nelson and District Chamber of
5 Commerce (Exhibit C2-3.)

6

7 **Q2: How is this evidence organized?**

8

9 A2: This Rebuttal Evidence is organized under the following main topic headings:

- 10 1. Cost Accounting
11 2. Shared Services
12 3. Asset Impairment
13 4. Assets Held for Future Use
14 5. Rate Stabilization Accounts
15 6. Main Extension Test and Excess Capacity
16 7. Property, Plant and Equipment
17 8. Goodwill
18 9. Deferred Charges and Credits
19 10. Uncertainty in Forecasts
20 11. Bill Impacts
21 12. Conclusion

22

23 Along with this Rebuttal Evidence, the FEU are also filing the following:

- 24 • Written Rebuttal Evidence authored by EES Consulting Inc. responding to the
25 evidence of Mr. Robinson on the topic of Rate Design;
26 • Written Rebuttal Evidence authored by Ms. Kathy McShane responding to the
27 evidence of Mr. Robinson on the topic of Cost of Capital.

28

1.0 Cost Accounting

Q3: Summarize Mr. Robinson's evidence regarding cost accounting.

A3: Mr. Robinson provides a definition and methodology of cost allocation based on the monograph of Charles T. Horngren et al., *Cost Accounting a Managerial Emphasis*. He states: "This methodology is crucial to the understanding of cost recovery through rate design application." Mr. Robinson reviews four criteria of cost allocation and states: "As much as possible this particular criteria of cause and effect should be applied to every service that is going to be recovered from a customer. This will ensure that unrelated charges cannot be smoothed over services and will not become part of the cost recovery through rate design methodologies." (Exhibit C11-4, pp. 5 to 7.)

Q4: How do you respond to Mr. Robinson's evidence?

A4: Mr. Robinson's definition and methodology of cost allocation are based in general cost accounting theory. His principal source, Charles T. Horngren et al., *Cost Accounting a Managerial Emphasis*, is a cost accounting text book. In a regulated entity, cost allocation is achieved through rate design methodology. Rate design criteria include a variety of factors and are broader and more complex than the general cost accounting methodology upon which Mr. Robinson's evidence is based. The purposes of cost allocation are many, and detailed rate design methodologies have been developed to specifically deal with cost allocation issues related to rate design. Rate design methodologies are not concerned with allocating indirect costs to particular services or products, but rather with the allocation of all costs (including those that have been capitalized to services) to customer classes.

Please also see the written rebuttal testimony of Mr. Gary Saleba.

2.0 Shared Services

Q5: Summarize Mr. Robinson's evidence related to shared services.

A5: After reviewing four criteria of cost accounting, Mr. Robinson states that by "amalgamating the utilities this could cause costs to be shared on a smoothed basis simply because there is more activity in one region rather than another." Mr. Robinson then quotes a paragraph from the June 2009 KPMG Shared Service Cost Allocation

1 Review and states that: “Cost allocation is a sensitive issue and should be monitored as
2 this was demonstrated by the changes from a benefits received/ability to bear to cause
3 and effect criteria in the above review when the basis for allocating shared costs was
4 change [sic] to a more comprehensive basis.” Mr. Robinson goes on to provide excerpts
5 from the Shared Services Cost Allocation Review. (Exhibit C11-4, pp. 7 to 9.)
6

7 **Q6: What is your response to this evidence?**
8

9 A6: The allocation of shared services amongst the FEU is reviewed and approved by the
10 Commission when setting rates for the FEU in the context of a revenue requirements
11 proceeding. The shared services costs for FEVI and FEW for 2012 and 2013 have been
12 reviewed in the FEU’s 2012-2013 Revenue Requirements proceeding and approved by
13 the Commission by Order No. G-44-12.
14

15 Shared services costs for FEVI and FEW are generally allocated on the basis of number
16 of customers, number of employees, and management estimates of time. The FEU’s
17 shared services allocations are based on cost causation in all cases. Although KPMG was
18 of the opinion that a financial composite driver may be more appropriate in some cases
19 than number of customers, there was no “change from a benefits received/ability to bear
20 to cause and effect criteria” either recommended by KPMG, adopted by the FEU, or
21 approved by the Commission.
22

23 With amalgamation, shared services among the gas utilities will no longer exist (see
24 section 7.2.4 of the Application.)
25

26 **3.0 Asset Impairment and Economic Viability of FEVI**
27

28 **Q7: Please summarize Mr. Robinson’s evidence related to asset impairment.**
29

30 A7: Mr. Robinson states that asset values can be reduced under an impairment provision.
31 Although Mr. Robinson notes that no impairment of assets was made for FEVI in its
32 financial statements, he appears to suggest that an asset impairment charge should be
33 made to decrease the asset base of FEVI. He indicates that “declining demand volumes
34 resulting from declining use per customer and declining Customer additions will, it can
35 be inferred, result in lower than planned revenues hence lower future cash flows.” Mr.
36 Robinson also quotes a section from FEI’s financial statements related to the adoption of
37 US GAAP. (Exhibit C11-4, pp. 10-11.)

1 **Q8: What is your response to this evidence?**

2

3 A8: As approved by the Commission in Order No. G-117-11, the FEU will follow US GAAP
 4 for 2012 through at least 2014. The evaluation of asset impairment under US GAAP is as
 5 noted in Mr. Robinson's evidence in the extract from FEI's financial statements:
 6 "Recoverability of assets is measured by a comparison of the carrying amount of an asset
 7 to estimated undiscounted future cash flows expected to be generated by the asset and
 8 eventual disposition." The financial statement note further states: "There was no
 9 impairment of long-lived assets for the years ended December 31, 2011 and 2010." The
 10 same note appears in FEVI's 2011 audited financial statements. As the financial
 11 statements of FEI and FEVI are audited, these notes indicate that there is no asset
 12 impairment issue for either utility.

13

14 While total demand is not in fact declining for FEVI (Exhibit B-3, Table 4-1, p. 54 and
 15 Exhibit B-9, response to BCUC IR 1.61.1), declines in customer usage and customer
 16 additions would not normally result in reductions to future cash flows. This is because of
 17 the forward-looking cost of service based ratemaking methodology that is applied to the
 18 FEU, which is described more fully in the excerpt from Page 39 of Understanding Utility
 19 Regulation: A Participant's Guide to the British Columbia Utilities Commission copied
 20 below:

21

22 "When the utility applies for an increase in rates to be charged to its
 23 customers, it must justify the revenue requirements that support the request for
 24 an increase. The primary costs associated with operating the utility are:

25

- 26 • the cost to build, operate and maintain the utility's facilities;
- 27 • the cost to finance debt incurred from building these facilities;
- 28 • depreciation and amortization expenses;
- 29 • the costs of financing debt generally; and
- 30 • return on shareholders' equity including the resulting income taxes.

31

32 The Commission uses a "future forecast" methodology to review utility
 33 expenditures. This means that utilities apply for rate increases prospectively,
 34 to cover expenses that they expect to incur over a specified period in the
 35 future, called the "forecast test year" period. The term "test year" refers to a
 36 typical year, usually one, two or three years in the future. Once the total
 37 revenue requirements for the test period have been determined by the

1 Commission, this total cost is divided by the annual forecast sales volume for
2 this period to arrive at the average rate that the utility may now charge for its
3 services.”
4

5 As a result of this methodology, the effect of declining volumes, all else equal, is
6 higher rates for all customers, but these declining volumes do not directly impact
7 the cash flows of the utility, since the utility still recovers its cost of service.
8

9 **Q9: Please summarize Mr. Robinson’s evidence on the economic viability of FEVI.**

10
11 A9: Mr. Robinson asserts in a number of places, without explanatory analysis, that FEVI is
12 uneconomic (e.g., Exhibit C11-4, pp. 4 and 13) and also asserts that the decision to
13 acquire FEVI was an unsound investment decision (Exhibit C11-4, p. 13.)
14

15 **Q10: What is your response to these assertions?**

16
17 A10: Since FEVI was acquired in 2002, FEVI has increased its customer base, recovered its
18 cost of service, paid down the balance in the Revenue Deficiency Deferral Account,
19 accumulated a positive balance in the Rate Stabilization Deferral Account and earned its
20 allowed return. FEVI continues to be profitable today.
21

22 **4.0 Assets Held for Future Use**

23
24 **Q11: Please summarize Mr. Robinson’s evidence with respect to assets held for future
25 use?**

26
27 A11: Mr. Robinson states that it is prudent to build gas plant with the future service
28 requirements in mind and that this “initial oversizing the system with excess capacity is
29 acceptable.” Mr. Robinson goes on to state, however, that: “This is a clear example of
30 building for the future and it would be consistent with current asset management policy to
31 classify this excess capacity as “asset held for future use”. He then quotes section 2.9 of
32 the FEU’s capitalization policy describing assets held for future use and states “The
33 above criteria allows for the oversizing of service mains and transmission lines to be
34 managed under the classification *held for future use.*” Mr. Robinson suggests this
35 reclassification in order to “decrease the asset base subject to rate regulation.” (Exhibit
36 C11-4, pp. 11 to 12.)
37

1 **Q12: What is your response to this evidence?**

2

3 A12: Mr. Robinson’s suggestion to reclassify assets (presumably of FEVI) is not supported by
4 the quoted extract from the capitalization policy which states that, to be classified as held
5 for future use, the plant must be “not in-service or part of unfinished construction” and
6 “intended for a specific potential use within 20 years.” The mains and lines of the FEU
7 are in-service and have a present use.

8

9 Mr. Robinson’s statement is also not supported by the BCUC Uniform System of
10 Accounts regarding Account 102, Gas Plant Held for Future Use, and Account 473,
11 Services, which state:

12

13 102. GAS PLANT HELD FOR FUTURE USE

14

15 This account shall include the cost of plant owned and held for future use in gas
16 service. There shall be included herein plant acquired but never used by the
17 utility in gas service, but held for such service in the future, and plant
18 previously used by the utility in gas service, but retired from such service and
19 held pending its re-use in the future in gas service. This includes land and land
20 rights held to insure a future supply of natural gas.

21

22

23 473. Services

24

25 This account shall include the cost installed of service pipes, from the point at
26 which the main is tapped to and including the meter shut off stop, whether
27 inside or outside the building, when the company incurs such cost or when the
28 company assumes full responsibility for the maintenance and replacement of
29 property paid for by the customer. **This includes the cost of stub services run
30 in anticipation of future use, even if such services have never been used.**

31

[Emphasis added.]

32

33 It is clear from these extracts that gas plant constructed to meet peak demand or future
34 growth should be included in rate base.

1 Moreover, FEVI's rate base has been approved by the Commission in FEVI's last
2 revenue requirements proceeding (Order No. G-44-12.)

3
4 **5.0 Rate Stabilization Accounts**
5

6 **Q13: Please summarize Mr. Robinson's evidence regarding rate stabilization accounts.**
7

8 A13: In Exhibit C11-4, page 4, Mr. Robinson refers to FEVI's Gas Cost Variance Account
9 (GVCA). He states:

10
11 "[Rate Stabilization Accounts] are not intended to be a means of FortisBC
12 Energy (Vancouver Island) Inc. (FEVI) hereafter referred to as the corporation
13 [to] compensate the corporation for errors in judgement [sic] particularly in the
14 estimation of customer growth, that is the lack of growth not caused by weather
15 and natural gas cost volatility, would be wrong. Customer growth has two
16 components, customer usage and customer additions. Therefore, the company
17 bears the risk of errors in customer usage (not related to weather) and customer
18 additions to the system. It can be further contended that rates approved by
19 BCUC should not be affected by the error of customer usage and customer
20 additions.
21

22 The reason that these errors should not be compensated for in the rates is based
23 on who has the ability to affect them, the corporation or the customers. It is
24 reasonable that current customers should not have to bear the burden of higher
25 rates because of something they have no control over."
26

27 **Q14: What is your response to this evidence?**
28

29 A14: The FEU forecast both customer usage and customer growth in its revenue requirements
30 applications, which are factors in the Commission's approved rates for the FEU.
31 Demand is a function of both customer usage and customer growth. Customer growth is
32 based on customer additions.
33

34 The Vancouver Island GCVA was established effective January 1, 2003 by Commission
35 Order No. G-2-03 to accumulate the variances between the actual and the forecast gas
36 costs on a royalty adjusted basis, for amortization and recovery from, or refund to, sales
37 customers in future rates. The GCVA was approved most recently in Order G-44-12 and

1 will continue to collect the variances between the actual and forecast gas costs during
2 2012 and 2013.

3
4 The GCVA and other rate stabilization accounts are established to decrease the volatility
5 in rates caused both by such factors as fluctuations in gas prices and the significant
6 impacts of weather and other changes on use rates. The GCVA is limited to variances in
7 gas costs, and none of the FEU's rate stabilization accounts are created to capture
8 variances in customer growth from the forecast. Therefore, variances in customer
9 additions are to the risk of the shareholder in the case of both FEI and FEW, although for
10 FEVI they flow through the RSDA. While the FEU recognize that a certain level of usage
11 is required to heat homes, for instance, customers do have some control over their usage,
12 such as in which appliances they purchase and how much they choose to use them. The
13 FEU also have Commission-approved energy efficiency and conservation programs to
14 incent customers to adopt demand-side management measures that will reduce their
15 usage.

16 17 **6.0 Main Extension Test and Excess Capacity**

18
19 **Q15: Please summarize Mr. Robinson's evidence with respect to the main extension test**
20 **("MX Test") and excess capacity in Exhibit C11-3.**

21
22 A15: Mr. Robinson states (Exhibit C11-3, pp. 4-5):

23
24 Only recently, in the last four years, have there been an effort to put some
25 degree of rationalization, using a set of constraining factors, on the extension
26 of mains decisions. This however does not eliminate the fact that the entire
27 system, prior to this constraint being imposed, had been built with capacity
28 that is not being utilized today. The proof needed then is whether this
29 overcapacity is being compensated in the rate structures of the delivery and
30 midstream charges.

31
32 Mr. Robinson goes on to discuss apparent errors in sizing mains and services capacity
33 due to incentives to customers to adopt high-efficiency appliances and LEED certified
34 systems and what size of appliances customers will use.

1 Mr. Robinson states:

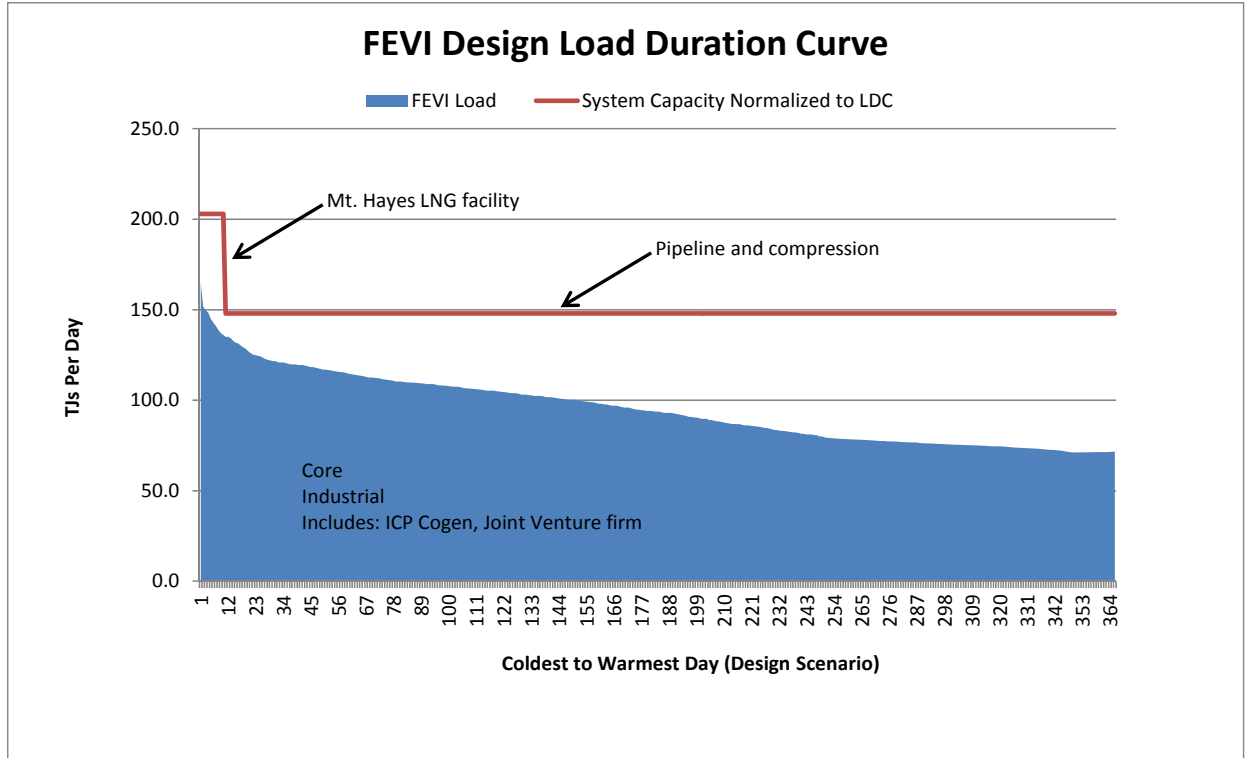
2
3 All of the above discussion is meant to support the proposition that estimates
4 and forecasts are highly subjective and follow-up on them is a problem. The
5 problem of main extensions on Vancouver Island is riskier than the lower
6 mainland where the system is established and the population is denser.
7

8 **Q16: What is your response to this evidence?**

9
10 A16: The FEU use a long-term least-cost of service approach in the planning, installation and
11 operations of the gas assets to ensure long-term use and usefulness. It is the goal of the
12 FEU to avoid pre-building capacity or stranding assets.
13

14 On an annual basis the FEU conduct a detailed analysis of peak day gas demand to
15 determine expected growth rates for all of the systems and required system improvements
16 (“SIs”). This analysis is based on actual customer demand correlated to actual
17 temperature to determine the use per customer (“UPC”). These UPCs are then combined
18 with the most current FEU forecast accounts to determine the expected peak day gas
19 demand that the FEU must meet on the coldest expected day of the year. Typically,
20 transmission system SIs are identified for a 20 year planning period; distribution SIs are
21 identified for a 5 year planning period.
22

23 In the case of FEVI, in the response to BCUC IR 2.33.2 a plot of the FEVI system
24 capacity is compared with the peak demand. The plot (copied below for reference)
25 shows that the FEVI system is designed to provide sufficient capacity to meet demand
26 and has not been over built.
27



1
2

3 Mr. Robinson's assertion that only within the last 4 years has there been a "degree of
4 rationalization" applied to the MX test is not correct. A consistent methodology to
5 review the cost inputs for main extensions has been used for many years and has been
6 filed with the Commission. The MX Annual Report for both FEI and FEVI has been
7 filed on a joint basis since 2008, each year providing an increased level of detail for the
8 Commission's review since the MX test methodology was harmonized for FEI and FEVI,
9 and approved by the Commission in 2006. FEVI filed reports with the Commission in
10 2004 that reviewed its main extension program, and in 2008 which reviewed main
11 extensions installed during 2006 and 2007. The FEU predecessor companies TGI and
12 Centra Gas were parties to the Commission's 1995 Generic System Extension Test
13 proceeding which developed the Profitability Index methodology. The main extension
14 tests used by each of the predecessor companies were approved by the Commission and
15 met the guidelines of the 1995 Generic System Extension Test proceeding.

16

17 Mr. Robinson further suggests that FEVI's use of an MX is more risky than FEI's
18 because it is a less established system in a less densely populated area. This is incorrect.
19 Population density or age of the system is irrelevant with respect to the risk portfolio of a
20 main extension. Each main extension is evaluated based upon the forecasted costs and
21 load expected to be incurred to serve a set group of customers. So long as the forecasted
22 revenues and forecasted costs (as part of the MX Test) produce an appropriate PI, the

1 main extension should be constructed and customers attached. The test takes into
 2 account the cost of future system improvements, but density of population or age of the
 3 system are otherwise irrelevant.

4
 5 While there are differences in cost for main extensions on Vancouver Island versus the
 6 Lower Mainland, there are also cost differences within the Lower Mainland, such as
 7 between West Vancouver, Vancouver and North Vancouver compared to Abbotsford.
 8 Similarly there are cost differences between mains within a specific municipality such as
 9 Vancouver. The MX Test is designed to incorporate these cost differences, which are
 10 then reflected in the outcome of such a test. The application of the MX Test is intended
 11 to be consistent amongst utilities while the forecasts of revenue and costs address the
 12 specific situation within each utility.

13
 14 **Q17: Summarize Mr. Robinson’s evidence on main extensions in his responses to**
 15 **information requests?**

16
 17 A17: In response to BCUC IR 2.1 (Exhibit C11-6-1), Mr. Robinson provides a number of
 18 “Base Cases” in which he indicates whether or not a main extension would proceed and
 19 whether the shareholder bears the risk for subsequent cash flows being different than
 20 forecast. Mr. Robinson goes on to state in response to BCUC IR 2.3 (Exhibit C11-6-1):

21 In each case there is a decision point. If an error is made in the
 22 forecasting of cash flows then the one responsible for the error
 23 bears the risk. When each party enters into an agreement to
 24 proceed, the risk is established at that point. You cannot charge
 25 someone for your error after the fact. Once the product has been
 26 delivered or service has been rendered neither party can go back on
 27 the other for anything which they assumed the risk.

28
 29 **Q18: What is your response to this evidence?**

30
 31 A18: In the Base Cases Mr. Robinson presents, it should be clarified that in cases where the PI
 32 is less than 0.8, such as in Base Case 3, the main extension would still proceed if a
 33 customer contribution were to be made as set out in section 12 of FEVI’s and FEI’s
 34 approved GT&Cs.

35
 36 Mr. Robinson’s views regarding who bears the risk for decisions and what parties can
 37 and cannot do ignore the role of the Commission in setting rates for the utility, are
 38 inconsistent with the Commission-approved GT&Cs and MX Test and are contrary to the

1 relevant regulatory principles, such as the utility’s right to have an opportunity to recover
2 its prudently incurred costs and a fair return on its investments. Under the MX Test, the
3 portfolio threshold of 1.1 is used to assess the performance of the portfolio of main
4 extensions in a given year. The utility is neither penalized for under-performing mains
5 nor rewarded for over-performing mains. Under section 12 of FEVI and FEI’s GT&Cs,
6 if a main extension overperforms, connecting customers may be eligible to a refund of a
7 portion of any contribution in aid of construction made. If there is a negative variance
8 from forecast with respect to a particular main extension, the question is not who is
9 responsible for “the error” but whether it was prudent for the utility to proceed with the
10 main extension and whether it is used and useful.

11 **7.0 Property, Plant and Equipment**

12 **Q19: Summarize Mr. Robinson’s evidence regarding property, plant and equipment.**

13
14
15
16 A19: Mr. Robinson discusses the capitalized overhead rate and allowance for funds used
17 during construction (“AFUDC”). He appears to suggest that they should be recalculated
18 based on actuals.

19
20 **Q20: What is your response to this evidence?**

21
22 A20: Mr. Robinson’s evidence appears to be based on the incorrect assumption that there is a
23 difference between the forecast and actual overheads capitalized and AFUDC rate.
24 Capitalized overheads for the FEU are calculated based on the overhead rate (a
25 percentage of O&M) approved by the BCUC from time to time. In Order No. G-44-12,
26 the Commission approved a 14% rate for 2012 and 2013. The AFUDC rate used by the
27 FEU is based on the cost of debt and equity approved by the Commission. The rates used
28 for rate setting purposes are also used to record actual capitalization amounts, in
29 accordance with regulatory practice.

30

1 **8.0 Goodwill**

2
3 **Q21: Please summarize Mr. Robinson's evidence with respect to goodwill.**

4
5 A21: On Page 6 of Exhibit C11-4, Mr. Robinson notes that there has been no impairment of
6 goodwill for FEVI. He suggests that there should be such an impairment, stating:

7
8 For goodwill to have any value there must be evidence that future cash flows
9 will be greater than normal from assets at the time of purchase. In the case of
10 FEVI there is an expected reduction in the future cash flows due to declines in
11 customer usage and customer additions from what was forecast originally.
12 This fact would necessitate that an impairment provision should be made to
13 Goodwill.

14
15 **Q22: What is your response to this evidence?**

16
17 A22: As indicated in the financial statement note quoted by Mr. Robinson, FEVI has
18 determined that for financial statement purposes there is no impairment in goodwill.
19 These financial statements have been audited. Furthermore, goodwill is not included in
20 rate base. Therefore, a reduction in goodwill would not impact the cost of service or
21 customer rates.

22
23 Mr. Robinson's statement about reduction in future cash flow is incorrect. See the FEU's
24 response above on the topic of asset impairment.

25
26 **9.0 Deferred Charges and Credits**

27
28 **Q23: Summarize Mr. Robinson's evidence on deferred charges and credits.**

29
30 A23: Mr. Robinson refers to a note in FEVI's financial statements regarding IFRS, stating that
31 there is still some uncertainty as to the implementation of accounting standards related to
32 IFRS. He also states: "Since FEVI is not growing as originally forecast the valuation of
33 assets is to be determined in the future." Mr. Robinson then refers to and comments on
34 an extract from FEW's financial statement regarding the capital contribution paid by
35 FEVI to FEW.

1 **Q24: Do you have any response to this evidence?**

2

3 A24: As indicated above, the FEU have adopted US GAAP as approved by the Commission.

4

5 In response to Mr. Robinson's assertion that FEVI is not growing as "originally forecast,"
6 FEVI's customer additions forecast variance since 2004 is shown below as was provided
7 in the FEU's 2012-2013 RRA proceeding in response to BCUC IR 1.25.4:

8

9

FEVI Customer Additions Forecast Variance

	Residential Customer Additions Forecast Variance (Number and %)		Commercial Customer Additions Forecast Variance (Number and %)	
2004	-1489	-37.7%	147	69.3%
2005	290	10.7%	229	-164.7%
2006	-17	-0.4%	-227	-80.2%
2007	-329	-8.8%	-66	-53.2%
2008	153	4.6%	-32	-15.8%
2009	582	20.9%	-15	-10.1%
2010	-150	-6.4%	38	46.3%

10

11 As can be seen from the above data, the forecast variance has been both positive and
12 negative. The average variance from 2007 to 2010 is +2.6 percent for the residential rate
13 schedule and -8.2 percent for commercial rate schedules. As customer additions are
14 based largely on housing starts, this level of variance is to be expected. In Order No. G-
15 44-12, the Commission approved the FEU's demand forecast, which incorporates the
16 customer additions forecast, for the purpose of calculating the FEU's 2012 and 2013
17 revenue requirements.

18

19 In response to Mr. Robinson's assertion that "the valuation of assets is to be determined
20 in the future," FEVI's assets have a Commission-approved rate base value for recovery
21 from customers, are not impaired and are not under prudence review.

22

10.0 Uncertainty in Forecasts

23

24 **Q25: Summarize Mr. Robinson's evidence regarding uncertainty in forecasts.**

25

26 A25: Mr. Robinson states that: "There is a degree of uncertainty in the estimates and forecasts
27 used in that utility. Any decision made with the information provided is too subjective to
28 support a decision that will have a long lasting impact on customers in both corporations
29 FEVI, FEW, and FEI."
30

1 **Q26: Do you have a response to this evidence?**

2

3 A26: There is uncertainty in estimates and forecasts in every utility and every company. Since
4 rates are set on a forward test year basis for the FEU, there is no way to avoid some
5 degree of forecast error. The forecast cost of service for the FEU, however, is determined
6 by the Commission in the context of setting rates in revenue requirement proceedings.
7 The FEU are proposing to update the cost of service of FEI Amalco for 2014 in a revenue
8 requirements application in 2013.

9

10 **11.0 Bill Impacts**

11

12 **Q27: Summarize the Fort Nelson and District Chamber of Commerce's evidence**
13 **regarding bill impacts.**

14

15 A27: The Fort Nelson and District Chamber of Commerce states that an over 50% increase to
16 residential rates and an over 27% increase in commercial natural gas rates is not a benefit.
17 The submission goes on to say that "FortisBC state in their application" that Fort Nelson
18 and other service areas "should pay to subsidize the cost of gas delivery to Whistler and
19 Vancouver Island." The Fort Nelson and District Chamber of Commerce includes a table
20 showing "FortisBC Current vs. Proposed Annual Rates" to compare the annual amounts
21 paid by Fort Nelson customers to the amounts paid by customers in other service areas.
22 The submissions suggest that perhaps other customers should subsidize Fort Nelson's
23 higher annual bills. (Exhibit C2-3, pages 1-2.)

24

25 **Q28: What is your response to this evidence?**

26

27 A28: Much of the Fort Nelson and District Chamber of Commerce's submission is legal
28 argument, which the FEU will respond to in their Final Submission. To be clear, the
29 FEU have never stated that customers should subsidize gas delivery to Vancouver Island
30 and Whistler. The FEU's proposed postage stamp rates are in accordance with accepted
31 rate design principles, under which each rate class will recover its allocated cost of
32 service.

33

34 The annual cost numbers shown in Table 1 of the Fort Nelson and District Chamber of
35 Commerce's evidence are not accurate as they are based on outdated figures. For
36 example, the 'Current Cost/GJ' numbers are based on information from the FEU's
37 December 2011 application that was withdrawn and replaced with the current April 2012,

1 Common Rates, Amalgamation and Rate Design Application. In addition to the table
 2 inaccuracies, in order to perform an ‘apples-to-apples’ comparison by region, the Annual
 3 Usage should be the same across all regions. Based on Appendices J-3 and J-4 of the
 4 FEU’s Application, and with the use of the same Annual Usage number, the correct
 5 annual bill comparisons are as follows:
 6

Rate Comparison Based on Annual Usage by Region

Area	Annual Usage (GJ)	Effective Rate \$/GJ	Proposed 2013 Annual Cost	Proposed 2014 Effective Rate \$/GJ	Proposed 2014 Annual Cost	Estimated Difference in %
FEFN	140	\$ 7.040	\$ 985.60	\$ 10.908	\$ 1,527.17	54.95%
FEI Lower Mainland	95	\$ 10.821	\$ 1,027.97	\$ 11.389	\$ 1,081.96	5.25%
FEVI	58.6	\$ 16.475	\$ 965.45	\$ 12.318	\$ 721.84	-25.23%
FEW	90	\$ 18.374	\$ 1,653.66	\$ 11.472	\$ 1,032.49	-37.56%

Based on information as included in the FEU's Common Rates, Amalgamation and Rate Design Application (Appendix J-4)

Rate Comparison Based on 90GJ Annual Usage for all Regions

Area	Annual Usage (GJ)	2013 Effective Rate \$/GJ	Proposed 2013 Annual Cost	Proposed 2014 Effective Rate \$/GJ	Proposed 2014 Annual Cost	Estimated Difference in %
FEFN	90	\$ 7.269	\$ 654.19	\$ 11.472	\$ 1,032.49	57.83%
FEI Lower Mainland	90	\$ 10.904	\$ 981.33	\$ 11.472	\$ 1,032.49	5.21%
FEVI	90	\$ 15.725	\$ 1,415.26	\$ 11.472	\$ 1,032.49	-27.05%
FEW	90	\$ 18.374	\$ 1,653.66	\$ 11.472	\$ 1,032.49	-37.56%

Rate Comparison Using Updated FEU Information as per the Application (Appendix J-4)

7
 8
 9
 10
 11
 12
 13

12.0 Conclusion

Q29: Does this conclude this rebuttal evidence.

A29: Yes.

1 *Managerial Emphasis, Sixth Edition, Pearson Canada Inc., p.559-561* in defining cost
2 allocation. While this is a standard cost accounting textbook used in the accounting
3 field, it is not specifically designed to address utility COSA nor is it used by cost of service
4 experts in developing COSA allocations and rate design.

5
6 In addition to numerous precedents in the industry and experience with COSA studies
7 for many other utilities, EES Consulting has relied on the following standard industry
8 references: *James C. Bonbright, Albert L. Danielsen, David R. Kamershen, Principles of*
9 *Public Utility Rates, second edition, 1988; The NARUC Gas Distribution Rate Design*
10 *Manual, June 1989; and American Gas Association, Gas Rate Fundamentals, fourth*
11 *edition, 1987.*

12
13 COSA allocations are typically based on cost causation, and allocations are heavily based
14 on engineering inputs as to how facilities are used by customers as well as what factors
15 the engineers used in planning the system for the utility in question. This approach is
16 more detailed and comprehensive than can be found in a standard cost accounting
17 textbook.

18
19 **Q. On page 13 of his evidence, Mr. Robinson states that “if the customer does not**
20 **demand a service over and above what they currently use, then the charges should**
21 **remain unchanged except for the cost of energy consumed and the inflationary effects**
22 **on the existing level of service costs. The forgoing reasoning would preclude the**
23 **allocation of an incremental cost of service that was not due to a customer’s change in**
24 **demand or service level.” These statements appear to imply that customers should**
25 **each be charged on the basis of the marginal cost of service. What is your response to**
26 **this evidence?**

27
28 **A. Use of incremental or marginal costs is not consistent with either the current or**
29 **proposed rates and is not appropriate to use in this context. The FEU have consistently**

1 used, and the Commission has consistently approved, the use of an embedded cost of
2 service whereby the approved revenue requirements are allocated among customer
3 classes using a COSA methodology to allocate common costs. As incremental costs are
4 not the basis for the rates designed for customers within FEI, FEVI, FEW and FEFN, we
5 do not see where it is appropriate to use it for determining the appropriateness of the
6 postage stamping of rates that are proposed under amalgamation.

7
8 **Q. Also on page 13, Mr. Robinson further states that “*The application proposes to*
9 *increase the cost of service to a group of customers, mainly Mainland gas customers,*
10 *who have not requested a change in the level of their existing service.* “ What is your
11 response to this statement?**

12
13 **A.** This is not an appropriate concept to apply when looking at the request for
14 amalgamation and postage stamp rates. Applying Mr. Robinson’s assertions, customers
15 would never be charged for any facilities that are not related to their direct request for
16 service. The postage stamping within FEI already assumes an allocation of all approved
17 costs to all customers, without direct assignment of specific facilities to specific
18 customers. Delivery rates are the same throughout the FEI service area despite the fact
19 that some areas within FEI have higher costs than other areas within FEI. Extending the
20 postage stamping to the entire system means that all customers are treated equally, as
21 opposed to segregating costs based on historical ownership differences. A portion of
22 the FEVI assets are already assigned to FEI in the approved rate base and revenue
23 requirements to reflect the FEI use of those facilities. While the FEI customers may not
24 have specifically asked to have access to the FEVI facilities, they do benefit from the use
25 of them and are able to defer capital costs within the FEI service area as a result of that
26 access.

1 **Q. In the evidence provided by Mr. Robinson, he addresses what he refers to as the**
2 **“Classification of Assets” on page 10. Is this the definition and discussion of the**
3 **Classification of Assets related to the COSA filed in support of the application?**

4
5 A. No. In the regulatory and COSA environment, classification is a term of art that refers to
6 whether the assets included in the rate base are related to energy use, peak demand or
7 the number of customers. Mr. Robinson’s comments do not refer to the classification of
8 assets that are discussed within the application, but rather refer to whether or not
9 certain FEVI assets have an economic value.

10
11 **Q. Does this conclude your rebuttal testimony?**

12
13 A. Yes.

14

1 Rebuttal Testimony of

2 Kathleen C. McShane

3 Prepared on Behalf of the FortisBC Energy Utilities

4 September 2012

5
6 **Q. What is the purpose of your rebuttal evidence in this proceeding?**

7
8 A. The purpose of my rebuttal evidence is to respond to certain issues related to capital
9 structure and return on equity raised in the Evidence of Randolph F. Robinson in Exhibit
10 C11-4. My qualifications were previously included in Appendix A to my Opinion on
11 Common Equity Ratios for the FortisBC Energy Utilities (Vancouver Island) Inc. and
12 FortisBC Energy (Whistler) Inc. filed as Appendix C-3 to the Application.

13
14 **Q. At page 4 of his evidence, Mr. Robinson states that the proposed allowed weighted
15 average return on equity of 3.85% (deemed common equity ratio X allowed ROE)
16 for FEI-Amalco is higher than the allowed weighted average return on equity for
17 pre-amalgamation FEI without any change in service. Mr. Robinson's evidence
18 suggests that the test for whether the proposed allowed return is fair is whether
19 there has been a change in service to customers. What is your response to this
20 evidence?**

21
22 A. In this proceeding, the test of whether the current rate of return is fair should be whether
23 there has been a change in risk. The evidence that has been filed in this proceeding
24 supports the conclusion that there is a marginal increase in risk for FEI-Amalco
25 compared to pre-amalgamation FEI as discussed in my Opinion on Impact of
26 Amalgamation on Cost of Capital for the FortisBC Energy Utilities filed as Appendix C-
27 4 to the Application and in BCUC IR 1.70.1. The net impact in terms of weighted
28 average cost of equity is 0.05%, reflecting no change to the 40% equity ratio and a 12
29 basis point risk premium relative to the benchmark utility, pre-amalgamation FEI ROE of
30 9.50%.

31 **Q. At page 4, Mr. Robinson claims that “when the Commission mandates a fixed rate**
32 **of return to be earned on the shareholders’ equity it takes the risk out of the**
33 **investment by the shareholder.” What is your response to this statement?**

34
35 A. The Commission does not mandate a “fixed rate of return to be earned on the
36 shareholders` equity” which “takes the risk out of the investment by the shareholder.”
37 The Commission awards an allowed rate of return on the utility’s deemed equity
38 component, which reflects both the short-term and long-term risks faced by the utility.
39 The allowed return will vary over time due to changes in risk as well as changes in
40 capital market conditions and requirements. The allowed return is not a guaranteed
41 return; the utility is given a reasonable opportunity to earn the allowed return, and to
42 recover the invested capital. The fact that the actual return in any given year may not
43 equal the allowed ROE due to variances in rate base, expenses, and revenues
44 demonstrates that the utility faces risks. While the Commission has a duty to afford the
45 utility a reasonable opportunity to earn a fair return on, and recovery of, the invested
46 capital, it cannot guarantee that the utility will be able to do so.

47
48 **Q. At page 4 Mr. Robinson states that “By blending the service costs with the larger**
49 **utility FortisBC Energy Inc. the problem that exists with the smaller utility will not**
50 **be corrected and the shareholders will not realize the negative result of a decision to**
51 **invest in a utility that requires more earnings than it can be reasonably obtained.”**
52 **At page 13, Mr. Robinson concludes that neither FEVI nor FEW are economically**
53 **viable, that FEVI’s utility asset base is overvalued given economic value based on**
54 **future cash flows, and suggests that the rate base of FEVI should be reduced, which**
55 **would reduce the equity of the shareholders, lessening the required return earned to**
56 **be recovered from rates. Please address Mr. Robinson’s conclusions.**

57
58 A. Mr. Robinson’s comment that the utility rate base is overvalued based on future cash
59 flows is at odds with the fundamentals of regulation and the fair return standard. Future
60 cash flows are in large part determined by what the Commission allows, subject to
61 competitive constraints. As noted above, and discussed at length in response to BCUC

62 IR 1.59, the Commission has a duty to afford the utility a reasonable opportunity to
63 recover a fair return on, and recovery of, the invested capital. Shareholders invest equity
64 capital in utilities on this basis, as do debt investors, and the return that they expect and
65 require on the invested capital is based on this fundamental premise. If the Commission
66 were to require FEVI and/or FEW to remove assets from the rate base which have been
67 previously found to be prudent, not only would such a requirement be contrary to the
68 regulatory compact and precedent, it would materially raise the cost rates of both debt
69 and equity capital, as well as potentially deterring any further investment in utility assets.

70

71 **Q. Does this conclude your rebuttal testimony?**

72

73 A. Yes.

74