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August 13, 2013

Via Email
Original via Mail

British Columbia Utilities Commission
6th Floor, 900 Howe Street
Vancouver, BC
V6Z 2N3

Attention: Ms. Erica M. Hamilton, Commission Secretary

Dear Ms. Hamilton:

Re: British Columbia Utilities Commission (BCUC or the Commission) Generic Cost of Capital (GCOC) Proceeding – Stage 2

FortisBC Inc. Response to the BCUC Information Request (IR) No. 1

In accordance with the Regulatory Timetable set out for Stage 2 of the GCOC proceeding by Commission Order G-77-13, FortisBC Inc. respectfully submits the attached response to BCUC IR No. 1.

If further information is required, please contact the undersigned.

Sincerely,

FORTISBC INC.

Original signed:

Dennis Swanson

Attachments

cc (email only): Registered Parties

1.0 Reference: Exhibit B1-72, Evidence of FBC, p. 11; Tab A Business Risk, p. 1

Overall Business Risk

FortisBC Inc. (FBC) states that it “operates in generally the same economic, financial, regulatory, and business environment as FEI” and that “[t]here has not been a material change since 2005 in terms of FBC’s overall business risk relative to that of FEI.” (Tab A, p. 1)

However, FBC concludes that “[t]he evidence in this Filing…support the requested equity premium over the benchmark allowed ROE of 0.50% - 0.75% and common equity ratio of 40% for FBC.” (Introduction, p.11)

1.1 Given that there has not been a material change since 2005 in FBC’s overall business risk, relative to the benchmark utility, please explain why FBC does not propose to maintain the equity risk premium of 40 bps?

Response:

FBC is proposing an equity risk premium relative to the benchmark utility, FEI, based on the expert evidence of Ms. McShane, which supports an equity risk premium in the range of 50 to 75 basis points. Based on a comprehensive assessment, the Company considers that the 40 basis point risk premium that it has previously been allowed is lower than warranted. FBC would note, although the Commission confirmed the basis point risk premium in FBC’s 2005 Revenue Requirements Application Decision (May 2005), the 40 basis point risk premium over the benchmark utility ROE actually dates back to a negotiated settlement approved by the BCUC in Order G-134-199 in December 1999. In other words, the current allowed equity risk premium is not supported by any quantitative analysis, and should, in FBC’s view, be reassessed from first principles. Based on the evidence in this proceeding, the equity risk premium should be set in the range of 50 to 75 basis points.

2.0 Reference: Exhibit B1-72, Evidence of FBC, p. 6

Credit Metrics

“FBC’s credit metrics are deteriorating.” (Section 4.1, p. 6) [Underlining added]

“Subsequent to the Phase 1 GCOC Proceeding Decision, on June 21, 2013, Moody’s put all of the rated FortisBC utilities on negative watch for a possible downgrade, citing the ‘severely weak’ financial metrics and the recent GCOC Stage 1 decision that further weakened the credit metrics of the utilities. Moody’s has also noted concern of further weakening of the credit metrics for the smaller utilities, which includes FBC, due to Stage 2 of the GCOC.

Subsequent to its change in ratings outlook, Moody’s issued a credit opinion on FBC at Baa1 (negative), dated June 26, 2013, stating that the Company’s weak financial weak financial metrics [sic] may get worse following BCUC’s generic cost of capital decision…” (Section 4.1, p. 7) [Underlining added]

2.1 Please provide FBC’s interpretations of “credit metrics” and “financial metrics.” Are they used interchangeably in the above excerpts?

Response:

Credit metrics and financial metrics are used interchangeably in the above excerpts.

3.0 Reference: Exhibit B1-72, Evidence of FBC, pp. 8-9; Tab B Opinion of Ms. McShane, p. 7

Credit Ratings

FBC states that "[a]t the current 40% allowed common equity ratio, FBC has only been able to obtain split credit ratings…As such, FBC faces a higher cost of debt than the benchmark utility, FEI, and potentially less robust access to capital than FEI during weak capital market conditions." (Introduction, p. 5)

3.1 Given that FBC proposes to maintain the common equity ratio at 40 percent, please comment how this may have any effect on the current split credit ratings?

<u>Response:</u>

Based on the required financial thresholds identified in Moody's June 26, 2013 Credit Opinion that could possibly support a ratings upgrade, FortisBC does not expect that maintaining its equity thickness at 40 percent is sufficient to obtain a ratings upgrade and thus eliminate the split credit ratings.

If the common equity ratio is maintained at 40 per cent and a 50 to 75 basis point equity risk premium relative to the benchmark utility is approved, FortisBC would expect that this regulatory support could mitigate a potential downgrade by Moody's, which would otherwise further widen the split in credit ratings between Moody's and DBRS. The avoidance of receiving a lower credit rating from Moody's is important, as the pricing in the investment-grade sector conservatively places greater weight on the lower rating than on the higher rating.

In Tab B, Ms. McShane states that "a utility with split-ratings (that is, one debt rating in the A category and one rating in the Baa/BBB category) faces a higher cost of debt and lesser market access relative to a utility with all debt ratings in the A category." (Tab B, p. 7)

3.2 Please provide a table showing FBC's debt issuance yields over the last 5 years, compared to FortisBC Energy Inc. (FEI) debt yields during the same times. What were the indicative spreads between the utilities?

<u>Response:</u>

Please refer to Attachment 3.2.

3.3 Please discuss "market access" to debt and how this can be objectively measured in both weak and normal market conditions.

Response:

Accessing the debt markets may be objectively measured by whether the debt issuer was successful or not in receiving the desired proceeds of capital at the desired term and relative credit spread. In adverse market conditions, such as in late 2008 and early 2009, an entity with a lower credit rating could have still raised debt, however, for a shorter term, and relatively higher spread, for example. This concept is further explained on page 14 of the FBC Utilities' 2012 GCOC Proceeding Final Argument Submission dated January 31, 2013 which stated that "regulated issuers with Baa/BBB ratings can be closed out of the Canadian debt market at times, particularly with longer end (20-30 year term) of the debt market necessary for financing long-term assets". FBC monitors the market through regular meetings with Debt Capital Market groups of the Canadian Chartered Banks, who provide detailed updates on the state of the markets including the demand of debt investors and deal flow. However, market access may be objectively measured on a historical basis by reviewing the terms and conditions of completed debt issuances relative to general market conditions. The one drawback of this approach in weak markets is that failed deals are not reported so access in weak markets may be overstated to the extent only successful deals are observed.

FBC states that the Company's financial risk profile was positively impacted by the 2009 ROE Decision, when the Company's ROE was adjusted from 8.87 percent to 9.9 percent, effective 2010. On page 8-9 of the Evidence, FBC indicates that if applying the benchmark utility's current capital structure and allowed ROE (38.5 percent equity and 8.75 percent ROE), FBC's crediting ratings would potentially be downgraded to a level that was seen prior to 2010. Further, FBC states that "any decrease in allowed ROE and/or decrease in equity thickness for FBC will have adverse impacts on its credit ratings and as a result, its ability to continue to obtain debt financing on similar terms as the Company enjoys currently." (p. 8)

3.4 Please discuss FBC's ability to obtain debt financing prior to 2010 (prior to the credit upgrade). Did FBC experience any liquidity issues or difficulty in obtaining lending? If so, for what reason? Was its debt financing obtained at terms which were deemed "unfavourable?" If so, how does FBC define "unfavourable?"

Response:

The following are instances, prior to the 2009 ROE Decision and rating agencies' credit upgrade in 2010, where FBC experienced certain challenges around obtaining debt financing.

FortisBC's November 2004 $140 million 10-year term debt issuance was partially restricted due to its Moody's credit rating of Baa3 at the time of issuance. The Company would have preferred to issue debt with a term of 30 years to better match the long-life of its assets, rather than a term of 10 years. Due to the Baa3 rating, the feedback from investors was that 30 year debt would be more costly and involve more execution risk given a smaller pool of buyers for 30 year Baa3 rated paper. At Baa3 the Moody's ratings was border-line investment grade and as a result many potential investors were unable or unwilling to invest for a 30 year-term.

FortisBC's July 2007 $105 million 40-year term debt issuance was partially restricted by the existence of an Earnings Coverage Test financial covenant that exists pursuant to the trust agreements for certain of its outstanding debentures. FortisBC would have preferred a larger dollar amount of proceeds from the debt issuance to finance its capital expenditure plan at the time, however, based on its cash flow and financial metrics that existed in early July 2007, the maximum dollar permitted under the Earnings Coverage Test was $105 million, the amount that was actually issued.

The structuring of FortisBC's borrowing credit facilities as $100 million short-term and $50 million long-term from 2007 through to 2009 was required due to a combination of the Company's allowed ROE during this period and the existence of the Earnings Coverage Test financial covenant. Only once the 2009 ROE Decision was received and FortisBC's allowed ROE increased from 8.87 per cent to 9.90 per cent was the Company able to change the terms of its credit facilities to $50 million short-term and $100 million long-term, thereby increasing its long-term liquidity which had been viewed as a credit challenge by the rating agencies. The 2009 ROE Decision allowed FortisBC to increase the long-term portion of its credit facilities and was a contributing factor, in combination with improved financial metrics, to the Company's two ratings upgrades in 2010.

FortisBC does not characterize the terms of these historical debt financings as "unfavourable", but does acknowledge that if FortisBC's current credit ratings, prior to the June 21, 2013 negative ratings outlook, were in place during the time of the historical financings, that the cost of debt and terms may have been more favourable. It should also be noted Moody's rating action on June 21, 2013 which changed FortisBC's outlook from "stable" to "negative" could adversely impact the Company's projected late 2013 debt issuance, which is being used to finance capital expenditures, and the Company's projected 2014 debt issuance, which is being used to refinance a maturing debt.

3.5 Did FBC raise any debt during the worst of the financial crisis in late 2008-2009? Was FBC shut out of the debt market?

Response:

No, FortisBC did not raise debt during the worst of the Financial Crisis nor did it attempt to raise debt during the worst of the crisis and, therefore, was not shut out of the debt market. FortisBC did complete a $105 million, 30 year debt issue in June 2009. At the time of issuance, the debt markets had improved and indicative interest rates had decreased by approximately 200 basis points from the highs reached in January 2009.

3.6 Is FBC's ability to obtain debt financing also impacted by the general economic environment and prevailing Bank of Canada interest rates (not solely on its credit ratings)?

Response:

Yes, FortisBC is subject to an Issuance Test financial covenant which must be passed in order to obtain new long-term debt financing. The new financing cost is an input to the Issuance Test and it is composed of the underlying Government of Canada bond yield, and an applicable credit spread, at the time of issue. The Government of Canada bond yield and credit spread are both influenced by the then prevailing economic environment. Economic conditions can lead to higher interest rates and lower the amount of debt financing available to FBC. Also, economic conditions could lead to supply and demand imbalances in the market, which could effectively shut out lower rated credits and reduce the tenors of debt issues, including those sought by FBC.

On pages 8-9 of the Evidence, FBC provides a scenario analysis of DBRS and Moody's potential credit metrics adjustments, when it applied the benchmark utility's current capital structure and allowed ROE (38.5 percent equity and 8.75 percent ROE) on a retro-active basis. The Tables are reproduced below for ease of discussion:

Table 1: DBRS Credit Metrics

EBIT Gross Interest Coverage	2012	2011	2010	avg
Per DBRS	2.4	2.4	2.1	2.3
Adjusted for 8.75% ROE and 38.5% Equity	2.2	2.1	1.9	2.1
Ratio Variance	-0.3	-0.3	-0.3	- 0.3
Percentage Variance	-11%	-11%	-12%	-11%
DBRS average EBIT Gross Interest Coverage ratio for 2005-2009				2.1

Cash Flow/Total Debt	2012	2011	2010	avg
Per DBRS	14%	13%	13%	13%
Adjusted for 8.75% ROE and 38.5% Equity	12%	12%	11%	12%
Ratio Variance	-2%	-2%	-1%	-2%
Percentage Variance	-12%	-12%	-11%	-12%
DBRS average cash flow/debt ratio for 2005-2009				11%

Table 2: Moody's Credit Metrics

(CFO Pre-W/C + Interest)/Interest Expense	2012	2011	2010	avg
Per Moody's	3.3	3.1	2.8	3.1
Adjusted for 8.75% ROE and 38.5% Equity	3.2	2.9	2.6	2.9
Ratio Variance	-0.1	-0.2	-0.2	- 0.2
Percentage Variance	-4%	-6%	-6%	-5%
Moody's average (CFO Pre-W/C+Interest)/Interest Expense ratio for 2005-2009				2.7

CFO Pre-WC/Debt	2012	2011	2010	avg
Per Moody's	10%	12%	11%	11%
Adjusted for 8.75% ROE and 38.5% Equity	9%	11%	9%	10%
Ratio Variance	-1%	-1%	-1%	-1%
Percentage Variance	-7%	-9%	-10%	-9%
Moody's average (CFO Pre-W/C/Debt ratio for 2005-2009				11%

3.7 Please explain whether the first line of each table (Per DBRS / Per Moody's) is based on FBC's current capital structure and ROE of 40 percent equity and a risk premium of 40 bps. If not, please explain the credit agencies' financial assumptions in this line.

Response:

While revenue requirement forecasts were established for each year using an approved capital structure of 40 percent equity and a risk premium of 40 bps, the first line of each table includes FortisBC's actual results for each of the years. No changes were made as these amounts are based on historical audited figures.

3.8 Please explain the derivation of the line labeled "percentage variance." Provide the calculations and discuss the significance of the figures.

Response:

The "percentage variance" is derived by dividing the "ratio variance" by the top line labelled Per DBRS/Per Moody's, which is the credit metric published by the rating agencies. This line item was shown to demonstrate the magnitude of the change should FortisBC's allowed ROE and capital structure equal the benchmark.

FBC states that "In their October 16, 2012 credit opinion Moody's identified that the CFO pre-working capital Interest coverage of below **2.7x** and CFO a pre-working capital to Debt below **10%** would lead to a downgrade." (p. 9)

3.9 Please file the October 16, 2012 credit opinion as evidence in this proceeding.

Response:

Please refer to Attachment 3.9.

3.10 In the above Table 2 illustrating Moody's credit metrics, does FBC agree that even after applying the benchmark utility's current capital structure and allowed ROE, the average ratios for the last 3 years are higher than the thresholds identified by Moody's which could lead to a potential downgrade?

Response:

Yes, the average ratios for the last three years are higher than the thresholds identified by Moody's in the October 16, 2012 credit opinion, cited in the preamble to the IR. However, FortisBC does not agree that this precludes a downgrade. At the current allowed ROE of 9.15% and 40% equity ratio, which is above the current benchmark utility's capital structure, Moody's has put FBC on negative outlook, which clearly indicates the potential for a downgrade. Moody's also stated at the time of the negative outlook that "ratings downgrades would be considered if financial metrics below 3.0x and 13% CFO pre-WC interest coverage and CFO pre-WC to debt, respectively". Calculating the credit metrics utilizing the benchmark capital structure and allowed ROE, produces 2.9x for the CFO pre-WC interest coverage and 10% for the CFO pre-WC to debt, both of which fall below Moody's most recent thresholds.

3.11 Are there any financial metric thresholds specified in the most current Moody's credit opinion? If not, is FBC able to rationalize the absence of such thresholds?

Response:

The decision to include specific financial metric thresholds in the credit opinion ultimately lies with the independent third party rating agency that retains editorial control over the form and content of all its publications.

In the most recent Moody's credit opinion, dated June 26, 2013, under the heading "What Could Change the Rating – Down", Moody's does refer to a threshold with the statement that "ratings could also fall if sustained CFO pre-WC to debt metrics remain around 10%". While only the CFO pre-WC to debt metric threshold is specifically identified, the FortisBC utilities have every expectation that Moody's has not deviated from its published ratings methodology, which still gives weight to a company's financial metrics. This is evident from comments in the recent June 21, 2013 ratings action which was released five days before its credit opinion. In its June 21, 2013 rating action of FortisBC, which changed the outlook from "stable" to "negative", Moody's indicated that "ratings downgrades would be considered if financial metrics below 3.0x and 13% CFO pre-WC interest coverage and CFO pre-WC to debt, respectively".

3.12 To the best of FBC abilities, please fill out the following tables using the assumptions provided in each scenario, restated on a retroactive basis:

Table 1 - Potential DBRS Credit Metrics

		EBIT Gross Interest Coverage				**Cash Flow/Total Debt**			
		2012	**2011**	**2010**	**Average**	**2012**	**2011**	**2010**	**Average**
Scenario 1	40% equity; +40 bps risk premium,								
Scenario 2	40% equity; +50 bps risk premium								
Scenario 3	40% equity; +60 bps risk premium								
Scenario 4	40% equity; +70 bps risk premium								

Table 2 - Potential Moody's Credit Metrics

		(CFO Pre-WC + Interest) / Interest Expense				**CFO Pre-WC / Debt**			
		2012	**2011**	**2010**	**Average**	**2012**	**2011**	**2010**	**Average**
Scenario 1	40% equity; +40 bps risk premium,								
Scenario 2	40% equity; +50 bps risk premium								
Scenario 3	40% equity; +60 bps risk premium								
Scenario 4	40% equity; +70 bps risk premium								

Response:

The pre-amble to this information request is from the October 16, 2012 Moody's credit opinion and refers to a CFO pre-working capital interest coverage below 2.7x and a CFO pre-working capital to Debt below 10%. Since that time, Moody's rating action on June 21, 2013, which changed FortisBC's outlook from "stable" to "negative", stated that "ratings downgrades would be considered if financial metrics below 3.0x and 13% CFO pre-WC interest coverage and CFO pre-WC to debt, respectively".

In the most recent Moody's credit opinion, dated June 26, 2013, under the heading "What Could Change the Rating – Down", Moody's stated that "ratings could also fall if sustained CFO pre-WC to debt metrics remain around 10%."

Scenario 1 of the Table 2 below highlights that any further degradation from FortisBC's current capital structure and allowed ROE would result in a CFO pre-WC to debt metrics of 10% in 2012.

The revised tables requested are as follows:

BCUC IR 1.3.12 - Table 1 - Potential DBRS Credit Metrics

		Estimated EBIT Gross Interest Coverage				Estimated Cash Flow/Total Debt			
		2012	2011	2010	Average	2012	2011	2010	Average
Scenario 1	40% equity; +40bps risk premium	2.3	2.3	2.0	2.2	13%	13%	12%	13%
Scenario 2	40% equity; +50bps risk premium	2.3	2.3	2.0	2.2	14%	13%	12%	13%
Scenario 3	40% equity; +60bps risk premium	2.3	2.3	2.0	2.2	14%	13%	12%	13%
Scenario 4	40% equity; +70bps risk premium	2.4	2.3	2.0	2.2	14%	13%	12%	13%

BCUC IR 1.3.12 - Table 2 - Potential Moody's Credit Metrics

		Estimated (CFO Pre-WC + Interest)/Interest Expense				Estimated CFO Pre-WC/Debt			
		2012	**2011**	**2010**	**Average**	**2012**	**2011**	**2010**	**Average**
Scenario 1	40% equity; +40bps risk premium	3.3	3.0	2.7	3.0	10%	12%	10%	11%
Scenario 2	40% equity; +50bps risk premium	3.3	3.0	2.7	3.0	10%	12%	10%	11%
Scenario 3	40% equity; +60bps risk premium	3.3	3.0	2.7	3.0	10%	12%	10%	11%
Scenario 4	40% equity; +70bps risk premium	3.3	3.1	2.8	3.0	10%	12%	10%	11%

4.0 Reference: Exhibit B1-72, Evidence of FBC, pp. 5 & 9; Tab D Moody's Credit Opinion

Financial Metrics

FBC states that it's "allowed common equity ratio has been stable at 40% since 1996, any reduction has the potential to be regarded by Moody's as a decline in the supportiveness of the regulatory framework for FBC, which would place FBC at relatively high risk of a downgrade." (p. 5)

FBC states that "In their October 16, 2012 credit opinion Moody's identified that the CFO pre-working capital Interest coverage of below **2.7x** and CFO a pre-working capital to Debt below **10%** would lead to a downgrade." (p. 9)

In Moody's Credit Opinion issued on June 26, 2013 included in Tab D, the key indicators used in the evaluation include:

Key Indicators

[1]FortisBC Inc

	[2]LTM	2012	[3]2011	2010
(CFO Pre-W/C + Interest) / Interest Expense	3.4x	3.3x	3.1x	2.8x
(CFO Pre-W/C) / Debt	10.0%	10.2%	9.4%	10.5%
(CFO Pre-W/C - Dividends) / Debt	7.4%	7.8%	7.8%	8.5%
Debt / Book Capitalization	55.3%	54.6%	55.6%	59.9%

Source: Moody's Financial Metrics TM

4.1 Given that FBC's common equity ratio and ROE has remained stable (40 percent equity, 40 bps risk premium) during the years that are included in the table above, its credit metric of "(CFO Pre-W/C + Interest) / Interest Expense" appears to have been increasing from 2.8x to 3.4x during this time period. Can it be concluded then that the determinations of capital structure and ROE do not directly impact this metric? Is it possible that other factors, such as the decrease in lending rates during this period, may have contributed to the improvement of this metric? Please discuss.

Response:

A decrease in FortisBC's current allowed ROE and equity thickness would absolutely impact the credit metric of (CFO Pre-W/C+ Interest)/Interest Expense. Should there be an increase or decrease in capital structure or allowed ROE, there would be a corresponding variability in the (CFO Pre-W/C+ Interest)/Interest Expense. Since FortisBC's allowed ROE and capital structure remained constant from 2010 to 2012, the increase in (CFO Pre-W/C+ Interest)/Interest Expense during this same period is primarily attributable to the following:

- actual earnings which were influenced by the earnings sharing mechanism permitted under the PBR agreement that was in place in 2010 and 2011, as well as earnings variances borne by FortisBC during its cost of service environment for 2012,
- increased rate base, and
- increased depreciation and amortization

This ratio can also be impacted by the changes in long-term regulatory assets and liabilities and allowance for funds used during construction. The ratio could be further impacted when debt is refinanced at a different interest rate. There is no expectation that any positive earnings variances that were realized from 2010 to 2012, that improved the metrics, will continue into the future under the 2014-2018 PBR Application and similarly affect future financial metrics.

4.2 Given that the Stage 1 GCOC Decision has determined the equity thickness of the benchmark utility is to be 38.5 percent, please discuss how this has had (if any) impact on FEI's risk profile. Provide support for any current credit risk profile of FEI, subsequent to the GCOC Stage 1 Decision, which may be relevant in your response.

Response:

The reduction in equity thickness has directly increased the financial risk (increased leverage) and hence overall risk profile of FEI. This increase in risk is seen by the action by Moody's to put FEI and the other FortisBC utilities on negative outlook due to the GCOC changes to the benchmark allowed ROE and capital structure. As noted, Moody's June 21, 2013 rating action of the FortisBC utilities which changed the outlook from "stable" to "negative" stated that "the change in rating outlook, for the FortisBC entities, reflect historically weak financial profiles that are expected to deteriorate further, given the Province's recent generic cost of capital decision."

On page 3 of Moody's Credit Opinion, it provides the context of what change could drive down FBC's credit rating:

> **What Could Change the Rating - Down**
>
> A determination that the BCUC has become a less supportive and predictable regulatory framework would likely result in a downgrade of FBC's rating, but today, we still view the regulator as supportive to long-term credit quality. The recent reduction in allowed ROE and the equity component in the capitalization for FEI, the benchmark utility, is viewed as the regulator exercising its authority over the utility monopoly's profitability, and not as a sign of a more contentiousness environment. Ratings could also fall if sustained CFO pre-WC to debt metrics remain around 10%.

4.3 Is it fair to conclude from the excerpt above that the BCUC's GCOC determinations do not signal more/less regulatory support nor is it meant to impact the utility's business environment? Does FBC agree with Moody's opinion?

<u>Response:</u>

Moody's bases its ratings on a number of factors, including regulatory environment. Within regulatory environment, a number of factors may be considered, such as the form of regulation, the regulatory process, timeliness of decisions, use of deferral mechanisms. In the context of all of those factors, FBC agrees that the general regulatory environment remains similar overall to what it was before the GCOC decision (i.e. generally supportive). However, the GCOC decision has directly contributed to a negative outlook for the FortisBC utilities, and Moody's has raised the concern of further Commission determinations further weakening the credit profile of the utilities.

Please also refer to the response to BCUC FBC IR 1.4.2.

4.4 Is it possible that FBC's CFO pre-WC to debt metrics could be impacted by other financial factors, not solely as a result of GCOC determinations? Please discuss.

<u>Response:</u>

Yes. Please refer to the response to BCUC FBC IR 1.4.1 which discussed the factors which influence the Cash from Operations (CFO) figure.

5.0 Reference: Exhibit B1-72, Tab D Moody's Credit Opinion

Financial Metrics

In the June 26, 2013 Moody's Report under the topic "What Could Change the Rating – Up," it states:

> "However, if BCUC support were to improve and financial metrics of CFO pre-WC interest coverage and CFO pre-WC to debt were to rise to 4.0X and 20%, respectively, on a sustainable basis, that would have a positive credit impact."

5.1 Assuming 40 percent equity thickness and all other input factors remain constant, what would be the equity risk premium required over the current Benchmark ROE at 8.75 percent in order for FBC to achieve the financial metrics in the preamble?

<u>Response:</u>

In order to achieve a CFO Pre WC Interest coverage of 4.0X (not considering the impact to the CFO Pre-WC to debt metric), FortisBC would require the following risk premiums over the current Benchmark ROE of 8.75%, assuming 40% equity thickness and all other input factors remain constant.

- 2012; a risk premium of approximately 700bps (7%) would be required
- 2011; a risk premium of approximately 1000bps (10%) would be required
- 2010; a risk premium of approximately 1300bps (13%) would be required

In order to achieve a CFO Pre-WC to debt of 20% (not considering the impact to the CFO Pre WC Interest coverage metric) FortisBC would require the following risk premiums over the current Benchmark ROE of 8.75%, assuming 40% equity thickness and all other input factors remain constant.

- 2012; a risk premium of approximately 22% would be required
- 2011; a risk premium of approximately 14% would be required
- 2010; a risk premium of approximately 17% would be required

While FortisBC has performed the above requested calculations to obtain the thresholds for a potential ratings upgrade, it is important to note that the Company has never suggested that its allowed ROE should be such that it achieves specific thresholds that may permit a ratings upgrade. FortisBC is more concerned with maintaining its current ratings and avoiding a downgrade as alluded to in Moody's June 21, 2013 negative outlook ratings action and Moody's June 26, 2013 Credit Opinion. However, a risk premium of 50 to 75 basis points over the allowed benchmark ROE for FortisBC would assist in mitigating this risk.

5.2 Assuming the current ROE at 9.15 percent (8.75% + 40 bps) remain constant, what would be the required equity thickness in order for FBC to achieve the financial metrics described in the preamble?

Response:

In order to achieve a CFO Pre WC Interest coverage of 4.0X (not considering the impact to the CFO Pre-WC to debt metric) FortisBC would require the following equity thickness, assuming the current ROE at 9.15 (8.75% + 40 bps) remain constant.

- 2012; an equity thickness of 52 per cent
- 2011; an equity thickness of 56 per cent
- 2010; an equity thickness of 61 per cent

In order to achieve a CFO Pre-WC to debt of 20% (not considering the impact to the CFO Pre WC Interest coverage metric) FortisBC would require the following equity thickness, assuming the current ROE at 9.15 (8.75% + 40 bps) remain constant.

- 2012; an equity thickness of 70 per cent
- 2011; an equity thickness of 58 per cent
- 2010; an equity thickness of 63 per cent

While FortisBC has performed the above requested calculations to obtain the thresholds for a potential ratings upgrade, it is important to note that the Company has never suggested that its capital structure should be such that it achieves specific thresholds that may permit a ratings upgrade. FortisBC is more concerned with maintaining its current ratings and avoiding a downgrade as alluded to in Moody's June 21, 2013 negative outlook ratings action and Moody's June 26, 2013 Credit Opinion.

6.0 Reference: Exhibit B1-72, Tab D Moody's Credit Opinion; Tab B Opinion of Ms. McShane, p. 17

Comparator to FBC

In Moody's Credit Opinion, it states that "[i]n general, the US maintains 10% (or slightly below) allowed ROEs for integrated, transmission and distribution (T&D) and LDC companies, with capital structures that approximate a 50/50 balance of debt and equity." (Moody's Credit Opinion, p. 2)

It also states that "[g]iven the GCOC's downward revision to ROE of the benchmark and the potential for a reduced equity layer, we expect that FBC's CFO pre-WC to debt will likely stay below 10% over the intermediate-term.…US integrated and transmission and distribution (T&D) peers, who have averaged 23% and 24%, respectively, since 2010." (Moody's Credit Opinion, p. 3)

6.1 Does FBC believe that US based integrated utilities are the best comparator to FBC? Why or why not?

<u>Response:</u>

FortisBC is of the view that these are relevant, appropriate and necessary comparators.

In Appendix B – Expert Opinion of Ms. McShane of FortisBC's GCOC Stage 2 Evidence submission, states that

"with only six publicly-traded utilities in Canada, it is impossible to estimate a beta for FBC using Canadian market data. However, the utility sector in the U.S. includes a sufficient number of publicly-traded companies…"

On page 100 of the Final Submission of the FortisBC Utilities for the 2012 GCOC Proceeding, Stage 1, filed on January 31, 2013, it states that:

"Canadian regulators, including the Commission, have accepted the relevance of U.S. comparables in the assessment of the cost of equity. The Commission's 2009 Decision provided: In addition, the Commission Panel continues to be prepared to accept the use of historical and forecast data of US utilities when applied: as a check to Canadian data, as a substitute for Canadian data when Canadian data do not exist in significant quantity or quality, or as a supplement to Canadian data when Canadian data gives unreliable results."

In addition, since it is Moody's that compares FortisBC to US utilities for credit metrics, the comparison is necessary as the Company's credit ratings are partially assessed on this comparison.

6.2 Did FBC or Moody's use any other Canadian based integrated utilities for comparative purposes? If not, why not?

Response:

Ms. McShane refers to other Canadian utilities for allowed Common Equity Ratios as provided in Section E – Capital Structures of Other Canadian Electric Utilities on page 22 of her evidence (Appendix B). Included in her evidence are two Canadian based integrated utilities, Newfoundland Power and Nova Scotia Power.

FortisBC cannot speak to the actual comparisons performed by the third party rating agency, Moody's, but would expect that they are required to analyze the financial metrics of each Canadian and US utilities that they rate within Moody's Regulated Electric and Gas Utilities Rating Methodology.

6.3 The above excerpt appears to only compare "integrated, transmission and distribution" companies. Does FBC or Moody's have comparative date on fully integrated utilities which include generation? If so, please provide any relevant data.

Response:

Moody's reference to integrated utilities is to vertically integrated electric utilities, for which the same summary data are provided in the FBC Credit Opinion as for T&D utilities. In other words, as the Moody's report indicates, the average CFO pre-WC to debt ratio since 2010 for US vertically integrated electrics utility peers has been 23% and for transmission and distribution (T&D) peers has been 24%.

Ms. McShane states "Since bond investors are more likely to focus on the lowest rating, it is appropriate to focus on the Moody's rating…" (Appendix B, p. 17)

6.4 Please explain the above opinion by Ms. McShane. In terms of providing a more balanced view of both DBRS and Moody's ratings and credit opinions, shouldn't the Commission consider both opinions equally? Please discuss.

Response:

No, as investors are more likely to focus on the lower rating. As discussed in response to Stage 1, BCUtilCust IR 1.5.3, a study by the Federal Reserve Bank of New York (Richard Cantor, Frank Packer and Kevin Cole, "Split Ratings and the Pricing of Credit Risk", March 1997), in analyzing split ratings of investment grade bonds, concluded that, "clearly, pricing in the investment-grade sector is more conservative-placing more weight on the lower rating than the higher rating". For bonds rated in the investment grade category, the authors concluded that, "the market prices split rated bonds between the yield implied by the lower rating and that implied by the average rating".

Two earlier studies which conclude that investors pay more attention to the lower rating are: Billingsley, R.S., R.E. Lamy, M.W. Mar, and G.R. Thompson, "Split Ratings and Bond Reoffering Yields," *Financial Management*, 14 (1985), pp. 59-65 and Liu, P., and W. Moore, "The Impact of Split Bond Ratings on Risk Premia," *Financial Review*, 22 (1987), pp. 71-85.

As an example of investors paying greater attention to the lower rating, in its "Statement of Investment Policies and Goals" for the Saskatchewan Pension Plan Contribution Fund (January 2012), the fund managers explicitly set forth their policy of looking at the lower rating when ratings differ between two rating agencies.

> "3.03.1 Balanced Fund ….
>
> (b) Split Ratings
>
> In cases where the Recognized Bond Rating Agencies do not agree on the credit rating for a bond, preferred share or asset-backed security, the security will be classified according to the following methodology:
>
> (i) If two agencies rate a security, use the lower of the two ratings;
>
> (ii) If three agencies rate a security, use the most common; and
>
> (iii) If all three agencies disagree, use the middle rating.

Please refer to Attachment 14, provided in the FBC response to ICG FBC IR 1.14.

In the case of FBC, it bears noting that the debt rating agency which accords FBC the lower rating (Moody's) placed FBC on Negative Outlook in late June 2013, raising the likelihood of a downgrade and, given investors' focus on the lower rating, an increase in debt spreads.

7.0 Reference: Exhibit B1-72, Evidence of FBC, pp. 8-9; Exhibit A2-56

Interest Rates and Debt Financing

7.1 Please discuss whether the prevailing Bank of Canada interest rate policy and capital market interest rates will have any effect on a company's ability to obtain debt financing? What about the terms of any new financing?

<u>Response:</u>

Yes, the prevailing Bank of Canada interest rate policy and capital market interest rates are factors that may affect the company's ability to obtain debt financing. Bank of Canada policy and interest rates effect the cost of borrowing but can also affect the market tone and can therefore impact debt financing. In addition, higher interest rates may negatively impact the amount of debt FortisBC can issue at a given time due to its issuance covenant that exists pursuant to certain of its indentures. The terms of debt are more effected by tone of the market and economic conditions as opposed to interest rates, however, the level of rates can impact demand for certain tenors of debt.

"A decrease in FBC's allowed ROE and/or a decrease in equity thickness from its current state, combined with <u>an environment of rising interest rates</u> and low effective taxes, would adversely impact FortisBC's liquidity arrangements." (Introduction, p. 9) [Underlining added]

Exhibit A2-56 is an article, dated July 17, 2013, which indicates that the Bank of Canada held its overnight rate at 1 percent. The central bank's Governor also states that "interest rates would in time move up and borrowers should be prepared….[b]ut the central bank won't set that trend in motion until global and domestic economic conditions recover fully …"

7.2 Pertaining to the above excerpt from FBC's evidence, please discuss whether FBC believes that there is an "environment of rising interest rates" that could occur within the next 6 months? Next 6 to 24 months? 3-5 years? Why or why not?

<u>Response:</u>

It should be noted that the specific FortisBC evidence that refers to "an environment of rising interest rates" was not put forward as a forecast of interest rates, but rather used in the context of describing the variables around FortisBC's restrictive financing covenant (referred to as the Earnings Coverage Test) that exists pursuant to the trust agreements for certain of its outstanding debentures. The main point is that if new debt issue interest rates do rise, the amount of debt that FortisBC can issue is restricted due to the existence of its Earnings Coverage Test financial covenant.

In terms of forecasting interest rates for short-term debt and rates on new issues of long-term debt over the next few months and years, FortisBC uses forecasts of Treasury Bills and benchmark Government of Canada bond interest rates provided by Canadian Chartered banks. These forecasts are provided in Appendix E to FortisBC's Performance Based Ratemaking Plan for 2014 through 2018 and were used to support the interest rate forecasts in Section D1 of this 2014RRA. Section D1 includes FortisBC's new issue interest rates on 30 year debt of 4.25%, 4.75% and 5.50% for 2013, 2014 and 2016, respectively. Also in Section D1 of the 2014 RRA, were short term interest rate forecasts of 2.40%, 2.60%, 3.50%, 4.20%, 4.50% and 4.80% for 2013 through 2018. Both long-term and short-term forecasted interest rates demonstrate an expected increase in interest rates.

FortisBC's interest rates have already risen since June 2013 as is evident by FortisBC's early August 2013 long-term debt new issuance indicative rate of 4.60% compared to the forecasted 2013 long-term debt new issuance rate of 4.25% included in the 2014 RRA filed on July 5, 2013. These forecasts of rising interest rates are also consistent with Exhibit A2-56 which quotes the Bank of Canada on July 17, 2013, stating in part that "*interest rates would in time move up and borrowers should be prepared*".

7.3 How does this view compare to the policy statement contained in the July 17th news article regarding the Bank of Canada's lending rates?

Response:

Please refer to the response to BCUC FBC IR 1.7.2.

7.4 Hypothetically, if interest rates remain low within the next 3-5 years, combined with a decrease in FBC's allowed ROE and/or decrease in equity thickness from its current state, how would this impact on FortisBC's liquidity arrangements? Please discuss and provide sample calculations where appropriate.

Response:

A further reduction in FBC's allowed ROE or capital structure would increase the potential of a downgrade in credit ratings. A downgrade would increase the cost of short and long term debt, and may restrict the tenor of long term debt issuance. With respect to debt issuance, on page 10, Table 3 – Earnings Coverage Test included in Section 1 – Introduction of FortisBC's GCOC Stage 2 evidence, the Company has provided sample calculations for the requested scenario. Table 3 shows, as at January 1, 2013, that FortisBC would lose the ability to issue $100 million ($289 million less $189 million) should its ROE and capital structure decrease to the benchmark. Table 3 shows, as at January 1, 2013, that FortisBC would lose the ability to issue approximately $130 million ($289 million less $157 million) should its ROE and capital structure decrease to the benchmark and new issue interest rates rise approximately 1 per cent.

Please also see the sensitivities provided in the responses to BCPSO FBC IRs 1.19.1 and 1.19.2.

7.5 Does FBC have any other evidence to suggest that interest rates would / could increase in the immediate term? Medium term? (Define the time period of the terms, as seen by FBC)

Response:

Please refer to the response to BCUC FBC IR 1.7.2.

7.6 Does FBC have any information with respect to fiscal policies of the respective federal and provincial governments including their corporate tax policies?

Response:

FBC obtains information with respect to government fiscal policies as they pertain to the business, as such policies are made available. For example, FBC obtained information regarding the increase in BC's general corporate income tax rate from 10% to 11% on April 1, 2013, which was implemented by Bill 2, Budget Measures Implementation Act, 2013, which received first reading on June 27, 2013 and subsequently received Royal Assent on July 25, 2013.

8.0 Reference: Exhibit B1-72, Tab A Business Risk, p. 7

Geography and Service Area

FBC states that "[n]egative events can have greater impact on the earnings and viability of a small utility operating in smaller geographic areas. A utility operating in a small geographic area has a greater potential to experience an event that impacts most or all of its service territory than a utility operating in a larger geographical area such as FEI."

8.1 Does FBC agree that the pine beetle issues centralized in the interior BC and within FBC's service territory is one example of the risk discussed in the above excerpt?

Response:

FBC agrees that the pine beetle issues are one example of a risk that impacts most or all of its service territory.

8.2 Are any other examples of risk that may affect the FBC service area where it is unable to diversify? Isn't FBC somewhat insulated from such events because of the small number and low margins of its industrial customers compared to the more stable residential and commercial classes?

Response:

Some other examples of risks that may affect the FBC service area include major road closures, adverse weather (such as snow and wind storms), forest fires, and economic downturns in certain industries.

The referenced section of FBC's Business Risk (Appendix A of Exhibit B1-72) discusses the impact and risk faced by FBC due to the geography and small size of its service area. Due to the small size of FBC's service area, FBC has a higher risk of experiencing events that are outside of the Company's control that impact most or all of its service area. The negative impacts of many of these events are not limited to FBC's Industrial customer class. Events such as major road closures, forest fires, and adverse weather can negatively impact all customer classes, as well as the electrical infrastructure in the area.

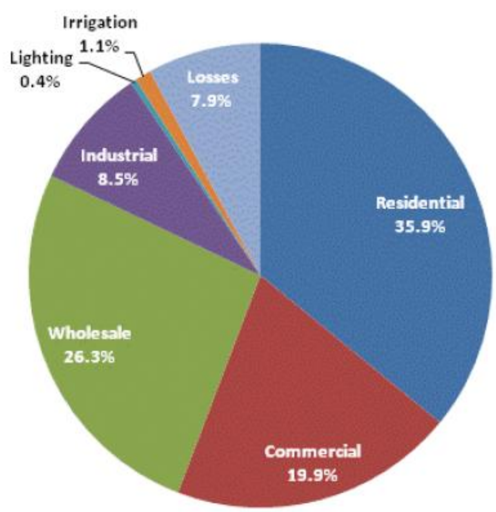
Even an adverse economic event that ostensibly only directly impacts an industrial customer can have spillover effects for other customer classes. For example, commercial customers, such as small store owners, in a community dominated by the affected industrial customer may be impacted if employment and disposable income in the community as a whole decline.

9.0 Reference: Exhibit B1-72, Tab A Business Risk, pp. 8 – 9; Tab B Opinion of Ms. McShane, p.12; FBC 2012-2013 RRA & ISP Decision, p. 116

Customer Profile – Wholesale Customer Class

FBC states that "In the case of the Wholesale customer class, approximately 22 percent4 of total utility load is sold to less than one percent of FBC's customers…the loss of their load would result in a reduction of over $32 million in revenue and a substantial rate increase of approximately 20 percent for FBC's remaining customers." (Tab A, p. 8)

FBC includes the following gross load data in its recent 2014-2018 Performance Based Ratemaking (PBR) application:[1]



(Source: FBC 2014-2018 PBR Application, Figure C1-1, p. 78)

9.1 Please clarify whether the load for the wholesale customer class is 22 percent or 26.3 percent as shown in the above figure?

Response:

The difference is attributable to the source data being from different years. Figure C1-1 in FBC's 2014-2018 PBR Plan shows the gross load composition of each customer class in 2012. Appendix A to Exhibit B1-72 sets out the 2013 load composition based on 2013 forecast data as filed in the 2014-2018 PBR Plan. Based on the 2013 forecast data, the Wholesale customer

[1] FortisBC Inc. Application for Approval of a Multi-Year Performance Based Ratemaking Plan for the 2014-2018 (2014-2018 PBR Application)

class is responsible for approximately 22 percent of total forecast load (not including losses). FBC notes that reduced Wholesale customer forecast load in 2013 is due to the acquisition of the utility assets of the City of Kelowna on March 31, 2013. The City of Kelowna is no longer a Wholesale customer of FBC.

FBC states that its "Wholesale customers have a number of options that would allow them to discontinue taking service from FBC. FBC's Wholesale customers can build generation to serve some or all of their load, purchase electricity on the open market or take service from BC Hydro through its Open Access Transmission Tariff (OATT)." (Tab A, p. 8)

9.2 Which Wholesale customers have indicated they might leave FBC and for what reasons?

Response:

Although to date, no Wholesale customers have indicated they might leave FBC service, Penticton has repeatedly made reference to its desire to generate some or all of its load through self-generation. Please refer to the response to BCUC FBC IR 1.9.4.

9.3 Please explain whether FBC's Wholesale customers' service agreements contain any take-or-pay clauses?

Response:

FBC's Wholesale customers' service agreements do not contain any take-or-pay clauses. None of FBC's Wholesale customers are required to make nominations of load and are able to discontinue embedded cost service as provided by the Access Principles Settlement Agreement (APSA) which also limits FortisBC's ability to collect stranded costs from departing customers.

9.4 Please discuss why FBC's Wholesale customers do not currently build its own generation, or purchase electricity from the open market or take service from British Columbia Hydro and Power Authority (BC Hydro) under its OATT? What are the barriers or conditions that would currently prevent the existing Wholesale customers from these supply options? Would not one expect the Wholesale customers to remain with FBC to retain access to FBC's very low cost generation? Please discuss.

Response:

FBC has not canvassed its Wholesale customers in order to determine why alternate sources of supply are not pursued. The factors which may influence this could include:

- Relative cost of existing FBC supply;
- Price risk associated with market based supply;
- Cost of transmission services;
- Cost of installation and maintenance of self-generation;
- Lack of alternate resource opportunities (such as wind and water availability);
- Lack of expertise to manage/run generation; and
- Existing contractual requirements (notice provisions)

The Company is aware that certain Wholesale municipal customers have explored generation opportunities in recent years. It assumes that historically, the cost of supply had made such resources uneconomic in the planning horizon used by the customers. However, given the current low market prices, interest in self-generation and upward pressure on rates, this situation may not persist. In fact one wholesale municipal customer currently generates part of its resource requirements and two others have expressed interest in doing so.

9.5 If the Wholesale customers purchased electricity from the open market (or from BC Hydro) and wheel the commodity over FBC's transmission infrastructure, would FBC be able to obtain wheeling revenue from these customers? How does wheeling revenue compare to sales revenues from the Wholesale customer class? Provide illustrative examples where appropriate.

Response:

FBC estimates that approximately $10.4 million in wheeling revenue would be received from the Wholesale customers if they all left FBC supply and wheeled supply to meet their loads. This is based on estimated 2014 wholesale loads and existing rates. As given in the Revenue

Requirement application in Table C1-4 on page 95, the expected Wholesale class revenue at existing rates for 2014 is $41.9 million.

To calculate the estimated wheeling revenue Rate Schedule 101, Long-Term Firm service was used. Ancillary service charges in Rate Schedule 103 to 109 were not applied since it is not certain which, if any, would apply, plus FBC anticipates significantly increased operating costs which would be offset by the ancillary service charges.

FBC currently has 6 wholesale customers, 5 of which are primary customers and one that is a transmission customer. The estimated wheeling revenue was calculated as follows:

Customer Type	Number of Customers	2014 Wholesale KVA Forecast	Monthly POD Charge Per Customer	Long Term KVA Rate
Primary Customer	5	1,066,710	$406.00	$8.60
Transmission Customer	1	270,658	$2,207.00	$4.43

(Point of Delivery Charge x 6 Points of Delivery x 12 months) + (KVA * Charge per KVA)

(((5 x $406.00) + (1 x $2,207.00)) x 12) + ($8.60 x 1,066,710) + ($4.43 x 270,658) = $10.4 million.

FBC states “all the service agreements between FBC and its Wholesale customers have early termination clauses, allowing FBC’s Wholesale customers to exit FBC’s service by providing notice.” (Tab A, p. 8)

9.6 Do the early termination clauses contain a financial penalty? If so, does FBC believe this would reduce the risk of termination?

Response:

If a Wholesale customer chooses to terminate their contract under the early termination subsection of the contract, the Wholesale customer may then be liable to pay such costs, including stranded costs, if any. The risk of being liable for costs, including stranded costs, reduces the risk of termination compared to what the risk would be in the absence of such provisions. However, given current low market prices and upward pressure on FBC rates, a Wholesale customer may still determine that pursuing alternative sources of supply is more economic, despite any early termination costs. This risk increases as FBC rates increase.

In FBC's 2012-2013 Revenue Requirement Decision, the Commission approved the establishment of the Power Purchase Expense Deferral Account and the Revenue Variance Deferral Account (2012-2013 RRA & ISP Decision, p. 116)

9.7 Please discuss the implications of these two deferral accounts and the ability of FBC to absorb any impact to revenues and expenses related to a potential shift in Wholesale customer load.

Response:

The existence of these two deferral accounts does not significantly reduce the overall business risk of FBC with respect to a potential shift in Wholesale customer load. These two deferral accounts serve to reduce short-term forecast risks with respect to power purchases and sales revenue but not the long-term risks. These deferral accounts have been put in place to ensure forecast variances do not result in costs being inappropriately borne by customers or by FBC, and are mainly used to mitigate the rate impacts and rate volatility for customers in the short-term.

As discussed in Appendix B of Exhibit B1-74, the loss of Wholesale customer load would result in a reduction of $32 million in revenue to be included in these deferral accounts, and would result in a substantial rate increase of approximately 5 percent for FBC's remaining customers. This rate increase as a result of the loss of Wholesale customer load would put even greater upward pressure on FBC's rates and make FBC more exposed to competition from alternative suppliers and forms of electricity.

Please also refer to the response to BCUC FBC IR 1.22.1.

10.0 Reference: Exhibit B1-72, Tab A Business Risk, p. 6; Commission Order C-4-13

City of Kelowna (COK)

FBC states that "[a]t December 31, 2012 the City of Kelowna municipal utility was a Wholesale customer of FBC and its approximately 15,000 customers were indirect customers of FBC. As of March 31, 2013, FBC purchased the utility assets of the City of Kelowna, and the approximately 15,000 former customers of the City of Kelowna became direct customers of FBC." (Notes to Table 2, p. 6)

10.1 Given that the COK was considered as one Wholesale customer and now equates to approximately 14,500 direct customers of FBC, does FBC agree that its customer base has grown because of this transaction?

Response:

FBC agrees, its direct customer base has grown as a result of the transaction, but in reality, one large wholesale customer has been replaced with multiple smaller customers, with no change in its load profile

10.1.1 Does the COK acquisition equate to an increase in the Company's billing determinants and hence an increase in the economies of scale?

Response:

Prior to the acquisition FBC was billing the City of Kelowna load to one customer under the Wholesale Rate Schedule. Following the acquisition FBC is billing the same City of Kelowna load to each individual customer of the City of Kelowna on the applicable rate schedule. As a result, the acquisition has increased FBC's retail billing determinants and decreased FBC's wholesale billing determinants by approximately the same amount. This provides a small amount of increased economies of scale which has provided both former CoK customers and existing FBC customers with the benefit of rate mitigation.

10.1.2 Does FBC agree that an increase in customer base equates to lowering of its customer risk? Why or why not?

Response:

FBC is unsure what is meant by customer risk. While FBC's competition risk with respect to the impact of a Wholesale customer (City of Kelowna) leaving FBC service for lower cost alternatives of electric supply has been somewhat reduced as a result of the transaction, FBC's operational risk has increased as a result of assuming ownership and operation of the assets used to serve these additional direct customers.

FBC still faces risk with respect to electricity price competitiveness in its service area even after increasing its direct customer base. Following the acquisition, the new direct residential customers (formerly indirect customers of FBC) are now subject to FBC's Residential Conservation Rate, which increases costs to those former CoK customers that heat electrically. Combined with the rate mitigation provided by the acquisition, FBC's electricity price competitiveness risk has not changed.

Overall, FBC's business risk has not changed as a result of the transaction.

10.2 Commission Order C-4-13 dated March 1, 2013, approved the COK assets to be included in FBC's regulated rate base, subject to a compliance filing detailing the specific calculations of the asset value. Please provide the calculations as evidence in this proceeding, showing the calculated net rate base along with a calculation showing the incremental amount of ROE that is related to this addition to rate base.

Response:

The necessary calculations for CoK showing the net rate base and the related ROE for this incremental Rate Base have been indicated in the Tables below:

CoK 2013 Rate Base & ROE Calculation

CoK Asset Acquisition Value per Order C-4-13	$ Millions	
NBV 2011	29.2	
CWIP 2011	3.7	
Plants 2012	4.1	
Depreciation 2011	(1.1)	
Plants Q1 2013	1.4	
Depreciation Q1 2013	(0.3)	
Land	0.7	
Total:	**37.7**	
Add: Property Transfer Tax & Registration Cost	0.07	
Total CoK Acquisition Cost:	**37.8**	
Add: CoK Year 2013 Growth & Sustaining Capital	6.2	
Total COK Plant Additions 2013	**44.0**	
2013 Mid Year Rate Base	22.0	
2013 Plant Adjustments	8.5	Refer Plant Adjustment Calculation below
CoK Rate Base 2013	**30.5**	Adjustment for Working Capital ignored for simplicity
Equity %	40%	
ROE %	9.9%	Pre GCOC Decision
Return on Equity for CoK for 2013:	**1.2**	

CoK Adjustment for Capital Additions - 2013

		CoK Acquisition Cost	CoK Growth & Sust.	Total Plant in Service	Months in Rate Base	Weighted Value
1	January			-	11.5	-
2	February			-	10.5	-
3	March			-	9.5	-
4	April	37.8	0.7	38.5	8.5	28.8
5	May		0.7	0.7	7.5	0.4
6	June		0.7	0.7	6.5	0.4
7	July		0.5	0.5	5.5	0.2
8	August		0.5	0.5	4.5	0.2
9	September		0.5	0.5	3.5	0.2
10	October		0.6	0.6	2.5	0.1
11	November		0.6	0.6	1.5	0.1
12	December		1.4	1.4	0.5	0.1
13	**Total**	**37.8**	**6.2**	**44.0**		**30.5**
14	**Less Simple Average**					22.0
15	**Adjustment to Rate Base**					**8.5**

10.3 Please provide a table showing the total gross load for each of FBC's Wholesale customers, including the COK, for the years 2010-2012.

Response:

Please refer to the below table.

	2010	2011	2012
	(GWh)		
City of Kelowna	301.3	329.3	330.7
City of Grand Forks	40.0	41.2	40.5
City of Penticton	335.5	343.8	340.2
District of Summerland	95.2	96.2	94.5
City of Nelson	88.1	88.1	79.7
BC Hydro Creston	3.3	3.2	4.8
BC Hydro Kaslo	9.4	7.6	6.0

In the FBC Purchase of COK Utility Assets proceeding,[2] FBC discusses the benefits of the transaction:

- "Existing and new FortisBC customers will receive the benefit of rate mitigation…" (COK Application p. 1)
- "Current City commercial and industrial customers will benefit by both an immediate reduction in rates and by the ongoing rate mitigation…" (COK Application p. 1)
- "All customers benefit from the increased efficiency related to the continuity of service territory…" (COK Application p. 1)

[2] In the Matter of an Application by FBC For the Purchase of the Utility Assets of the City of Kelowna (COK Application)

- "Having all customers served by one entity will increase the efficiency of providing electrical service to all Kelowna residents and provides rate mitigation benefits to all customers …" (COK Application p. 6)

10.4 Based on the benefits provided by FBC in the COK proceeding, does FBC agree that its business risk was somewhat reduced through this transaction? Why or why not?

Response:

While the transaction provided benefits to FBC customers, the benefits are not sufficient to alter the overall business risk faced by FBC. Please refer to the response to BCUC IR 1.10.1.2.

10.5 Please discuss FBC's potential opportunities to acquire other Wholesale or indirect customers (City of Penticton, Corporation of the City of Nelson, City of Grand Forks, District of Summerland)? File in confidence if required.

Response:

FBC believes that there are currently limited opportunities to acquire the other municipal wholesale customers. In part, FBC is not aware of a similar situation as existed with CoK, where the aforementioned municipalities have considered a disposition of utility assets. More importantly, FBC believes the decision approving the CoK acquisition may increase the regulatory risk to FBC in acquiring such assets that may preclude the successful conclusion of future transactions.

In 2012 FBC applied for a CPCN for the approval of the purchase of the City of Kelowna's utility assets for the purchase price of approximately $55 million. In the Application, FBC requested rate base inclusion of the full purchase price. In the Company's opinion, that purchase price was the lowest purchase price achievable in order to acquire those assets and the acquisition of those assets provided both immediate and long term benefits to both existing and soon-to-be FBC customers. Commission Order C-4-13, which approved the Application, determined that approximately $38 million was to be included in rate base, with the associated cost of capital recovered by customers, while approximately $17 million ($55 million purchase price minus $38 million rate base) to be financed by the Company shareholders, with no recovery of the cost of capital associated with the $17 million. The result of which is that the Company will earn less than the allowed ROE on the total investment in the CoK assets.

It is unlikely that the Company would pursue an acquisition with the potential for a regulatory decision that negatively impacts the allowed ROE of FBC.

10.6 Does FBC believe that the benefits (identified in the COK Application) could also apply to other Wholesale customer acquisition by FBC, allowing FBC to grow its service area and thereby increasing its rate base and customer base?

Response:

Should FBC conclude the acquisition of the other municipal wholesale customers, it would attempt to conclude such a transaction with similar benefits. However, please refer to the response to BCUC IR 1.10.5, regarding such acquisition opportunities.

10.7 Moody's Credit Opinion was issued in June 2013. To the best of FBC's knowledge, please explain why the Moody's Report did not discuss the implications on the Company's earnings or risk profile as a result of FBC's purchase of the COK distribution system.

Response:

The determination to exclude the City of Kelowna implications in the most recent credit opinion was at the discretion of Moody's. Moody's has full access to the regulatory decisions and FortisBC's continuous disclosure documents, but retains ultimate editorial control over the form and content of its publications.

10.7.1 Has FBC obtained any other credit opinion since the purchase of the COK assets where the credit review considers the COK implications for FBC?

Response:

No. DBRS' most recent report is dated March 25, 2013, prior to the close of the COK transaction on March 28, 2013.

10.8 What are FBC's views on the impact to the Company's earnings and risk profile due to the purchase of the COK assets?

Response:

The earnings of FBC will increase due to the increase in rate base of $38 million resulting from the transaction. However, as the BCUC denied $17 million of assets from rate base, FortisBC will not be able earn the approved cost of capital associated with the full value of this investment.

The addition of the CoK assets to the operations and rate base of FortisBC, as the assets and customer base are similar, does not fundamentally change the risk profile of FBC. Please refer to the responses to BCUC FBC IRs 1.10.1.2 and 1.10.9.

10.9 Please explain why Ms. McShane's evidence, provided in Appendix B, does not discuss the COK asset purchase?

Response:

Ms. McShane was aware of the COK purchase. She did not discuss the COK asset purchase because her evidence provided a higher level discussion. She did not consider that, on its own, the COK asset purchase was a material factor in the assessment of FBC's overall business risk.

The effect on rate base is no different than incurring a couple larger capital expenditures, such as substations, in a given year. As such, the financial effect does not necessarily warrant separate discussion. From the perspective of customer and economic base, FortisBC's risk is essentially unchanged relating to the City of Kelowna customers whether they were direct or indirect customers.

Ms. McShane's focus from the perspective of regulatory risk is on the fact that FBC is subject to the same basic regulatory framework as FEI.

10.10 What is Ms. McShane opinion on this asset purchase transaction and how does it impact FBC's business risk going forward?

Response:

As stated in the response to BCUC FBC IR 1.10.9, Ms. McShane does not consider that the asset purchase transaction, on its own, constitutes a material factor (i.e., change) in FBC's business risk.

Please refer to the response to BCUC FBC IR 1.10.8.

11.0 Reference: Exhibit B1-72, Tab A Business Risk, pp. 8 – 9; Tab B Opinion of Ms. McShane, p. 12; FBC 2012-2013 RRA & ISP Decision, p. 116

Customer Profile – Industrial Customer Class

FBC also states that "If FBC's 10 largest Industrial customers elected to discontinue taking service from FBC and pursue any of the opportunities for supply discussed below instead, the loss of their load would result in a reduction of approximately $14 million in revenue and a rate increase of approximately 2 percent for FBC's remaining customers." (Tab A, p. 9)

11.1 Please identify FBC's Transmission Industrial customers and Distribution Industrial customers that make up the 10 largest industrial customers.

Response:

FBC's 10 largest Industrial customers include Vaagen Fibre Canada (Distribution), Wynndel Box & Lumber Co. (Distribution), Princeton Co-Generation Corp. (Distribution), Kalesnikoff Lumber Co. (Distribution), International Forest Products (with two separate sites one distribution and one transmission), Zellstoff Celgar Limited Partnership (Transmission), Weyerhaeuser Co. Ltd. (Distribution), UBC Okanagan (Distribution) and Roxul Inc (Transmission).

11.2 Does the 2percent rate increase calculation include the savings in power purchase costs to the benefit of all remaining customers? If not, please include that impact into the estimated rate impact.

Response:

Yes, the 2 percent rate increase calculation includes savings in power purchase costs due to the loss of the load of FBC's 10 largest Industrial customers.

FBC states "eligible Industrial customers can also discontinue taking service from FBC by building generation to serve some or all of their load, purchasing electricity on the open market or taking service from BC Hydro through its OATT. Additionally, subject to any previously existing contract requirements, the Terms and Conditions of FBC's Electric Tariff only requires a customer to provide timely notice to FBC of termination of service." (Tab A, p. 9)

11.3 Please discuss the likelihood of an Industrial customer that could potentially build generation? What are the barriers to entry for self-generators?

Response:

Barriers to entry to the construction of self-generation are any factors that reduce the cost competitiveness of self-supply as compared to continued reliance on utility supply. Typical considerations are:

- Capital cost of building generation;
- Ongoing costs related to operation and maintenance;
- Cost of expertise to manage the self-generation;
- Availability and/or cost of fuel;
- Potential requirement for back-up supply; and
- Environmental and permitting requirements.

Such factors are unique to each customer and it is therefore difficult to generalize on the likelihood of a customer to build generation. However, FBC is aware that interest in self-generation has been expressed by several of its larger customers in recent years and rising utility rates may push potential projects into the realm of being economically justifiable.

11.4 Do the existing contracts with Industrial customers contain a take-or-pay clause? Are there any early termination penalties? Please discuss.

Response:

There are no take-or-pay clauses in the contracts with industrial customers. There are no explicit early termination penalties. Customers who terminate service with little or no notice may be liable for Customers Charges and any ongoing demand related charges (ratchets) for the remaining term of the Agreement, but this can be avoided by simply giving reasonable notice.

11.5 Please discuss the impact to open market electricity rates when BC Hydro's rates increase.

Response:

BC Hydro rates are not market based and therefore FBC does not see any direct relationship between BC Hydro rates and market rates. However, there could be a small impact since as BC Hydro rates change, there could be a change in BC Hydro customer demand. This may change the amount of power BC Hydro either has to buy or is free to sell on the market. Depending on market conditions at the time, this may have an impact one way or another.

11.6 Does FBC believe that a potential increase in BC Hydro rates will impact the Wholesale and Industrial customers' willingness to purchase electricity in the open market, therefore reducing this flight risk? Please discuss why or why not?

Response:

Please refer to the response to BCUC FBC IR 1.11.5. While a potential increase in BC Hydro's rates may result in a small impact to the open market, FBC does not believe it will have a significant influence on a FBC wholesale or Industrial customer's willingness to purchase electricity in the open market one way or another.

11.7 Doesn't access to FBC low cost generation act as a deterrent to customers leaving the FBC supply for self generation and isn't this a business risk reduction for FBC?

Response:

The risk of customers leaving for self-generation is increasing over time, so FBC would not agree with the characterization of a "business risk reduction" if the point of reference is the risk faced by FBC in the past. Historically, the relatively low rates offered by FortisBC have limited the likelihood that a customer would choose to install self-generation or develop the expertise required to use an alternate source of power. However, in recent years, this disincentive has been reduced by the increases in FortisBC rates relative to other sources of supply. Beyond the two industrial customers that currently have self-generation, the Company has received inquiries from at least two other industrial customers and one Wholesale customer regarding the installation of self-generation.

11.8 Please generally discuss the implications of FBC's current Application that is before the Commission: "FBC Stepped and Stand-By Rates for Transmission Voltage Customers." What potential BCUC determinations could result in higher/lower risk for the industrial customer class? Would FBC classify this as Regulatory risk?

Response:

The Company assumes that by, "industrial customer class", the Commission is asking about the *Large Commercial Service – Transmission* customer class to which the referenced Application applies.

The Transmission Stepped Rates Application primarily seeks approval of:

- A two-tier stepped rate for customers served at transmission voltage; and
- A stand-by rate for self-generating customers

As the subject of the current Application considers the risk profile of FBC, the Company assumes that the question intends to query the potential impact of the TSR Application on FBC rather than on the Large Commercial customers.

Approval of the rates proposed in the TSR Application would increase the risk to FBC primarily due to the potential for uncertain and/or decreased revenues. For example, if the transmission customers manage to decrease load relative to a customer baseline load (CBL) revenues will decrease. This decrease in revenues is not matched by an equal decrease in costs to serve those customers. This situation will cause additional rate pressures. Also, approval of the Standby Rate for self-generating customers would almost certainly lead to a decrease in revenue without a corresponding decrease in costs, thus again contribution to rate pressure and decreasing competitiveness of the Company's electricity sales

The general discussion of the risk to the Company of the TSR Application is found in the Energy Price Risk section of Exhibit B1-72, in this proceeding, Appendix A – Business Risk, page 17.

In FBC's 2012-2013 Revenue Requirement Decision, the Commission approved the establishment of the Power Purchase Expense Deferral Account and the Revenue Variance Deferral Account (2012-2013 RRA & ISP Decision, p. 116)

11.9 Please discuss the implications of these 2 deferral accounts and the ability of FBC to absorb any impact to revenues and expenses related to a potential shift in Industrial customer load.

Response:

The existence of these two deferral accounts does not significantly reduce the overall business risk of FBC with respect to a potential shift in Industrial customer load. These two deferral accounts serve to reduce short-term forecast risks with respect to power purchases and sales revenue but not the long-term risks. These deferral accounts have been put in place to ensure forecast variances do not result in costs being inappropriately borne by customers or by FBC, and are mainly used to mitigate the rate impacts and rate volatility for customers in the short-term.

Furthermore, as discussed in Appendix B of Exhibit B1-74, the loss of Industrial customer load would result in a reduction of $14 million in revenue to be included in these deferral accounts, and would result in a substantial rate increase of approximately 2 percent for FBC's remaining customers. This rate increase as a result of the loss of Industrial customer load would serve to put even greater upward pressure on FBC's rates and would increase the business risk faced by FBC from alternative suppliers and forms of electricity.

Please also refer to the response to BCUC FBC IR 1.22.1.

12.0 Reference: Exhibit B1-72, Tab A Business Risk, pp. 12-13

Energy Consumption Trends

FBC provides the two figures that show the throughput of both FEI and FBC (Figures 4 and 5).

12.1 Does FBC agree that it appears to have had a stable and steady growth in throughput and customer growth since 2001 which has been better than FEI?

Response:

FBC agrees that its Use per Customer (UPC) has been stable, with steady growth since 2001. FortisBC notes that, as shown in Figures 4 and 5, in 2005, when FBC's risk premium was last confirmed by the Commission, FEI's UPC was declining while FBC's throughput and customer growth were stable. This situation still exists today. As a result, there has been no material change to FBC's risk related to UPC relative to FEI.

12.2 From the two figures presented in Tab A, discuss FBC's conclusions as it relates to risk.

Response:

Please refer to the response to BCUC FBC IR 1.12.1.

13.0 Reference: Exhibit B1-72, Tab A Business Risk, pp. 13-14

Economic Conditions

FBC states that "the median income in the service territory of FBC is lower in comparison to the FEI service territory and BC." (Appendix A, p. 13)

13.1 What is the significance of lower median income in the FBC's service territory, as it relates to risk? Is this a signal of potential bad debts for FBC or is FBC implying that elasticity of demand is higher in the FBC territory? If so, please show evidence of bad debts or demand elasticities to income levels.

Response:

FBC has provided the economic statistics applicable to FBC's specific service area and customer base to provide a more complete picture of FBC's service area. FBC has not drawn any conclusions regarding risk specific to lower median incomes, higher unemployment or higher variances in housing starts in its service area. FBC is also not asserting a link between median income and bad debt exposure.

The section on economic conditions does provide context to some of the risks discussed in other sections. For example, as discussed in Section 5 (Appendix A, Exhibit B1-74), as FBC's electricity rates increase and due to the introduction of the Residential Conservation Rate, the costs of heating a home with electricity may cause many of FBC's customers to explore lower cost alternatives. Intuitively, this risk is heightened in a service area with lower median income and higher unemployment. In addition, having less affluent customers, on average, is symptomatic of less overall economic activity within a region, which does impact the utility.

FBC provides the following table relating to housing starts in its service territory:

Table 5: Housing Starts in FBC Service Territory (2006 to 2011)

	2006	2007	2008	2009	2010	2011
British Columbia						
Housing Starts (% Change)	5.1	7.6	-12.4	-53.4	65.2	-1.1
City of Kelowna						
Housing Starts (% Change)	-2.3	4.2	-19.5	-70.9	45.7	-2.4
City of Penticton						
Housing Starts (% Change))	15.3	-37.0	6.1	-56.2	92.0	-66.2

*BC Stats

(Source: Tab A, Table 5, p. 14)

13.2 Based on the information in the above table, housing starts within the FBC service area have had substantial variances (as in, between the City of Kelowna and the City of Penticton) for any given year. Similarly, housing starts in the FBC service area have had substantial variances compared to the average in BC. What kind of conclusions can FBC make with regards to the housing starts data?

Response:

Please refer to the response to BCUC FBC IR 1.13.1.

13.3 Since housing starts are a good determination of residential customer additions, what conclusions are FBC making with regards to risk in this area? Please clarify.

Response:

Housing stats appear to be more volatile in FBC's service territory (both Kelowna and Penticton) than in the Province more generally. Although FBC does not use housing starts as a direct determination of residential customer additions (as discussed in Section C1.4.1 of FBC's 2014-2018 PBR Plan, FBC uses a regression of the year-end customer accounts on population in the FBC direct service area to forecast residential customer growth), FBC believes that housing start volatility is indicative of the higher customer forecast risk in the FortisBC service territory. Please also refer to the response to BCUC FBC IR 1.13.1.

14.0 Reference: Exhibit B1-72, Tab A Business Risk, pp. 15-17; Tab B Opinion of Ms. McShane, p. 12;

Exhibit A2-57, News Articles on BC Hydro's Rate Increases

Energy Price Risk

FBC has made several references to BC Hydro's rates:

- "BC Hydro's low electricity rates are a factor in FBC's ability to expand beyond its current service area." (Tab A, p. 15)
- "[t]he relatively low price of electricity in BC Hydro's service territory…." (Tab A, p. 16)
- "...the government's policy of maintain low electric prices in the province." (Tab A, p. 17)

14.1 Please clarify whether the above references are FBC views on historical BC Hydro rates or does FBC believe that BC Hydro's rates will remain low in the near term? Medium term?

Response:

The above references are FBC's views on historical BC Hydro rates. However, FBC notes that while BC Hydro faces significant cost pressures that may result in rate increases over the near to medium term, FBC is also impacted by BC Hydro rate increases through its power purchases. Even if BC Hydro's rates begin to rise at a higher rate than has historically been the case, BC Hydro's rates will still likely be lower than FBC's in the near to medium term.

Please also refer to the response to BCUC FBC IR 1.14.3.

Exhibit A2-57 contains two different articles which suggest that BC Hydro's rates will be increasing. BC's Energy Minister, Bill Bennett, indicates that "BC Hydro's rates will be going up, possibly before the end of the year."

FBC states that it "competes with BC Hydro in …underdeveloped areas were the borders of [its] service territory and BC Hydro's service territory meet." (Tab A, p. 15)

14.2 Please discuss how BC Hydro's potential rate increases may impact FBC's ability to expand beyond its current service area and hence, the potential to increase its customer base. Please comment on the impact to FBC's business risk should this scenario occur.

Response:

As stated in the response to BCUC FBC IR 1.14.1 above, FBC is impacted by BC Hydro rate increases through its power purchases. As a result, even if BC Hydro's rates begin to rise at a higher rate than has historically been the case, BC Hydro's rates will still likely be lower than FBC's in the near to medium term. However, these BC Hydro rate increases in the near to medium-term will add to the upward pressure on FBC's rates and will contribute to FBC's competitive risk and impact the ability to expand beyond its current service area and increase its customer base.

14.3 Please discuss, and provide calculations, to illustrate FBC and BC Hydro's current rate differential. What percentage of increase to BC Hydro's residential rate would make it on par with FBC's residential rate?

Response:

At monthly usage of approximately 1,100 kWh, an FBC residential customer's overall bill is approximately 25% higher than a BC Hydro residential customer's overall bill, as shown in the below table.

01/04/2013	**BC Hydro**		**FortisBC**		**Difference**	
1,100 kWh monthly		**Total**		**Total**		
Rate Rider	5.0%					
Energy rate ($/kwh) - Tier 1	0.0690	90.52	0.08803	109.28	**$18.76**	**19%**
Energy rate ($/kwh) - Tier 2	0.1034		0.12952			
Basic customer charge	4.64	4.64	15.17	15.17	**$10.52**	
Total		$99.92		$124.45	**$24.52**	**25%**

The percentage of increase to BC Hydro's residential rate that would make it on par with FBC's residential rate at the monthly usage of 1,100 kWh is an approximate 29 percent one time increase. This takes into account that for every 8 percent increase in BC Hydro's rate, FBC's rates will also increase by 1 percent, as discussed in response to BCUC FBC IR1.14.5.1. This analysis also assumes a full year rate increase (BC Hydro's rate increase would be implemented at the same time as FBC's rate increase), and was calculated based on BC Hydro's current April 1, 2013 Residential rate and FBC's current January 1, 2013 Residential rate.

14.4 Given the cost pressures facing BC Hydro related to IPP generation contracts and transmission renewal, doesn't FBC expect that its costs and rate increases will grow at a slower rate than BC Hydro for the foreseeable future. Please discuss.

Response:

FBC expects that given the cost pressures faced by BC Hydro it may be the case that BC Hydro's rates will grow at a faster rate than FBC's for the foreseeable future. However, since FBC purchases a portion of its power from BC Hydro, BC Hydro rate increases also impact FBC's rates through higher power supply costs. As discussed in the responses to BCUC FBC IRs 1.14.1 and 1.14.3, even if BC Hydro's rates grow at a higher rate than FBC's, in the near to medium term, FBC's rates will likely still be higher than BC Hydro's.

"Even as BC Hydro rates increase, those increases effect [sic] FBC's power supply costs and therefore put additional upward pressure on FBC rates." (Tab A, p. 15)

14.5 Provide an illustrative example to show what proportionate increase in BC Hydro's rate would impact FBC's rate increases and by how much.

14.5.1 If BC Hydro's rate increased by 5percent, how does this impact FBC's residential customer rates?

Response:

The Table below illustrates the relationship between BC Hydro's rate increase and its consequent impact on FBC's rates for the year 2014:

2014 BCH Rate Increase	2014 FBC Impact	2014 Proportion of Impact
5.0%	0.60%	8 to 1
10.0%	1.20%	8 to 1

Empirically speaking (as indicated in the Table above), for the year 2014, every 8% increase in BC Hydro's rates will impact FortisBC's customer rate increases by 1%.

The Table specifically shows the impact on FortisBC's rates for a 5% and 10% rate increase by BC Hydro.

14.5.2 If BC Hydro's rate increased by 10percent, how does this impact FBC's residential customer rates?

Response:

Please refer to the response to BCUC FBC IR 1.14.5.1.

15.0 Reference: Exhibit B1-72, Tab A Business Risk p. 18; FBC 2014-2018 PBR Application, p. 15; FBC 2012-2013 RRA & ISP Decision, p. 116

Customer Profile – Residential Customer Class

FBC states that "with the introduction of the Residential Conservation Rate (RCR) on July 1, 2012, FBC's residential sales related to heating are subject to increased competition as households look to other forms of energy…to heat their homes." (Tab A, p. 18)

In FBC's 2014-2018 PBR Application, FBC states that "customer satisfaction survey has reflected the effect of customers' perceptions of and reactions to the recently implemented two-tiered [RCR] and the proposed AMI Project" and, "The Company believes that given the increased level of interest in the RCR, and the need for a better understanding of the impacts on customers and conservation, the report [on its effectiveness of the rate] should be filed as soon as possible." (FBC 2014-2018 PBR Application, p. 15)

15.1 Does the excerpt from FBC's 2014-2018 PBR Application suggest that it is taking steps to mitigate customer concerns with the potential to curtail any fuel switching opportunities? Please discuss.

Response:

No, the excerpt from 2014-2018 PBR Application is only intended to relay the current situation with respect to the RCR and the pending report on its impact to customers. Part of the intent of the report is to determine the impact on customer's bills and perceptions of the RCR, as well as any impact on conservation. The Company will use the report to better understand the impact of the RCR prior to determining what, if any, changes to the rate should be considered. To date, steps taken to mitigate customer concern with the rate have been focussed on helping customers to better understand the rate and its impact on an individual basis, as well as providing additional information on its website and through the media.

15.2 Has FBC conducted any other studies to suggest that residential customers are ready to switch to other forms of energy? If so, how many residential customers are potentially at risk? What proportion of FBC's residential customer base does this represent?

Response:

The Company has not completed any formal studies that can quantify the number of customers ready to switch to other forms of energy. The Company may be able confirm through the RCR report the anecdotal information received from customers since the introduction of the RCR that moving to gas heat is being considered by some customers as a means of reducing the amount of consumption exposed to the higher Tier 2 rate. The Company can confirm that approximately 50% of the air source heat pumps installed with the Company's knowledge since 1999 have gas back-up making the switch of fuel source for these customers easier.

In FBC's 2012-2013 Revenue Requirement Application Decision, the Commission approved the establishment of the Power Purchase Expense Deferral Account and the Revenue Variance Deferral Account (2012-2013 RRA & ISP Decision, p. 116)

15.3 Please discuss the implications of these two deferral accounts and the ability of FBC to absorb any impact to revenues and expenses related to a potential shift in Residential customer load.

Response:

The existence of these two deferral accounts does not significantly reduce the overall business risk of FBC with respect to a potential shift in Residential customer load. These two deferral accounts serve to reduce short-term forecast risks with respect to power purchases and sales revenue but not the long-term risks. These deferral accounts have been put in place to ensure forecast variances do not result in costs being inappropriately borne by customers or by FBC, and are mainly used to mitigate the rate impacts and rate volatility for customers in the short-term.

Furthermore, as discussed in Appendix B of Exhibit B1-74, the loss of Residential customer load would result in reduced revenue to be included in these deferral accounts and ultimately collected from FBC's remaining customers. This upward pressure on rates as a result of the loss of Residential customer load would serve to put even greater upward pressure on FBC's rates and would increase the business risk faced by FBC from alternative suppliers and forms of electricity.

Please also refer to the response to BCUC FBC IR 1.22.1.

16.0 Reference: Exhibit B1-72, Tab A Business Risk, p. 19; Tab D Moody's Credit Opinion Report, p. 2

Energy Supply Risk

"FBC's supply risk has been slightly mitigated through long-term capacity agreements; however, price risk has increased due to <u>uncertainty with respect to future rate increases</u> related to FBC's Power Purchase Agreement (PPA) <u>with BC Hydro</u>, and prices on the open market." (Tab A, p. 19) [Underlining added]

16.1 Given that BC Hydro has filed its Rate Schedule 3808 (FBC's PPA) with the Commission on May 24, 2013, does this mitigate the "uncertainty" with respect to FBC's future power purchase cost? Please discuss why or why not?

<u>Response:</u>

No, it does not. Primarily, the uncertainty with respect to the price risk of the BC Hydro PPA is not the contract but the rate itself. FBC remains exposed to BC Hydro embedded cost rates. As discussed in the response to BCUC FBC IR 1.14.1, BC Hydro embedded cost rates may rapidly increase at a much greater average rate than they have in the past.

In FBC's 2012-2013 Revenue Requirement Decision, the Commission approved the establishment of the Power Purchase Expense Deferral Account (2012-2013 RRA & ISP Decision, p. 116)

16.2 Please confirm that any uncertainty with regards to future power purchases costs (irrespective of whether it is purchased through BC Hydro's 3808 PPA or through the open market) would be captured in the newly established Power Purchase Expense Deferral Account.

<u>Response:</u>

No. The Power Purchase Expense Deferral Account was established as part of 2012-2013 RRA proceeding and allows FBC to recover (or refund) any variances between forecast power purchase costs that are embedded in approved rates and actual costs. As such it is a tool to manage short term variances in power purchase costs but does not protect FBC or its customers from the uncertainty of future power purchase costs related to increases in BC Hydro costs or longer term shifts in the regional market environment.

16.3 Does FBC agree that this deferral account mitigates a large part (if not, completely) FBC's power purchase risks? If not, why not?

Response:

FBC does not agree. As stated in the previous response to BCUC FBC IR 1.16.2, the Power Purchase Expense will capture variances between forecast costs and actual costs until such time rates are reset. The deferral account has been put in place to ensure forecast variances do not result in costs being inappropriately borne by customers or by FBC. However, the existence of the Power Purchase Expense deferral account does not protect FBC or its customers from the uncertainty related to future power purchase expense due to the uncertainty related to BC Hydro PPA costs or market conditions. To the degree future power purchase expenses result in upward pressure on rates paid by customers, this increases FBC's business risk.

"The Company relies on the market to meet short-term energy gaps when any unanticipated needs arise as well as to offset purchases under the BC Hydro PPA if and when market supplies are more cost effective." (Tab A, p. 21)

16.4 Please provide a table showing the proportion of FBC's power purchases over the last 5 years (in volume purchased, and dollars). Please comment on any trends that can be seen relating to the FBC's reliance on its resource stack.

Response:

$000s		Actual 2008	Actual 2009	Actual 2010	Actual 2011	Actual 2012
1	Brilliant	30,193	31,083	33,216	32,247	35,591
2	BC Hydro	34,140	34,584	29,556	28,006	26,037
4	Independent Power Producers	678	1,039	890	195	180
5	Market and Contracted Purchases	3,485	5,255	10,288	12,209	14,366
6	Surplus Sales Revenues	-2,180	-773	-1,000	-63	0
7	Special and Accounting Adjustments	-924	-597	89	-864	-156
8	Balancing Pool	618	185	-1,075	-213	-18
9	**TOTAL Power Purchase Expense**	**66,010**	**70,776**	**71,964**	**71,519**	**75,999**

GWh		Actual 2008	Actual 2009	Actual 2010	Actual 2011	Actual 2012
1	FBC Owned Resources	1,608	1,585	1,529	1,525	1,531
2	Brilliant	921	923	922	922	921
4	BC Hydro	825	836	600	508	418
5	Independent Power Producers	29	38	36	6	5
6	Market and Contracted Purchases	44	121	291	489	524
7	Surplus Sales Revenues	-48	-38	-49	-10	0
8	Special and Accounting Adjustments	21	13	-4	12	14
9	**TOTAL Gross Load**	**3,400**	**3,478**	**3,324**	**3,452**	**3,413**

Over the past five years, the FortisBC gross load has been fairly flat. The major "trend" has been a greater reliance on market and contracted purchase energy with a corresponding reduction in BC Hydro PPA purchases as well as reduced use of FortisBC owned generation. During this time, market prices in the Pacific Northwest have shifted lower as a result of lower natural gas prices, increased renewable generation in the region and a large snow pack and run off in 2011 and 2012. This created opportunities for the Company to displace both BC Hydro purchases and, to a much smaller degree, Company owned generation with lower cost market and contracted energy in order to mitigate power purchase expense. While these market conditions were very favourable in recent years, the Company has since seen prices increase, and expects market prices to continue to increase such that although there may still be economic opportunities to displace BC Hydro PPA energy with market purchases, it will be at a rate much closer to the PPA rate, thereby reducing the potential for market savings. In any case, FortisBC continues to rely on all of the resources in its power supply portfolio to ensure it has firm resources to meet its load requirements and ensure long term reliability and security of supply.

Another trend in FBC's resource stack over the past five years is lower surplus sales, which is mainly due to reduced market prices over the past couple of years. Under normal load conditions, FBC has a surplus of energy over the May, June and July period, which it can sell to the market. Since market prices were very low during this period over the past couple of years, selling this surplus to the market did not cover the cost of generation and it was therefore not generated. The amount of surplus sales in 2013 is anticipated to be more than in 2011 and 2012, due to increases in market prices from the 2011 and 2012 levels.

Furthermore, over the past five years, there has been a step change in the amount of IPP purchases the Company has made since the major IPP generator made other arrangements to sell their power.

In Moody's Credit Opinion Report, page 2, it states:

> "FBC's hydrology risk is substantially mitigated by the Canal Plant Agreement (CPA), which runs until at least 2035. Under the CPA, FBC and others cede scheduling control of their generation facilities to BC Hydro (BCH; Aaa negative) in exchange for power based on 50-year historical hydrology regardless of the actual hydrological conditions in any contract year. Consequently, we consider FBC's business risk to be lower than that of other cost-of-service regulated vertically integrated utilities." [Underlining added]

In Ms. McShane's evidence, it states that "FBC is able to recover differences between actual and forecast purchased power expenses through a deferral account. … The ability of FEI to recover variances between forecast and actual commodity costs of gas and pipeline costs… are the natural gas distribution utility analogues to FBC's deferral account for purchased power cost variances." (Tab B, p. 13)

16.5 Given Moody's opinion on FBC's power supply and Ms. McShane's opinion on the use of deferral accounts in both FBC and FEI, please explain why Energy Supply Risk is ranked "Higher" than FEI on page 2 of Tab A.

Response:

It should be noted that the comparison Moody's is making in the above quoted passage is between FBC and other "vertically integrated utilities" which in the electric industry generally refers to a utility that operates its own generating plants, transmission and distribution system, effectively providing all aspects of electric service. Natural gas utilities are typically not vertically integrated. Like FEI, they are primarily distribution companies and procure all of the commodity in the wholesale natural gas market. FBC's Energy Supply Risk is ranked higher than FEI due to FBC's generation supply risk. As stated in section 6 of Appendix A (Exhibit B1-72), FBC generates 45 percent of its energy needs and approximately 30 percent of its capacity needs from its own hydro generating facilities. In addition, FBC buys the output of the Brilliant plant (and beginning in 2015 the Waneta Expansion) under long term firm contracts, giving it the operational equivalent from a generation supply risk perspective. As identified in the referenced excerpt from the Moody's report, due to operation the Canal Plan Agreement, the FBC's hydrological risk related to these facilities is mitigated. However, failure of a unit of one of these generation facilities would require that FBC find replacement power which may not be available due to lack of supply or lack of available transmission. In addition, the replacement power, if able to be acquired, may be at a significantly increased cost on the open market.

This risk of supply disruption or increased power purchase expense as a result of costly replacement power due to generation failure, can impact reliability and/or put upward pressure on rates to be paid by customers, and increases the business risk faced by FBC from alternative suppliers and forms of electricity.

"FBC recently put in place a long-term capacity agreement with the Waneta Expansion Limited Partnership beginning upon completion of the Waneta Expansion (WAX) project expected in 2015. These resources are expected to be sufficient to meet FBC's capacity requirements for at least 10 years." (Appendix A, p.20)

16.6 Does FBC agree that the WAX project is good assurance on FBC's capacity requirements over the next 10 years? Please explain how this relates to Energy Supply Risk being ranked "Higher" than FEI on page 2 of Tab A.

Response:

Yes, the capacity available to FBC under the WAX capacity agreement gives FBC greater certainty of a firm resource to meet to help FBC's long term capacity requirements. However, as discussed in the response to BCUC IR1.16.5, the generation supply risk for FBC, as a vertically integrated utility, is related to the reliance on the operation of the generation units it owns or to which it holds long term off take commitments. FEI, on the other hand, is a natural gas distribution utility that buys all of it commodity on the wholesale market. As a result of the generation supply risk, FBC's overall energy supply risk is considered to be higher than that of FEI.

16.7 In a hypothetical environment of surplus capacity, does FBC have the opportunity or potential to sell this capacity and achieve incremental revenues?

Response:

Yes, FBC expects to sell surplus WAX capacity and has included the forecast of these revenues as an offset to the expected cost of power in its Revenue Requirement Application. The revenues from these sales flow through to FortisBC's customers.

16.8 To the best of FBC's knowledge, please explain why the Moody's Credit Opinion Report does not address the WAX capacity arrangement? How does FBC determine its level of business risk as a result of the WAX project?

Response:

The effect of the WAX capacity arrangement on cost of service has been put forward in FortisBC's Performance Based Ratemaking Plan for 2014 through 2018 (the "Filing") that was filed on July 5, 2013. The Filing was subsequent to the issuance of Moody's June 26, 2013 Credit Opinion. FortisBC expects Moody's will review all matters raised in the filing and the associated decision for issues that may be relevant in future credit opinions. While Moody's has access to the regulatory decisions and FortisBC's continuous disclosure documents, Moody's retains editorial control over the form and content of all its publications and ultimately decides whether or not to speak to the WAX capacity arrangement.

Moody's does state that FBC's hydrology risk is substantially mitigated by the Canal Plant Agreement. FortisBC believes that Moody's statement would apply equally to the WAX capacity available to FBC under the WAX capacity agreement.

FBC does consider that the WAX capacity agreement has improved FBC's business risk related to the uncertainty regarding availability of FBC's long term resources to meet its capacity requirements, however as discussed in the response to BCUC IR 1.16.6, due to FBC's generation supply risk, FBC energy supply risk is greater than FEI energy supply risk.

16.9 Please explain whether the WAX capacity agreement has specified any energy requirements for FBC? Please specify whether this will have any impact of FBC's power purchases of energy, in terms of volume and cost risk.

Response:

It is unclear what is meant by the phrase "specified any energy requirements" in the question. FBC is not purchasing any energy under the WAX capacity agreement and therefore it will have no impact on the volume of energy that needs to be purchased to meet FBC's requirements.

16.10 Please explain the relationship between FBC and its parent company, in terms of the WAX agreement. Who are the beneficial parties for any capacity revenues? Who are the responsible parties for energy purchases?

Response:

FBC's ultimate parent company is Fortis Inc. Fortis Inc., Columbia Power Corporation (through a holding company named CPC Waneta Holdings Ltd.) and Columbia Basin Trust (through a holding company named CBT Waneta Expansion Power Corp.) are the partners in the Waneta Expansion Limited Partnership, the owner of the WAX project.

BC Hydro is responsible for purchasing all of the energy, as well as the associated capacity, and FBC is responsible for purchasing the excess capacity from the WAX project.

16.11 Given the establishment of the Power Purchase Expense Deferral Account and the Revenue Variance Deferral Account along with the Waneta capacity agreement, would FBC agree that its generation supply risk has been reduced since 2009 and the differential to the Benchmark utility has been reduced since the last Cost of Capital hearing in 2009? Please discuss.

Response:

FBC does not agree. As discussed in the responses to BCUC FBC IRs 1.16.2 and 1.16.3, the Power Purchase Expense Deferral Account (and likewise the Revenue Variance Deferral Account) does not impact FBC's generation supply risk. The Waneta Capacity Agreement does mitigate FBC's long term resource uncertainty. However, as discussed in the responses to BCUC FBC IRs 1.16.4 and 1.16.5 , its generation supply risk associated with WAX is similar to FBC other owned generation, and therefore overall the risk is unchanged relative to FEI since 2009.

17.0 Reference: Exhibit B1-72, Tab A Business Risk, pp. 22 - 27

Operating Risk

"To date, FBC has completed refurbishments of these electrical and mechanical components at 11 of the 15 generating units. FBC faces increased operating risk with respect to the remaining four generating units that have not seen any refurbishment, and therefore may be at risk of an increased rate of deterioration." (Tab A, p. 23)

17.1 Please provide FBC's reliability indexes for the last 10 years.

<u>Response:</u>

The following table includes the Forced Outage Rate (FOR (%)) for each FortisBC unit over the past ten years. As per the Canadian Electrical Association (CEA) definition the FOR (%) is the ratio of Total Forced Outage Time to Total Forced Outage Time plus Total Operating Time times 100.

$$FOR = \frac{FO + FEMO + FEPO}{FO+FEMO+FEPO+O+O(FD)+O(SD)} X100$$

O: the number of hours the generating unit was in the Operating State during the period.

O (FD): the number of hours the generating unit was operating under a Forced Derating during the period.

O (SD): the number of hours the generating unit was operating under a Scheduled Derating during the period.

FO: the number of hours the generating unit was in a Forced Outage State.

FEMO: the number of hours the generating unit was in a Forced Extension of a Maintenance Outage State.

FEPO: the number of hours the generating unit was in a Forced Extension of a Planned Outage State.

FOR(%)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Lower Bonnington - 01	0.63%	0.24%	0.00%	1.18%	0.03%	0.04%	0.00%	1.56%	0.00%	0.00%
Lower Bonnington - 02	0.04%	0.13%	0.01%	39.61%	0.01%	0.00%	0.08%	0.08%	1.07%	0.05%
Lower Bonnington - 03	0.22%	0.32%	0.00%	0.83%	0.06%	0.00%	0.07%	0.05%	0.00%	0.00%
Upper Bonnington - 01	0.00%	1.23%	0.00%	0.03%	0.00%	0.00%	0.08%	1.57%	0.00%	2.90%
Upper Bonnington - 02	0.00%	0.07%	0.00%	5.77%	0.00%	0.00%	0.17%	0.23%	0.00%	0.00%
Upper Bonnington - 03	0.00%	0.97%	0.05%	2.00%	0.14%	0.20%	42.58%	0.24%	0.00%	0.00%
Upper Bonnington - 04	0.00%	1.65%	0.00%	0.02%	1.12%	1.80%	0.21%	6.56%	0.00%	0.00%
Upper Bonnington - 05	0.00%	0.07%	0.14%	0.00%	0.47%	0.40%	0.00%	0.40%	0.00%	0.31%
Upper Bonnington - 06	0.00%	0.32%	0.05%	0.46%	0.00%	0.11%	0.00%	0.58%	0.03%	0.19%
South Slocan - 01	0.01%	0.27%	0.00%	0.07%	0.00%	0.00%	0.00%	0.02%	0.00%	0.10%
South Slocan - 02	0.12%	0.18%	0.01%	0.20%	0.00%	0.12%	0.09%	0.03%	0.00%	0.01%
South Slocan - 03	0.00%	0.11%	0.02%	0.01%	0.00%	0.00%	0.00%	0.00%	0.01%	0.00%
Corralinn - 01	0.00%	0.22%	0.00%	14.28%	0.00%	0.06%	0.00%	0.00%	0.40%	0.00%
Corralinn - 02	2.13%	0.09%	0.02%	0.08%	0.02%	0.00%	0.00%	0.01%	0.01%	0.04%
Corralinn - 03	0.00%	0.03%	0.01%	0.02%	0.12%	0.04%	0.07%	0.16%	0.00%	0.06%

17.2 Has FBC seen an improvement of generator reliability over this period?

Response:

FBC has completed refurbishments of the electrical and mechanical components at 11 of its 15 generating units and has therefore extended the life of these 11 units. FBC would not characterize its generator reliability over this period as having improved but rather that existing reliability has been maintained as a result of the refurbishments on these 11 generating units.

"The risk associated with [PCB] contaminated assets relates primarily to the legislated prohibition of the release of more than one gram of PCB into the environment, and the possibility of penalties including fines of up to $1 million and/or imprisonment." (Tab A, p. 25)

17.3 Given FBC's current 2014-2018 PBR Application, would these types of fines be considered as a Z-factor item and hence, flowed through into rates according to the PBR formula?

Response:

Where a PBC related fine is incurred as a result of an event outside of the Company's control (such as catastrophic events, a major seismic incident, acts of war, terrorism or violence), FBC would seek z-factor treatment of those fines.

17.4 Does FBC currently have a deferral account to capture variances in PCB related costs or is FBC seeking a flow-through of PCB related costs in its 2014-2018 PBR Application currently before the Commission? Please discuss these accounting methods as it relates to risk.

Response:

FBC does not currently have a deferral account to capture variances in PCB related costs. As part of the 2014-2018 Performance Based Ratemaking Plan, FBC is proposing to include PCB distribution sustainment program costs in the capital PBR formula. The stations component of the PCB program is not included in the proposed 2014-2018 base capital formula, as expenditures for this component were approved through Orders G-195-10 and G-110-12. FBC expects to complete the stations component of the PCB program in 2014.

FBC describes incidences of conductor theft as unexpected events.

17.5 In accordance with the proposed PBR Plan, would conduct thefts be considered a Z-factor item and hence, flowed through into rates according to the PBR formula?

Response:

Conductor thefts are included in FBC's insurance expense. As part of FBC's proposed PBR Plan, insurance expense variances would be captured in the Insurance Expense Variance deferral account.

18.0 Reference: Exhibit B1-72, Tab A Business Risk, pp. 29 – 30; Tab B Opinion of Ms. McShane, p. 14

Regulatory Risk

"FBC faces increased forecast risk as a result of the introduction of BC MRS. FBC recently underwent an MRS Audit in 2012, which was FBC's first audit under the newly-imposed MRS program…. there is difficulty in accurately forecasting the costs of compliance with the BC MRS program. This gives rise to short-term earnings risk." (Tab A, p. 29)

18.1 Please explain whether the Commission has denied any recovery of MRS expenditures in the past?

Response:

To date, the Commission has not denied recovery of MRS expenditures.

18.2 Please explain to what extent MRS expenditure variances are captured in deferral accounts. Please explain FBC's proposal with on-going MRS expenditures during the 2014-2018 PBR period.

Response:

FBC currently has two BC MRS related deferral accounts, which capture the variance from forecast of the MRS Audit done by WECC in 2012 and the variance from approved 2012 and 2013 O&M expense. The Company is proposing in its 2014-2018 PBR Plan to amortize the amounts in these deferral accounts in 2014. As a result, FBC will no longer have any MRS related deferral accounts.

On-going expenditures related to the BC MRS program are included in FBC's Operating & Maintenance (O&M) expense, which the Company has proposed to set by formula as set out in FBC's 2014-2018 PBR Plan. Given that FBC is proposing to amortize the amounts in its existing MRS deferral accounts in 2014, FBC faces short-term forecast risk for any variances from the formula-set O&M expenditures related to the existing standards within the BC MRS program.

19.0 Reference: Exhibit B1-72, Tab B Opinion of Ms. McShane

Business Risks

Ms. McShane summarizes FBC's business risk on pages 11 to 15 in her Opinion.

19.1 **With all of the business risks that are discussed on pages 11 to 15 of Tab B, please discuss which one of these risks are new today that did not exist in at the time of the last Cost of Capital hearing in 2005? Provide a side by side comparison in table format for illustrative purposes.**

Response:

Please refer to the below table, which identifies the risk factors applicable to FBC in 2013 versus the risk factors that were applicable in 2005.

Business Risk	2005	2013
Utility Size (Small)	✓	✓
Utility Type (Fully Integrated Utility with transmission, distribution and generation assets)	✓	✓
Service Area Type (Primarily rural on a proportional basis)	✓	✓
Economic base (low diversity, dependent on few industries)	✓	✓
Competition (with electric utilities, natural gas utilities, open market, alternative energy)	✓	✓
Supply (Generation failure, costs of open market, BC Hydro rate increases)	✓	✓
Operating (Aging infrastructure, unexpected events, generator failure)	✓	✓
Political (BC Energy Plan)	✓	✓
Regulatory (Regulatory Lag, BC Mandatory Reliability Standards, Administrative Penalties)	Not MRS or Administrative penalties	✓

Ms. McShane states that "[t]he conclusion that FBC is a somewhat higher business risk utility than FEI is borne out by FBC's credit ratings." (Tab B, p. 15)

19.2 Given that the above remark was included in the conclusion of the "Business Risk" section, is it Ms. McShane's opinion that the higher level of business risk of FBC over FEI is relatively the same at present than it was at the time of the last Cost of Capital hearing in 2005? Please explain why or why not?

Response:

Ms. McShane considers that FBC's business risk, in absolute terms, has not changed materially since 2005, whereas FEI's business risk is higher today than in 2005. Consequently the risk differential between FEI and FBC is smaller today than in 2005.

However, the recommended risk premium for FBC is not based on an increase in the level of relative risk over the periods referenced. It is based on what the quantitative analysis supports, which is a premium of 50-75 basis points, higher than the 40 basis points which represented the Commission's judgment in its 2005 cost of capital decision for FBC.

20.0 Reference: Exhibit B1-72, Tab B Opinion of Ms. McShane, pp. 10, 22-23, 26-28

Capital Structure & Equity Risk Premium

Ms. McShane states that "[t]he "Alberta approach" adopts the same ROE for each utility and attempts to distinguish the return requirements for each of the Alberta utilities using only the common equity ratio….In contrast, the "BC approach" uses both the common equity ratio and the ROE to establish an overall return that meets the fair return standard." (Tab B, p. 10)

On page 22 of her evidence, Ms. McShane provides a table showing the equity ratios allowed for Canadian electric utilities across multiple regulatory jurisdictions other than BC range from 36% to 47%. Ms. McShane proposes that the recommended 40 percent equity for FBC is "well within the the range of allowed equity ratios" of FBC's peers. (Tab B, p. 22)

20.1 In reference to Table 5 provided in Tab B, please include a column which lists the Allowed ROE's for each utility. Please also indicate whether any of the ROE's contain a component for equity risk premium. If so, how much?

Response:

Please refer to the response to BCUC FBC IR 1.20.1.1.

20.1.1 Please also include a column in the above requested table to identify which jurisdictions use the "Alberta approach" (only adjusts equity thickness) versus the "BC approach" (which factors in equity thickness and equity risk premiums).

Response:

This response addresses BCUC FBC IRs 1.20.1 and 1.20.1.1. The requested data are provided below.

Utility	**Regulator**	**Date of Capital Structure Decision**	**Allowed Common Equity Ratio**	**Rate Base ($M)**	**Customers (000s)**	**Currently Allowed ROE**	**Risk Premium (Basis Points)**	**Approach**
FortisBC Inc.	BCUC	5/05	40%	$1089	163	9.55%	40	BC
AltaLink	AUC	12/11	37%	$2504	N/A	8.75%	0	Alberta
ATCO Electric-Transmission	AUC	12/11	37%[2/]	$2790	N/A	8.75%	0	Alberta
ATCO Electric-Distribution	AUC	12/11	39%	$1840	216	8.75%	0	Alberta
FortisAlberta	AUC	12/11	41%	$2003	530	8.75%	0	Alberta
Maritime Electric	IRAC	11/10	43.5%	$347	76	9.75%	na	na
Newfoundland Power	NLPUB	12/09	45%	$884	251	8.8%	na	na
Nova Scotia Power	UARB	12/12	37.5% - 40.0%	$3531	497	9.0%	na	na
Ontario Electricity Transmitters and Distributors	OEB	12/06	40%	Various	Various	8.98%	0	Alberta
Ontario Power Generation	OEB	11/08	47%	$7940	N/A	9.55%	0	Alberta

Ms. McShane addresses why the BC approach continues to be appropriate at pages 6 and 7 of her Stage 2 Evidence regarding FEVI and FEW.

> Ms. McShane concludes that "FBC's existing common equity ratio of 40% is well within the range of allowed equity ratios; and (2) a reasonable range for FBC's equity ratio based on the equity ratios of its peers is 40% to 45%; and (3) FBC's existing deemed 40% equity ratio is at the lower end of the range of reasonableness based on its relative business risk." (Tab B, p. 23)

20.2 In Ms. McShane's discussions comparing the relative risk of FBC to its peers (Tab B, p. 22-23), please explain why Ms. McShane does not take into account the equity risk premiums of each of the utilities being compared to?

Response:

There is no explicit allowed incremental equity risk premium (relative to a benchmark) associated with any of the utilities discussed.

Ms. McShane observes that "as part of the Company's 2005 revenue requirements application…the BCUC confirmed the previously approved deemed equity ratio of 40% and equity risk premium of 40 basis points." Additionally, "[i]n its 2012-2013 revenue requirements decision, the Commission confirmed the previously approved equity ratio and risk premium, pending the generic cost of capital proceeding, stating that it agreed with FortisBC that "there has not been a substantive change in risk." (Tab B, p. 4)

20.3 Given Ms. McShane's current recommendation for a 50-75 bps above the benchmark allowed ROE, does this signify that there is currently an increase (maybe even a substantial change) in the level of risk between FBC and FEI over the differential that had existed back in 2005? What about the differential between 2005 and the period of the 2012-2013 RRA review? Please discuss.

Response:

No, Ms. McShane's recommended risk premium is not based on an increase in the level of relative risk over the periods referenced. It is based on what the quantitative analysis supports, which is a premium of 50-75 basis points, higher than the 40 basis points which represented the Commission's judgment in its 2005 cost of capital decision for FBC.

On pages 26-28 of Tab B, Ms. McShane discusses the relative difference in the cost of capital between the benchmark utility and FBC and how that can be reflected in the capital structures versus the difference in ROE. Commission staff summarizes the results in the following table:

	Description	**FBC's equity thickness:**	**Recommended Equity Risk Premium**
Approach 1	Deductibility of interest expense for corporate income tax offset by personal income taxes on interest	If 40% equity	70 bps
Approach 2	Overall cost of capital declines as the debt ratio rises due to income tax shield on interest expense	If 40% equity	50 bps
Approach 3	Assumes benefits of corporate tax deductibility of interest accrue to rate payers and not shareholders, as in the case with unregulated companies.	If 40% equity	60 bps
	Average (based on equal weight to all three approaches)		60 bps
		If 38.5% equity	75 bps

20.4 Does Ms. McShane agree with Commission Staff's summary of the recommendations?

<u>Response:</u>

Yes, with the caveat that these calculations are the indicated equity risk premiums at different capital structures under different theories of capital structure. They do not represent Ms. McShane's final equity risk premium recommendations for FBC.

21.0 Reference: Exhibit B1-72, Appendix B, Opinion of Ms. McShane

Size Premium

On pages 32-35, Ms. McShane discusses the concept of utility size and references the Ibbotson study which includes a size premium analysis.

21.1 Please clarify that Ms. McShane is not recommending a size premium in this proceeding, and that the firm's small size is only relevant in the context of the recommended equity risk premium for FBC?

Response:

Ms. McShane is not recommending an explicit, separate size premium for FBC but rather its smaller size relative to FEI is one consideration in the recommended risk premium.

21.2 Does Ms. McShane agree that the recommended range of the equity risk premium for FBC already includes a consideration for its smaller size as compared to FEI?

Response:

Yes, as stated in the response to BCUC FBC IR 1.21.1.

22.0 Reference: General

22.1 Please provide a table showing all of FBC's current deferral accounts (including names of each deferral account) in comparison to FEI. How many of these will continue to exist during the Company's proposed PBR period of 2014-2015.

Response:

FBC provides the following Table BCUC FBC IR 1.22.1a comparing the current deferral accounts of both FBC and FEI. As can be seen in the table, FBC employs Commission-approved deferral accounts that are generally similar to FEI. As a result (and as discussed in Section 9 of FBC's Evidence, Appendix B, Exhibit B1-74), FBC's regulatory risk with respect to the use of deferral accounts is similar to FEI.

Also included is a column setting out which deferral accounts are proposed to continue into the PBR period. Note that the table does not include requested deferral accounts set out in the 2014-2018 PBR Plan Application.

FBC also provides Table BCUC FBC IR 1.22.1b setting out the deferral accounts of FBC and FEI that are specific to the applications, processes and projects of each of the utilities. These deferral accounts are not directly comparable and are not listed in any specific order.

Table BCUC FBC IR 1.22.1a

FBC		**FEI**	**Comments**
Energy Policy	**Exist during PBR Period?**		
Demand Side Management	Yes	Energy Efficiency and Conservation (EEC)	
On-Bill Financing (OBF) Pilot Program	Yes	On-Bill Financing (OBF) Pilot Program	
On-Bill Financing (OBF) Participant Loans	Yes		
		NGV Conversion Grants	N/A to FBC
		Compliance with Emissions Regulations	N/A to FBC
		Biomethane Program Costs	N/A to FBC
		NGT Incentives	N/A to FBC
		Fuelling Stations Variance Account	N/A to FBC

FBC		FEI	Comments
Margin Related			
Power Purchase Expense Variance	Yes	Commodity Cost Reconciliation Account (CCRA)	
		Midstream Cost Reconciliation Account (MCRA)	
Revenue Variance	Yes	Revenue Stabilization Adjustment Mechanism (RSAM)	
		Interest on CCRA, MCRA, RSAM and Gas in Storage	
		Revelstoke Propane Cost Deferral Account	N/A to FBC
		SCP Mitigation Revenues Variance Account	N/A to FBC, specific to FEI's Southern Crossing Pipeline project
Non-controllable			
Pension & Other Post-Retirement Benefits Expense Variance	Yes	Pension & Other Post-Retirement Benefits	
Prepaid Pension Costs and OPEB Liability	Yes	Pension & Other Post-Retirement Benefits Funding	
US GAAP Pension and OPEB Transitional Obligation	Yes	US GAAP Pension and OPEB Funded Status Account	
Property Tax Variance Deferral	Yes	Property Tax Deferral	
		Insurance Variance	Requested by FBC in 2012-13 RRA but denied by BCUC
		BCUC Levies Variance	FBC has not requested a similar deferral account
		Interest Variance	Requested by FBC in 2012-13 RRA but denied by BCUC
		Tax Variance Account	Requested by FBC in 2012-13 RRA but denied by BCUC

FBC		FEI	Comments
		Customer Service Variance Account	N/A to FBC, specific to FEI project to in-source customer service activities
Preliminary and Investigative			
Preliminary and Investigative Charges	Yes		N/A to FEI, preliminary and investigative charges accounted for differently
Kelowna Bulk Transformer Capacity Addition (KBTCA) Project	Balance to be amortized into rates in 2014. Account discontinued effective Jan. 1, 2015		N/A to FEI, project specific to FBC
Corra Linn Spillway Concrete & Spill Gate Rehab CPCN	Yes		N/A to FEI, project specific to FBC

The following table lists the deferral accounts of FBC and FEI that are specific to the applications, processes and projects of each of the utilities. The deferral accounts are listed in no specific order and are not directly comparable to each other.

Table BCUC FBC IR 1.22.1b

FBC		FEI
Regulatory Compliance and Cost of Applications	Exist during PBR Period?	
2014 - 2018 PBR Application	Yes	BCUC Generic Cost of Capital (GCOC)
BCUC Generic Cost of Capital Proceeding	Yes	AES Inquiry Costs
BCUC Inquiry into the MRS Program	Costs proposed to be amortized into rates in 2014.	NGV for Transportation Application
Kettle Valley Expenditure Review	Costs proposed to be amortized into rates in 2014.	Long Term Resource Plan Application
Transmission Customer Rate Design	Costs proposed to be amortized into rates in 2014.	Amalgamation and Rate Design

City of Kelowna Acquisition Legal and Regulatory Costs	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	
Other		
Right of Way Reclamation (Pine Beetle Kill)	Yes	2010-2011 Customer Service O&M and Cost of Service
2012 Integrated System Plan – Engineering	Yes	Gas Asset Records Project
2014 – 2018 Capital Expenditure Plan	Yes	BC OneCall Project
2012 Mandatory Reliability Standards Audit	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	Gains and Losses on Asset Disposition
Mandatory Reliability Standards 2012 -2013 Incremental O&M Expense	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	Negative Salvage Provision
City of Kelowna Acquisition Customer Benefit	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	
Deferred Debt Issue Costs	Yes	
Residual		
2011 Flow-Through and ROE Sharing Mechanism Adjustments	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	Depreciation Variance
2012 Deferred Revenue	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	Southern Crossing Pipeline Tax Reassessment
Harmonized Sales Tax Removal/ Provincial Sales Tax Implementation	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	Tillbury Property Purchase (Subdividable Land)
Section 71 Filing (Waneta Expansion Power Purchase Agreement)	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	CNG and LNG Recoveries
Cost of Service and Rate Design Application	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	BFI Costs and Recoveries
2012 - 2013 Revenue Requirements and 2012 Integrated System Plan	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	Overhead and Marketing Recoveries from NGT Class of Service
Residual		
2011 Revenue Requirement Application Costs	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	2011 CNG and LNG Service Costs and Recoveries

Residential Inclining Block Rate	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	Olympic Security Costs
Implementation of New Rate Structures	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	IFRS Implementation Costs
Irrigation Rate Payer Group Consultation and Load Research	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	2009 ROE and Cost of Capital Application
Negotiation of new PPA between BC Hydro and FBC	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	2010-2011 Revenue Requirement Application
Right of Way Encroachment Litigation	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	2012-2013 Revenue Requirement Application
Residual		
Trail Office Lease Cost	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	CCE CPCN Application
Trail Office Rental to SD20	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	Deferred Removal Costs
Princeton Light and Power Deferred Pension Credit	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	US GAAP Conversion Costs
US GAAP Conversion Costs	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	US GAAP Transitional Costs
Joint Pole Use Audit, 2008	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	Mark to Market – Customer Care Enhancement Project
Demand Side Management Study	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	
Residual		
Mandatory Reliability Standards Implementation	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	
Revenue Protection	Costs proposed to be amortized into rates in 2014. Account to be discontinued.	

22.2 During a period of PBR where there are formula controlled increases in expenses, along with certain flow through adjustments, would FBC consider this ratemaking methodology to be less risky or more risky than the traditional cost of service methodology? Please provide analysis and discussion.

Response:

PBR methodology is typically more risky than Cost of Service ratemaking.

PBR plans typically entail productivity factors that limit the allowed increase in costs to be passed through in rates. Consistent achievement of productivity gains becomes more difficult over time, particularly with small utilities such as FBC with a relatively small service area and limited ability to achieve economies of scale and scope. Risks of being unable to achieve productivity gains are increased in the face of large capital expenditures without corresponding load increases. FBC's proposed PBR plan has mechanisms for flowing through variances for certain costs. This type of PBR which retains a link to actual costs exposes FBC to a moderately higher level of business risk than traditional cost of service ratemaking.

Reopeners and off-ramps are intended to moderate this risk. However, they can result in asymmetric risk because the utility may have losses that would not be enough to reopen the plan but would be more than enough to file a new case under cost of service. Further, if the earnings exceed the reopener provision or off-ramp provision, experience in Ontario with the Union Gas PBR has been that the plan is adjusted as quickly as possible. This means that the overall risk of these provisions is lower earnings that could not be offset.

Ms. McShane's has confirmed that her opinion is not based on ascribing any elevated risk to the implementation of PBR. That is, directionally, her recommendation would be higher accounting for PBR.

22.3 Please provide a table showing the percentage of FBC's approved versus achieved ROE over the last 10 years.

Response:

Please refer to the below table.

Year	Allowed	Achieved
	%	
2012	9.90	10.52
2011	9.90	10.67
2010	9.90	9.65
2009	8.87	9.41
2008	9.02	9.28
2007	8.77	9.23
2006	9.20	9.94
2005	9.43	9.88
2004	9.55	10.70
2003	9.82	10.88

In FBC's 2014-2018 PBR Application, FBC states that "[i]ntegration with the gas utility enabled certain efficiencies to be achieved. Integration driven opportunities involved a common management team, common processes and sharing of resources. Additionally, integration driven efficiencies were not only focused on lowering costs but also on increasing the capacity of both the electric and gas businesses and providing employee growth and development opportunities." (FBC's 2014-2018 PBR Application, p. 12)

22.4 Please describe if, and how, the sharing of resources, leveraging technology and common processes make each utility more efficient.

Response:

As described further in section 3.2 of FBC's 2014-2018 Performance Based Ratemaking (PBR) Plan, some examples of the efficiencies gained through the sharing of resources, leveraging of technology and common processes include:

- Common management team between both FBC and FEI which results in consistent leadership and direction for both companies at a lower cost than two separate management teams. Communication of company direction and policies is more effective by a management team with responsibilities in both companies;
- Alignment of employee development, talent sourcing, labour relations, compensation administration, pension and benefits administration and corporate HR functions. Integration and alignment of these HR functions eliminates the need to administer and look after duplicate programs.

- Alignment and integration of Environment, Health and Safety process, programs, operating standards and roles also eliminates the need to administer and look after duplicate programs and processes; and
- Sharing of labour resources across the companies allows for effective and efficient use of personnel and knowledge.

22.5 To what extend do the integration opportunities between FBC and FEI reduce the business risks faced by each utility on its own. Please discuss.

Response:

The Business risks faced by FBC and FEI are inherent to the nature of both a fully integrated electric utility and a natural gas distribution utility, which cannot be mitigated by integration. For example, integration between FBC and FEI does not help to diversify the economic and customer base of FBC's service area, change the risks faced by FBC as a fully integrated electric utility with distribution, transmission and generation assets, nor change the susceptibility of FBC's above-ground infrastructure from weather and other unexpected events. Integration may assist in reducing certain operating costs, but the savings are not likely significant enough when considered in the context of the overall utility operating costs to alter the business risks of each utility.

23.0 Reference: General

Commission Order G-187-12 dated December 10, 2012 sets out the rates for all utilities as interim effective January 1, 2013. Letter L-31-13A clarifies for all regulated utilities that the interim rates remain interim until a decision is rendered for Stage 2 of the GCOC Proceeding.

Commission Order G-75-13 that accompanied the GCOC proceeding – Stage 1 Decision sets the Return on Equity at 8.75% for the Benchmark Utility FEI.

23.1 Using the assumptions that the risks faced by FBC relative to the Benchmark utility have remained unchanged for 2013 and using the equity risk premium of 40 bps and holding all other factors constant, please calculate the respective revenue requirements, rate impact and bill impact of the new benchmark ROE on FBC.

Response:

The Table below provides the necessary Revenue Requirements & Rate Impact information.

For the purpose of clarity, the data has been provided in three columns as follows:

Column A: Indicates 2013 Revenue Requirements per the Commission's Order C-4-13 with respect to the City of Kelowna (CoK) transaction.

This is pre-GCOC Stage-1 having an ROE of 9.90%.

This indicates a Rate Impact of **4.2% in 2013.**

This is the actual Customer Rate Increase in place effective January 1, 2013.

Column B: Indicates 2013 Revenue Requirements including CoK. This is post-GCOC Stage-1 having an ROE of 8.75% + 0.40% (Risk Premium) = 9.15%.

This indicates a Rate Impact of **2.6% in 2013.**

Column C: Indicates 2013 Revenue Requirements including CoK. This is post-GCOC Stage-1 having an ROE of 8.75% + 0.40% (Risk Premium) = 9.15%, but the Rate Impact has been adjusted back to 4.2% in 2013 (as in Column A) by introducing a "Flow through Adjustment". This flow through adjustment will be refunded back to customers in 2014, as indicated in FortisBC's "Application for Approval of a Multi-Year PBR Plan for 2014-2018 (Refer: Application – Vol. 1, Tab E, Table 2C – "Flow through Adjustments").

1

Revenue Requirements Overview 2013	RRA with COK Pre GCOC Stage-1	RRA with COK & GCOC Stage-1	RRA with COK & GCOC Stage-1
	BCUC Order: C-4-13		Adjusted
	A	B	C
	Forecast 2013	Forecast 2013	Forecast 2013
Sales Volume (GWh)	3,233	3,233	3,233
Rate Base	1,203,669	1,203,568	1,203,669
Return on Rate Base	7.48%	7.18%	7.18%
Equty Thichkness	**40%**	**40%**	**40%**
ROE %	**9.90%**	**9.15%**	**9.15%**
REVENUE DEFICIENCY			
POWER SUPPLY			
Power Purchases	91,942	91,942	91,942
Water Fees	9,871	9,871	9,871
	101,813	101,813	101,813
OPERATING			
O&M Expense	57,621	57,621	57,621
Capitalized Overhead	(11,524)	(11,524)	(11,524)
Wheeling	5,233	5,233	5,233
Other Income	(7,165)	(7,165)	(7,165)
	44,166	44,166	44,166
TAXES			
Property Taxes	15,085	15,085	15,085
Income Taxes	7,666	6,461	7,666
	22,751	21,546	22,751
FINANCING			
Cost of Debt	42,377	42,374	42,377
Cost of Equity	47,665	44,051	44,054
Depreciation and Amortization	51,090	51,090	51,090
	141,132	137,515	137,521
Flow Through Adjustments	669	669	4,281
	669	669	4,281
TOTAL REVENUE REQUIREMENT	**310,530**	**305,709**	**310,531**
LESS: REVENUE AT APPROVED RATES	298,005	298,005	298,005
REVENUE DEFICIENCY for Rate Setting	12,525	7,703	12,525
RATE INCREASE	**4.20%**	**2.60%**	**4.20%**

23.2 Does FBC have a view regarding: (a) whether its 2013 interim rates should be made permanent; and (b) whether the allowed cost of capital as a result of the review that takes place in Stage 2 should be made effective January 1, 2013 or January 1, 2014?

Response:

The Commission's letter L-31-13A, issued on June 5, 2013, appears to have determined that the Stage 2 decision will be effective January 1, 2013.

23.3 If the allowed costs of capital from this proceeding were to be made effective January 1, 2013 would it be efficient to recover the difference between the interim and approved cost of capital in 2013 from a deferral account to be recovered perhaps as a rate rider amortized over one or two years? What approach would work best for FBC?

Response:

FBC has proposed in its 2014-2018 PBR Plan to record the 2013 revenue requirements impact of the GCOC Stage 1 decision in a deferral account and to amortize the amount in 2014. In addition, FBC has proposed to use this deferral account to record and flow through any further revenue requirements impacts as soon as reasonably possible following a Stage 2 decision.

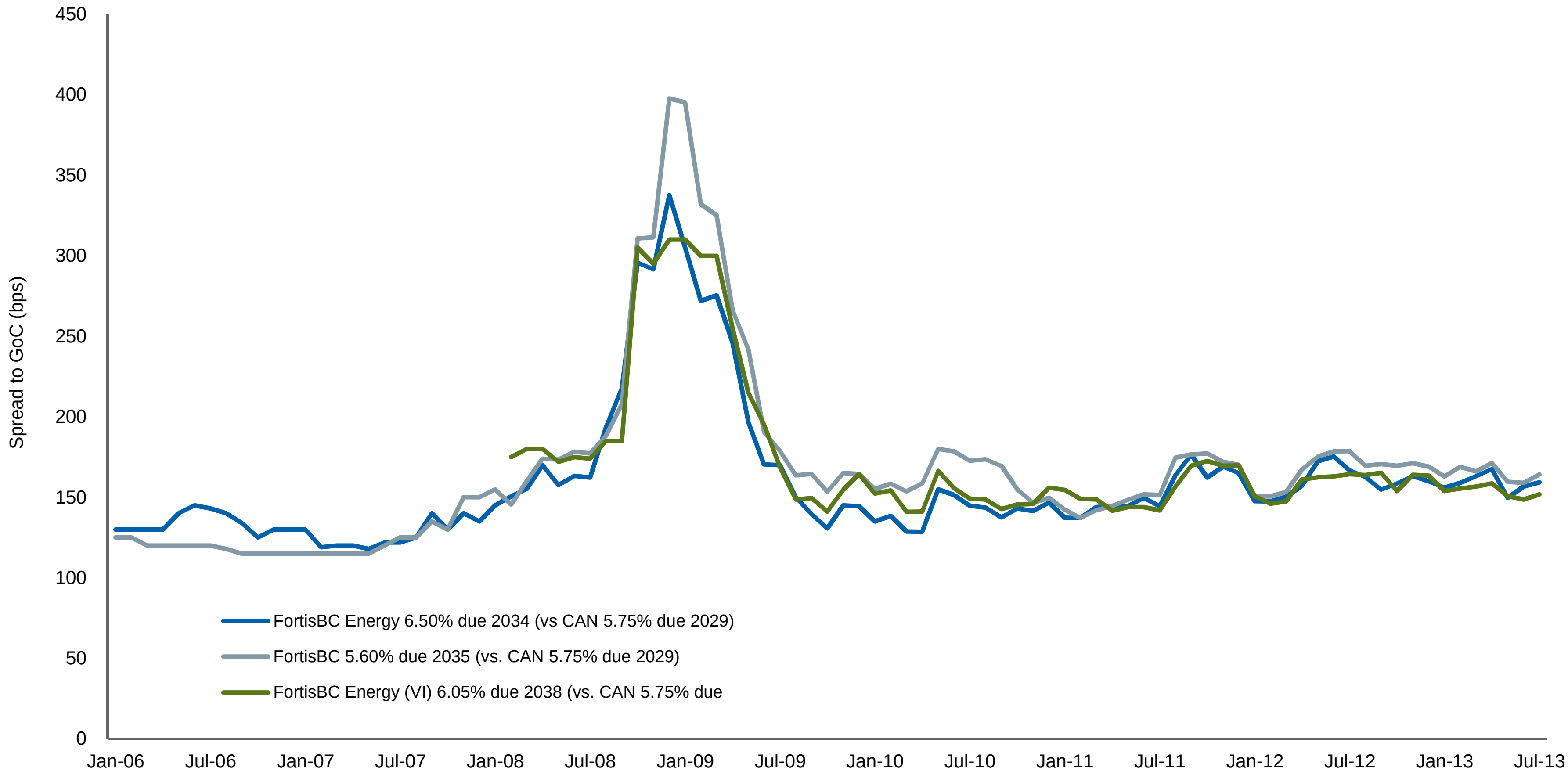
As part of this Revenue Requirements Application, the Company has also proposed a rate smoothing mechanism over the period of the PBR. The proposed rate smoothing mechanism includes all cost items affecting customer rates, including the impacts of the GCOC Stage 1 decision deferral being amortized in 2014. To the extent that any item is removed from general revenue requirements and rates and handled through a rate rider, either the rate smoothing mechanism will not produce smoothed results, or the rate smoothing mechanism would need to be adjusted to accomplish the same smoothed results.

In conclusion, the Company recommends the treatment as proposed in it 2014-2018 PBR Plan, which is to amortize the GCOC Stage 1 decision deferral account through the 2014 revenue requirements rather than through a rate rider.

Attachment 3.2

Month End	BCG 06.5000 05/01/34	CAN 05.7500 06/01/29	Spread	FTSB 05.6000 11/09/35	CAN 05.7500 06/01/29	Spread	TGVI 06.0500 02/15/38	CAN 05.7500 06/01/33	Spread
31-Jan-06	5.58	4.28	130	5.53	4.28	125	0.00	4.24	
28-Feb-06	5.50	4.20	130	5.45	4.20	125	0.00	4.15	
31-Mar-06	5.61	4.31	130	5.51	4.31	120	0.00	4.26	
30-Apr-06	5.86	4.56	130	5.76	4.56	120	0.00	4.52	
31-May-06	5.93	4.53	140	5.73	4.53	120	0.00	4.50	
30-Jun-06	6.10	4.65	145	5.85	4.65	120	0.00	4.61	
31-Jul-06	5.84	4.41	143	5.61	4.41	120	0.00	4.37	
31-Aug-06	5.62	4.22	140	5.40	4.22	118	0.00	4.19	
30-Sep-06	5.46	4.12	134	5.27	4.12	115	0.00	4.09	
31-Oct-06	5.37	4.12	125	5.27	4.12	115	0.00	4.09	
30-Nov-06	5.32	4.02	130	5.17	4.02	115	0.00	3.99	
31-Dec-06	5.47	4.17	130	5.32	4.17	115	0.00	4.14	
31-Jan-07	5.55	4.25	130	5.40	4.25	115	0.00	4.22	
28-Feb-07	5.32	4.13	119	5.28	4.13	115	0.00	4.10	
31-Mar-07	5.43	4.23	120	5.38	4.23	115	0.00	4.20	
30-Apr-07	5.43	4.23	120	5.38	4.23	115	0.00	4.20	
31-May-07	5.60	4.42	118	5.57	4.42	115	0.00	4.39	
30-Jun-07	5.74	4.52	122	5.72	4.52	120	0.00	4.49	
31-Jul-07	5.72	4.50	122	5.75	4.50	125	0.00	4.46	
31-Aug-07	5.74	4.49	125	5.74	4.49	125	0.00	4.46	
30-Sep-07	5.86	4.46	140	5.81	4.46	135	0.00	4.45	
31-Oct-07	5.70	4.40	130	5.70	4.40	130	0.00	4.38	
30-Nov-07	5.58	4.18	140	5.68	4.18	150	0.00	4.16	
31-Dec-07	5.48	4.13	135	5.63	4.13	150	0.00	4.11	
31-Jan-08	5.65	4.20	145	5.75	4.20	155	0.00	4.20	
29-Feb-08	5.60	4.09	150	5.55	4.09	145	5.85	4.10	175
31-Mar-08	5.50	3.95	155	5.55	3.95	160	5.75	3.95	180
30-Apr-08	5.79	4.09	170	5.83	4.09	174	5.89	4.09	180
31-May-08	5.73	4.15	157	5.89	4.15	174	5.87	4.15	172
30-Jun-08	5.76	4.13	163	5.91	4.13	178	5.86	4.11	175
31-Jul-08	5.78	4.15	162	5.93	4.15	177	5.87	4.13	174
31-Aug-08	5.99	4.06	193	5.94	4.06	188	5.89	4.04	185
30-Sep-08	6.48	4.30	218	6.38	4.30	208	6.13	4.28	185
31-Oct-08	7.38	4.42	296	7.53	4.42	311	7.43	4.38	305
30-Nov-08	6.97	4.05	291	7.17	4.05	311	6.97	4.02	295
31-Dec-08	6.93	3.56	338	7.53	3.56	398	6.63	3.53	310
31-Jan-09	6.97	3.92	305	7.87	3.92	395	6.97	3.87	310
28-Feb-09	6.56	3.84	272	7.16	3.84	332	6.81	3.81	300
31-Mar-09	6.39	3.63	275	6.89	3.63	325	6.64	3.64	300
30-Apr-09	6.36	3.90	246	6.56	3.90	266	6.46	3.91	255
31-May-09	6.04	4.07	197	6.49	4.07	242	6.24	4.09	215
30-Jun-09	5.68	3.97	171	5.88	3.97	191	5.93	3.98	195
31-Jul-09	5.76	4.06	170	5.85	4.06	179	5.75	4.06	169
31-Aug-09	5.50	4.00	150	5.64	4.00	164	5.49	4.00	149
30-Sep-09	5.34	3.95	140	5.59	3.95	165	5.44	3.95	150
31-Oct-09	5.35	4.04	131	5.58	4.04	154	5.45	4.03	141
30-Nov-09	5.39	3.94	145	5.59	3.94	165	5.49	3.95	155
31-Dec-09	5.63	4.19	145	5.83	4.19	165	5.83	4.19	164
31-Jan-10	5.34	3.99	135	5.54	3.99	155	5.54	4.02	152
28-Feb-10	5.42	4.04	138	5.62	4.04	158	5.62	4.08	154
31-Mar-10	5.37	4.08	129	5.62	4.08	154	5.52	4.11	141
30-Apr-10	5.31	4.02	129	5.61	4.02	159	5.46	4.05	141
31-May-10	5.28	3.73	155	5.53	3.73	180	5.43	3.76	167
30-Jun-10	5.13	3.61	151	5.40	3.61	178	5.23	3.67	156
31-Jul-10	5.11	3.66	145	5.39	3.66	173	5.21	3.72	149
31-Aug-10	4.84	3.40	144	5.14	3.40	174	4.94	3.45	149
30-Sep-10	4.69	3.31	137	5.01	3.31	169	4.79	3.36	143
31-Oct-10	4.77	3.34	143	4.89	3.34	155	4.87	3.42	146
30-Nov-10	4.88	3.47	142	4.93	3.47	147	4.98	3.53	146
31-Dec-10	4.95	3.48	147	4.98	3.48	150	5.11	3.55	156
31-Jan-11	5.08	3.71	137	5.13	3.71	142	5.31	3.77	155
28-Feb-11	5.05	3.68	137	5.05	3.68	137	5.22	3.73	149
31-Mar-11	5.17	3.73	144	5.15	3.73	142	5.27	3.78	149
30-Apr-11	5.10	3.66	145	5.10	3.66	145	5.13	3.72	142
31-May-11	4.85	3.41	144	4.89	3.41	148	4.92	3.49	144
30-Jun-11	4.96	3.46	150	4.98	3.46	152	4.98	3.54	144
31-Jul-11	4.62	3.18	144	4.69	3.18	151	4.68	3.26	142
31-Aug-11	4.61	2.97	164	4.72	2.97	175	4.64	3.07	157
30-Sep-11	4.41	2.64	177	4.41	2.64	177	4.46	2.76	170
31-Oct-11	4.40	2.78	162	4.55	2.78	177	4.63	2.90	173
30-Nov-11	4.29	2.60	169	4.32	2.60	172	4.39	2.70	170
31-Dec-11	4.04	2.39	165	4.09	2.39	170	4.19	2.49	170
31-Jan-12	3.85	2.38	148	3.88	2.38	151	4.00	2.50	151
29-Feb-12	3.95	2.47	148	3.98	2.47	151	4.05	2.58	146
31-Mar-12	4.03	2.52	150	4.06	2.52	153	4.11	2.63	147
30-Apr-12	4.06	2.48	157	4.16	2.48	167	4.21	2.59	161
31-May-12	3.86	2.14	172	3.89	2.14	175	3.89	2.27	162
29-Jun-12	3.93	2.18	175	3.96	2.18	178	3.93	2.30	163
31-Jul-12	3.77	2.10	167	3.89	2.10	179	3.87	2.23	164
31-Aug-12	3.82	2.19	163	3.89	2.19	170	3.94	2.30	164
28-Sep-12	3.71	2.16	155	3.87	2.16	171	3.92	2.27	165
31-Oct-12	3.82	2.24	159	3.93	2.24	170	3.88	2.34	154
30-Nov-12	3.77	2.13	163	3.85	2.13	171	3.90	2.26	164
31-Dec-12	3.81	2.21	160	3.90	2.21	169	3.97	2.33	164
31-Jan-13	3.97	2.41	156	4.04	2.41	163	4.07	2.53	154
28-Feb-13	3.92	2.33	159	4.02	2.33	169	4.02	2.47	155
29-Mar-13	3.92	2.29	163	3.95	2.29	166	4.00	2.44	157
30-Apr-13	3.80	2.13	167	3.84	2.13	171	3.87	2.29	159
31-May-13	3.93	2.44	150	4.03	2.44	160	4.08	2.58	151
28-Jun-13	4.32	2.75	157	4.34	2.75	159	4.35	2.86	149
31-Jul-13	4.37	2.78	159	4.42	2.78	164	4.42	2.90	152

SOURCE: RBC Capital Markets



Spread to GoC (bps)
450
400
350
300
250
200
150
100
50
0
Jan-06
Jul-06
Jan-07
Jul-07
Jan-08
Jul-08
Jan-09
Jul-09
Jan-10
Jul-10
Jan-11
Jul-11
Jan-12
Jul-12
Jan-13
Jul-13
FortisBC Energy 6.50% due 2034 (vs CAN 5.75% due 2029)
FortisBC 5.60% due 2035 (vs. CAN 5.75% due 2029)
FortisBC Energy (VI) 6.05% due 2038 (vs. CAN 5.75% due

Attachment 3.9

MOODY'S
INVESTORS SERVICE

Credit Opinion: FortisBC Inc

Global Credit Research - 16 Oct 2012

British Columbia, Canada

Ratings

Category	Moody's Rating
Outlook	Stable
Senior Unsecured -Dom Curr	Baa1

Contacts

Analyst	Phone
David Brandt/Toronto	416.214.3864
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Key Indicators

[1]**FortisBC Inc**

	[2]LTM	2011	2010	2009	2008
(CFO Pre-W/C + Interest) / Interest Expense	3.1x	3.1x	2.8x	2.9x	2.8x
(CFO Pre-W/C) / Debt	12.4%	12.4%	10.5%	11.9%	11.2%
(CFO Pre-W/C - Dividends) / Debt	10.3%	10.3%	8.5%	9.6%	8.9%
Debt / Book Capitalization	50.2%	59.0%	59.9%	59.4%	63.8%

[1] All ratios calculated in accordance with Moody's Regulated Electric and Gas Utilities Rating Methodology using Moody's standard adjustments. [2] Last twelve months ended June 30, 2012 reflect changes to US-GAAP whereas prior years are reported under Canadian GAAP. Goodwill is included on FBC's balance sheet with the most notable impact on Debt/Book Capitalization ratios

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

Low-risk vertically integrated hydro-electric utility operating in supportive regulatory environment

Parent's acquisition of Central Hudson is credit neutral for FortisBC Inc.

Relatively weak financial metrics

Adequate liquidity

Corporate Profile

Headquartered in Kelowna, British Columbia, FortisBC Inc. (FBC) is a vertically integrated regulated hydro-electric utility that operates primarily under a cost-of-service regulatory regime. FBC is an indirect, wholly-owned subsidiary of Fortis Inc. (FTS, not rated), a diversified electric and gas utility holding company based in St. John's, Newfoundland.

SUMMARY RATING RATIONALE

FortisBC Inc.'s Baa1 rating reflects the low risk nature of the utility where over 95% of its operations are regulated and the few unregulated operations are relatively low risk. The rating also considers FBC's location in a generally supportive regulatory environment governed by the British Columbia Utilities Commission (BCUC). The supportive regulatory environment is offset by weak financial ratios that map below FBC's rating of Baa1. FBC self generates about 45% from its hydroelectric generation and the balance is met through contracts with BC Hydro (BCH, Aaa, stable) and Brilliant Power Corporation (BPC, A1, stable), other small power purchase contracts and spot market purchases.BCH assumes all of FBC's hydrology risk beyond the 50 year norm via the Canal Plant Agreement.

DETAILED RATING CONSIDERATIONS

LOW-RISK VERTICALLY INTEGRATED HYDRO-ELECTRIC UTILITY IN SUPPORTIVE REGULATORY ENVIRONMENT

FBC's rating reflects the company's low business risk profile where over 95% of its operations are regulated and its unregulated operations are low-risk in nature. While vertically integrated utilities are often exposed to commodity price and volume risks in their generation segments (fuel purchase and electricity sales), a hydro-electric utility's most significant risk is hydrology. Actual water flows can vary significantly from those forecast with potential impacts on cash flows. FBC's hydrology risk is substantially mitigated by the Canal Plant Agreement (CPA), which runs until at least 2035. Under the CPA, FBC and others cede scheduling control of their generation facilities to BCH in exchange for power based on 50-year historical hydrology regardless of the actual hydrological conditions in any contract year. Consequently, Moody's considers FBC's business risk to be lower than that of other cost-of-service regulated vertically integrated utilities. FBC's hydro-electric generation facilities provide about 45% of its annual energy requirements. FBC has power purchase agreements (PPAs) with BCH and BPC (BPC, A1, stable), which combined, represented approximately 40% of its 2011 energy requirements.

FBC operates in British Columbia (BC), which we view as a relatively supportive regulatory environment. Proceedings tend to be less adversarial and balanced decisions are rendered on a timely basis. We do note, however, that the current generic cost of capital review has been initiated by the regulator, not in response to a rate application. We will assess the outcome of that process for any changes to our view of the regulatory environment. On a periodic basis, FBC submits a capital plan to the BCUC for review and approval. The capital plan's rate impacts are also reviewed during FBC's annual revenue requirement application process. This process of obtaining regulatory pre-approval of capital spending reduces the risk of being unable to fully recover capital investments that have already been incurred.

For the 2012-13 timeframe, FBC is regulated on a full cost-of-service basis. In its application, FBC requested rate increases of 1.5% in 2012 and 6.5% in 2013 with the former being approved on an interim basis in December 2011. On August 15, 2012, the BCUC objected to FBC's proposed rate increases for 2012 and 2013, directed FBC to cut its capital expenditure program by $10.5 million and asked the company to re-file its revenue requirement application. Aside from the reduction in capex, the BCUC demanded a reduction in labor costs by $250,000 and indicated that FBC increase its productivity by integrating more common functions among the group of FortisBC entities. The BCUC approved a continuation of various deferral accounts related to power purchases, revenues, and pension costs with the notable exception of short and long-term interest rates. We view certainty of recovery of power costs as high because the majority of FBC's power purchases occur pursuant to the BPC and BCH PPAs, both of which have been approved by the BCUC. The costs incurred by FBC under these agreements are therefore effectively a flow-through to ratepayers. The BCUC continues to acknowledge the necessity of rate disparity between BCH and FBC as the two companies have a different set of customers and supply sources underscoring our view of the generally supportive regulatory environment for FBC.

PARENT'S ACQUISITION OF CENTRAL HUDSON IS CREDIT NEUTRAL TO FBC

We do not rate FTS but have considered its business and risk profile using publicly available information to determine the likelihood of FTS pulling funds out of FBC, in particular to finance the $1.5BN pending acquisition of CH Energy Group, Inc., which owns Central Hudson Gas & Electric Corp. (A3, outlook stable), by FTI. We expect the acquisition to be financed by issuing $600MM in common shares, with the balance from a combination of debt and preferred share issuance, and we do not expect FTS to call upon FBC for extraordinary dividends beyond the $20 to $25 million range registered in each of the next two years to help finance the acquisition. In addition, equity injections into FBC have phased out over the last years and we do not expect any additional equity injections in the near future absent any acquisitions. We view the CH Energy transaction as part of FTS' continued growth strategy in low risk regulated assets and indicative of its commitment to the maintenance of strong investment grade ratings both at the parent and operating subsidiary levels.

RELATIVELY WEAK FINANCIAL METRICS

FBC's financial metrics have improved modestly in the last two years. We expect FBC's financial metrics to remain relatively stable over the next few years with CFO pre-W/C to Debt in the range of 12% to 14% and Interest Coverage of approximately 3x. Sustaining these metrics is dependent upon, among other things, execution of BCUC-approved capital spending on budget and effective management of forecast risk. As prescribed in our Regulated Electric and Gas utilities methodology we view the liability portion of the capital lease from the PPA with BPC as an operating liability rather than debt and have adjusted FBC's debt and financial ratios accordingly. FBC's adoption of US-GAAP had a significant effect on FBC's debt/book capitalization ratios due to the implementation of push-down accounting which puts the goodwill associated with the acquisition by Fortis Inc. in 2004 on FBC's balance sheet with an offset to paid-in capital.

Despite the modest improvement in FBC's metrics, the company's ratios remain weak relative to its Baa1-rated peers. However, we believe that FBC's relatively weak financial profile is substantially offset by the company's relatively low business risk and location in an above average supportive regulatory environment.

Liquidity Profile

We view FBC's liquidity as adequate.

For the next twelve months, we estimate the company will generate funds from operations of approximately $100 million. After dividends of approximately $20 million, capital expenditures and changes in working capital of around $130 million, FBC is expected to be free cash flow negative by approximately $50 million.

The company has a debt maturity of $15 million during this period in Q4 of 2012 so its funding requirement will be approximately $65 million. FBC had undrawn committed credit facilities of approximately $83 million at June 30 which excludes the $50 million 364-day revolving Facility B expiring in May 2013, which we view as not being re-committed for the next year. FBC's Facility A is a $100 million three-year revolving facility with a May 7, 2015 maturity. The credit facilities do not include features like a material adverse change clause that would limit access to funds during a period of financial stress. They are, however, subject to a covenant that requires FBC's debt to capitalization ratio not to exceed 75%. At June 30, 2012, the company had considerable headroom under this covenant.

Rating Outlook

The rating outlook is stable based on our expectation that FBC will continue to achieve the rate increases necessary to support its capital spending program or, in the absence of such rate increases, that FBC will restrict the scope and scale of its capital program to ensure that its financial metrics are not materially weakened.

What Could Change the Rating - Up

FBC's rating could be positively impacted if FBC were able to demonstrate a sustainable improvement in financial ratios, such as CFO pre-W/C Interest Coverage of approximately of 4x and CFO pre-W/C to Debt above 16%.

What Could Change the Rating - Down

A downgrade of FBC's rating would likely require a combination of a deterioration of FBC's regulatory framework or liquidity and financial profile, or an inability to earn its allowed return. This might include sustained weakening of FBC's metrics such as CFO pre-W/C Interest coverage of below 2.7x and CFO pre-W/C to Debt below 10%.

Rating Factors

FortisBC Inc

Regulated Electric and Gas Utilities Industry [1]	[2]**Current**		[3]**Moody's 12-18 month Forward View As of**

				September 2012	
Factor 1: Regulatory Framework (25%)	**Measure**	**Score**		**Measure**	**Score**
a) Regulatory Framework		A			A
Factor 2: Ability To Recover Costs And Earn Returns (25%)					
a) Ability To Recover Costs And Earn Returns		A			A
Factor 3: Diversification (10%)					
a) Market Position (10%)		Baa			Baa
b) Generation and Fuel Diversity (0%)		Aa			Aa
Factor 4: Financial Strength, Liquidity And Key Financial Metrics (40%)					
a) Liquidity (10%)		Baa			Baa
b) CFO pre-WC + Interest/ Interest (3 Year Avg) (7.5%)	3.0x	Baa		3.0x-3.2x	Baa
c) CFO pre-WC / Debt (3 Year Avg) (7.5%)	11%	Ba		10%	Ba
d) CFO pre-WC - Dividends / Debt (3 Year Avg) (7.5%)	9%	Ba		8%	Ba
e) Debt/Capitalization (3 Year Avg) (7.5%)	59%	Ba		58%	Ba
Rating:					
a) Indicated Rating from Grid		Baa1			Baa1
b) Actual Rating Assigned					Baa1

* THIS REPRESENTS MOODY'S FORWARD VIEW; NOT THE VIEW OF THE ISSUER; AND UNLESS NOTED IN THE TEXT DOES NOT INCORPORATE SIGNIFICANT ACQUISITIONS OR DIVESTITURES

[1] All ratios calculated in accordance with Moody's Regulated Electric and Gas Utilities Rating Methodology using Moody's standard adjustments [2] LTM = last twelve months to June 30, 2012 [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures

any investment decision based on this credit rating. If in doubt you should contact your financial or other professional adviser.