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September 20, 2013

<u>Via Email</u>
Original via Mail

British Columbia Municipal Electrical Utilities
c/o Owen Bird Law Corporation
P.O. Box 49130, Three Bentall Centre
2900 – 595 Burrard Street
Vancouver, BC V7X 1J5

<u>Attention</u>: Mr. Christopher P. Weafer

Dear Mr. Weafer:

Re: FortisBC Inc. (FBC)

Application for Approval of a Multi-Year Performance Based Ratemaking Plan for 2014 through 2018 (the Application)

Response to the British Columbia Municipal Electrical Utilities (BCMEU) Information Request (IR) No. 1

On July 5, 2013, FBC filed the Application as referenced above. In accordance with Commission Order G-109-13 setting out the Preliminary Regulatory Timetable for the review of the Application, FBC respectfully submits the attached response to BCMEU IR No. 1.

If further information is required, please contact the undersigned.

Sincerely,

FORTISBC INC.

Original signed:

Dennis Swanson

Attachments

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

1. Reference: General

The BCMEU has reviewed the FortisBC's Application as well as the Fortis Energy Inc. (FEI) 2014 through 2018 Multi-Year PBR Plan and notes there are many similarities between the two filings. There has been some discussion with respect to establishing a common record where the evidence is common between the two Fortis Utilities and the BCMEU wishes to clarify how the record will be dealt with.

1.1 Please confirm that the responses provided by FEI to the first round of information requests are adopted by FortisBC in regard to areas of common evidence.

<u>Response:</u>

Not confirmed. The evidentiary records for the FEI and FBC applications are distinct. However FBC has endeavoured to identify questions and responses, related to the proposed PBR Plan, that are the same as questions issue to FEI in its Round 1 IRs.

1.2 Please describe how FortisBC intends to proceed with regulatory process to find efficiency between the evidence of FEI and FortisBC.

<u>Response:</u>

On September 13, 2012, The Commission issued Order G-151-13 setting out the remainder of the Regulatory Timetable for review of the Application. The review of the PBR methodology for FBC and FEI will be combined to promote efficiencies and reduce duplication. Other components of each company's applications will be reviewed separately, by way of written hearing.

1.3 Please describe any material differences that FortisBC sees between it and FEI in regard to the utilization of the evidence filed by the Utilities on the use of PBR mechanisms.

<u>Response:</u>

The FBC and FEI 2014-2018 PBR Plans do have many similarities as noted in the question and this is intentional. However, FBC and FEI are different utilities providing electric and gas service, respectively and have differing (although overlapping) service territories, and different stakeholders / intervener groups. The differences arise from these areas, and from the history and particular circumstances of each utility.

Having similar PBR models will enable utility management to seek efficiencies and establish priorities for both utilities based on similar business drivers and business case metrics. Hence FBC and FEI believe there is value for both utilities in establishing the very similar PBR models but ultimately the evidence filed for each utility must be considered in respect of that utility's PBR Plan.

Order G-151-13 issued on September 13, 2013, established a common oral hearing process for the review of FEI's and FBC's PBR methodology.

1.4 Do the Utilities see any difference between gas and electric utilities operating in a PBR environment?

Response:

FBC and FEI do not see any fundamental differences between gas and electric utilities in terms of whether they can successfully operate in a PBR environment, particularly with the PBR approach proposed, which (with certain variations) has been used successfully for both utilities in the past. Electric and gas utilities do, of course, have different energy products. There will be differences in the operating conditions affecting gas and electric utilities, just as there may be differences between two electric utilities. Different TFP studies should be undertaken for gas and electric utilities, as B&V has described in their evidence. On the whole, however, PBR is effectively a flexible and adaptable ratemaking construct that can take on various forms to suit differing circumstances faced by utilities. The positive track record in BC of the proposed PBR model supports continuing to use it for both Utilities for the long term benefit of gas and electricity customers of the two Utilities.

1.5 Does FortisBC see any difference in terms of the size of the respective gas and electric utilities of Fortis in terms of number of customers and does Fortis have a view as to whether it will be easier to achieve efficiencies in a larger utility as opposed to a smaller utility?

Response:

FEI's current customer base is approximately six times the size of FBC's customer base.

In general, it is difficult to conclude whether it is easier for a larger utility, as defined by the number of customers, to achieve efficiencies as opposed to a smaller utility. A number of factors, irrespective of size, are more likely to influence the ease of achieving operational efficiencies.

These factors include differences regarding customer service expectations and requirements; IT systems and applications used; complexity and integration of existing business processes; operating practices and environment; and flexibility of the workforce. For example, the flexibility of the workforce is somewhat dependent on the nature of the labour agreement in place and less so on the size of the organization.

A further consideration, unrelated to the size of the organization, is the extent to which efficiencies have been realized already. In general, regardless of the size of the organization, efficiencies may be easier to achieve if the organization has only realized limited efficiencies to date. In contrast, an organization that has already achieved a great deal of efficiencies will be challenged to realize further efficiencies. With respect to FEI and FBC, both utilities have a great deal of experience operating in a PBR environment, and have been successful in achieving the productivity improvement factors previously agreed to. Indeed, considering FBC has already embedded a great deal of efficiency in its operations (approximately 10.4 percent over the term of the last PBR plan), it is expected that further efficiency opportunities will be more challenging to realize as they will be focused on business processes that cross departments in the organization and which may require capital investments.

As indicated in the Application, future FEI-FBC integration related productivity opportunities are expected to be more complex than the integration achieved to date and will be dependent on the Company's ability to overcome certain challenges. These challenges include concerns raised by unions representing gas and electric employees around shifting of unionized work from one entity to another (i.e. dependent on labour agreement), and the need to transition to common IT platforms (i.e. capital investments) before more harmonization of business processes can occur. Differences in the nature of the gas and electric operations also pose challenges and limit the breadth of opportunities available (i.e. operating practices and environment).

1.6 Does FortisBC see any difference between the geographic distribution of the Fortis gas utility over the electric utility and does it see any difference in terms of ability to obtain efficiencies in a PBR environment.

Response:

FEI's geographic distribution is much larger in the province of B.C., providing service in more than 100 communities in four services areas of the Lower Mainland, Inland, Columbia and Revelstoke. In comparison, FBC operates only in the southern interior of B.C. serving communities including Kelowna, Princeton, Oliver, Osoyoos, Trail, Castlegar, Creston and Rossland.

In general, FBC does not anticipate any significant difference in terms of its ability to obtain efficiencies as compared to FEI as a result of the geographic distribution of utility assets. Please also refer to the response to BCMEU IR 1.1.5. As indicated in that response, a number of factors, irrespective of size and geographic distribution, may influence the ability of a utility to realize operational efficiencies.

2. Reference: Application Overview

FortisBC identifies at page 1, lines 11 to 12, an objective "to reinforce FBC's productivity improvement culture while ensuring safety and customer service requirements continue to be me…". Given that FortisBC has operated in a productivity improvement culture for several years, why would it be concerned that employees would not continue in a productivity improvement culture irrespective of whether there were incentives or not given that the FortisBC shareholder is already awarded a reasonable rate of return on its investments?

<u>Response:</u>

FBC refers to the Commission's decision on FBC's 2012-2013 Revenue Requirements for context. In its 2012 decision, the Commission provided its position with respect to productivity improvements and outlined its expectations as to how a utility should address the issue within its day-to-day operations (page 21):

> *"The Commission Panel is of the view that there is an ongoing need for utilities to manage their business in a manner that actively seeks out and creates efficiencies resulting in what might be described as a "productivity improvement culture". We believe this in the interests of both the ratepayer and the shareholder. Put most simply, a productivity improvement culture is one where there is a demonstrated capability of a company to regularly undertake a review of the organization from both a macro and micro point of view to examine what is being done, how it is being done and where warranted, to make decisions to do things differently, or in some cases, not at all."*

FBC highlights the words "actively seeks" and "regularly undertake" which are essential to a productively improvement culture, as contemplated by the Decision. FBC's view of productivity is similar in that it must be a focus for the organization and be reinforced (emphasized) regularly, recognizing that the environment and business conditions which FBC operates in change over time. This will help to ensure that the focus and emphasis is maintained in the organization in the face of changing business conditions. FBC has every confidence that its employees are cognizant of the importance of continuous improvement regarding efficiency, as it is something that is encouraged by the Company.

That said, there are inherent characteristics of cost of service ratemaking that limit the extent to which efficiencies can be captured. Notably, PBR extends the period before rebasing and provides for sharing of a portion of savings before rebasing, creating an opportunity for the utility to invest in incremental efficiency initiatives that may not otherwise be cost effective for the Company to undertake if rebasing were to occur immediately. PBR thus provides the incentive to actively seek out *incremental* efficiencies. Please refer to the responses to CEC IRs 1.2.2 and 1.24.3.

As well, this emphasis on PBR as a means of encouraging a productivity improvement culture is consistent with the direction provided by the Commission letter dated April 18, 2013 regarding FBC's next Revenue Requirement Application. In the letter, FBC and FEU were requested to propose a PBR methodology and explain how to address the limitations in the various PBR methodologies, and will achieve a productivity improvement culture.

3. Reference: Approvals Sought, Page 7

The PBR plan is for a five year period (2014-2018). Please comment on the impact of a shorter term PBR term of three years and articulate the benefits to ratepayers of establishing a longer PBR period.

Response:

Please refer to the responses to ICG IR 1.5.2 and CEC IR 1.3.1.

4. Reference: General Rate Increases, Page 7, Lines 13 through 16

4.1 Please describe how FortisBC is proposing to deal with BC Hydro rate increases which may occur through the PBR term.

Response:

FBC has forecast its Power Purchase Expense through 2018 based on existing BC Hydro rates, consistent with past practice. The Company intends to set rates based on approved (permanent or interim) BC Hydro rates at the time of each Annual Review. BC Hydro rate changes generally take effect on April 1. All variances from forecast, including those resulting from BC Hydro rate changes, will continue to be captured in the Power Purchase Expense Variance Deferral Account and amortized into rates in the following year as provided by Order G-110-12.

4.2 The wholesale customers are concerned with the potential for multiple rate changes within a year and wish to understand whether any BC Hydro rate impacts will be implemented as part of one annual rate change from FortisBC or whether there will be multi changes to rates within the year during the PBR period. Please comment.

Response:

Please refer to the response to BCMEU 1.4.1. FBC does not intend to implement the effect of any BC Hydro rate changes in mid-year.

5. Reference: 2.3 – Deferral Accounts, Page 7

5.1 Please provide a summary of deferral accounts which were in place at the commencement of the 2007 to 2011 PBR period.

Response:

The following is a summary of deferral accounts that were in use in 2007.

- Demand Side Management;
- Deferred Revenue – Incentive Adjustment and Provision for True-up for 2006 Incentive;
- 2005, 2006, 2007 and 2008 Revenue Requirements;
- 2007 BC Hydro Rate Design;
- Terasen Gas ROE Application;
- Trail Office Lease Costs and Rental to SD# 20;
- Prepaid Pension Costs and Post-Retirement Benefits;
- Renegotiation of Canal Plant Agreement;
- 20 Year Transmission System Plan;
- 2008 System Development Plan Update;
- 2008 COSA & Rate Design Application;
- AMI Feasibility, Resource Plan and Hydro Electric Supply Studies;
- BC Hydro PPA Renewal;
- Discount Forfeit Defense;
- Revenue Protection;
- Big White Supply Project;
- Innovative Clean Energy Fund Levy Implementation;
- Princeton Light and Power (PLP) Transition and Settlement Costs, Potential Substation, Computer Software, Pension Credit and Rate Stabilization Account; and
- Deferred Debt Issue Costs.

5.2 Has there been an increase in the utilization of deferral accounts by FortisBC since 2007 such that a higher proportion of costs and revenues are being dealt with through deferral accounts today than at the commencement of the 2007 PBR period?

Response:

Due to certain changes in accounting and regulatory treatment the utilization and number of deferral accounts has increased since 2007. However, the total deferred charge balance has decreased since 2007.

As can be seen in the table below, total deferred charges as at December 31, 2007 were about $14.5 million while the forecast balance as at December 31, 2013 is expected to be approximately $10.3 million. There have been increases in both deferred charges and deferred credits over the same time period. Increases to deferred charges were due to increases in Demand Side Management costs, increases in deferred Regulatory costs and MRS costs. Offsetting those charges were increased credit balances associated with incentives and other flow through adjustments for the benefit of customers, as well as increased credits for Pension and OPEB obligations.

As a result, amortization expense as a percentage of revenue requirements has also decreased between 2007 and forecast 2013.

DEFERRED CHARGES AND CREDITS

	Actual	Forecast		
	Balance at Dec. 31, 2007	Balance at Dec. 31, 2013		
	Total Deferred Charges	Rate Base Accounts	Non Rate Base Accounts	Total Deferred Charges
Energy Management	6,334	18,188	-	18,188
Deferred Revenue incentives and flow-through	(1,111)	(1,046)	(10,813)	(11,859)
Deferred Regulatory Expense	376	840	1,590	2,430
Preliminary and Investigative Charges	321	150	-	150
Prepaid Pension & OPEB Costs	3,839	-	(4,705)	(4,705)
Other Deferred Charges and Credits	498	722	930	1,653
Deferred Debt Issue Costs	4,216	2,879	1,540	4,419
Total Deferred Charges	14,473	21,733	(11,457)	10,276
Mid Year Utility Rate Base	746,543	1,146,662		1,146,662
Deferred as a % of Rate Base	1.9%			0.9%
Rate Base Deferred as a % of Rate Base	1.9%	1.9%		
Amortization Expense	2,807			2,289
Revenue Requirement (RR)	207,368			310,531
Amortization Expense as a % of RR	1.4%			0.7%

6. Reference: Productivity Focus, Page 12

At lines 9 through 12 of page 12, FortisBC highlights that in 2012 and 2013 employees were asked to pursue efficiencies through "streamlining processes, leveraging technology and optimizing opportunities for integration with FEI". This is commendable and given this was occurring during a non-PBR period, why is there a necessity to incent the Company through share mechanism when this would appear to be the role of employees in any prudently run utility?

Response:

Please refer to the responses to CEC IRs 1.2.2 and 1.24.3. As these responses note, there are different incentives under PBR and cost of service. B&V indicates that a prudently run utility has multiple constraints under pure cost of service regulation that PBR is designed to remove allowing more flexibility to operate the utility under more market like principles.

7. Reference: Sharing of Gas and Electric Utility

The BCMEU was pleased to see the efforts to work towards sharing of gas and electric services for the purpose of reducing costs. FortisBC states that "the introduction of a cost allocation model will provide a representative approach to allocate costs and efficiencies between electric and gas, while minimizing the administrative efforts associated with the time sheet allocation approach."

7.1 Please describe what mechanisms FortisBC will put in place to ensure ability to audit of the cost allocation to determine accuracy, so that the Commission can be assured that the costs are allocated properly.

Response:

To ensure the accuracy of a shared services cost allocation model between FEI and FBC, FortisBC would ensure that the allocation model is well understood and that there is a transparent and supportable methodology. This will include providing information about the cost drivers used and the basis on how they are determined. Additionally, the cost allocation approach will be supported by a defined and documented methodology

7.2 Please comment on the differences between the cost allocation model and the time sheet allocation approach.

Response:

For a description of the different cost allocation methods, please refer to the response to BCUC IR 1.2.1 which outlines the various methods and the pros and cons of each method.

8. Reference: Organizational Performance and Monitoring, Page 18

8.1 Please provide a copy of the balanced score card as utilized for each category of employee within the company executive, management, exempt and union employees.

<u>Response:</u>

Please refer to the response to BCPSO IR 1.9.2 for a copy of the 2012 FBC scorecard.

Please also refer to the response to BCUC IR 1.4.1 for discussion of how FBC's scorecard affects compensation for eligible employees (i.e. management and exempt, executives, and certain unionized employees).

8.2 Please provide any other pertinent performance review documents for these categories of employees that exist at this time and as maybe implemented in the multi-year PBR plan proposed.

<u>Response:</u>

There are no other organizational performance review documents that exist at this time, or which FBC expects to implement in the multi-year PBR plan proposed.

8.3 Please provide any current plans for changes to these review processes during the proposed PBR period.

<u>Response:</u>

There are no plans for changes to the organizational performance review processes currently in place.

9. Reference: Proposed Regulatory Process, Page 20

FortisBC proposes a negotiated settlement process. Please comment on whether given the long term nature of the PBR term, it would be more appropriate to have direct Commission involvement in the review process.

<u>Response:</u>

By Order G-151-13 the Commission determined that a Negotiated Settlement Process will not be used in this proceeding.

10. Reference: 2014/2018 Rate Forecast, Page 75

10.1 What is the assumed rate increase in each of the years of the PBR 20014 through 2018?

Response:

The assumed rate increase over the term of the PBR Plan is 3.3 percent annually, exclusive of the items listed in the description of the RSDM at page 3 of the Application, that is, changes arising from the Annual Reviews, future capital projects that will be the subject of CPCN applications, and the Commission decision in the current Generic Cost of Capital Proceeding. FBC estimates the impact of its expected CPCN projects in to be approximately 1.6 percent (cumulative) over the 2014-2018 period but cannot estimate the rate impacts of the remaining items

10.2 Does the rate increase include a potential BC Hydro rate increase during the PBR period?

Response:

Please refer to the response to BCMEU IR 1.4.1.

11. Reference: 2014/2018 Load Forecast, Page 77

Please highlight any difference in the Load Forecast methodology adopted for the 2014 through 2018 period as compared to the most recent Load Forecast filed by FortisBC with the Commission.

Response:

A summary of the Load Forecast methodology changes can be found in Exhibit B-1-1, Appendix E2, Section 5.

12. Reference: Power Purchase Expense, Page 96

The BCMEU understands that ratepayers have benefitted from market opportunities pursued by FortisBC in recent years resulting in a credit to ratepayers. Would FortisBC agree that those opportunities lessened during the PBR period given the proposed BC Hydro Rate Schedule 3808 PPA which expires on September 30, 2013, and given the take or pay requirements set out in that agreement?

Response:

Not necessarily. FBC agrees that the take or pay requirements in the New PPA that will replace the expiring agreement limits the flexibility the Company has to capture market opportunities in the spot market by the 75% take or pay requirement of its Annual Energy Nomination. However, FBC is able to reset its Nomination each year, and can reduce this minimum take requirement by entering into transactions that lock in lower prices for future deliveries prior to making the Nomination. This will require greater level of planning and monitoring of market conditions, however as discussed in the response to ICG IR 2.20.2, FBC believes that it will be able to realise the same overall benefit for customers as it would have under the expiring PPA while maintaining reliability and security of supply.

As discussed in FBC's Application (Exhibit B-1, Sec 2.4, pages 99-100), in order to improve the accuracy of its power purchase expense forecast, FBC has made changes to the way it develops its forecast that take into account expected market activities. In previous years, FBC has based its forecast on the assumption that it will maximise the use of PPA energy before taking into account any market opportunities. The overall PPE was then reduced by the PPE adjustment, which was effectively a "fudge factor" to account for mitigation of the PPA through market displacements. FBC's 2014 PPE forecast is based on its best estimate after taking into account market mitigation. Therefore although FBC believes that it will be able to deliver the same level of overall benefit to customers notwithstanding the minimum take requirements under the New PPA, the difference between 2014 forecast PPE and actual costs as a result of market activities is expected to be minimal.

13. Reference: Labour Inflation and Benefits, Heading 4.33

13.1 Please file all compensation and benefit programs for each of the categories of employees, executive, management, exempt and unionized employees.

Response:

Details of the compensation programs provided for each affiliation of employees are set out below.

1. Executive Employees: The following are components of FBC's compensation program for executive employees:

   a. Annual Base Salary: Salary is a market-competitive, fixed level of compensation. Base salaries are established annually by reference to the range of salaries paid generally by comparable Canadian commercial industrial companies and are targeted at the median of the comparator group.

   b. Short-term Incentive Pay: An annual short term incentive plan provides for annual cash bonuses which are determined by way of an annual assessment of corporate and individual performance in relation to targets. FBC's annual earnings must reach a minimum threshold level before any payments are made. The objectives of the annual incentive plan are to reward achievement of short-term financial and operating performance and focus on key activities and achievements critical to the ongoing success of the company. Corporate performance is determined with reference to the performance of FBC relative to weighted targets in respect to financial, safety, customer satisfaction and regulatory performance. Individual performance is determined with reference to individual contribution to corporate objectives.

   c. Long-term Incentive Pay includes:

      i. Stock Options: Annual equity grants are made in the form of stock options. The amount of annual grant will be dependent on the level of the executive and their current share ownership levels. Planned grant value is converted to the number of shares granted by dividing the planned value by the pre-determined, formulaic planning price derived using the Black-Scholes Option Pricing Model.

      ii. Performance Share Units (PSU): Annual PSU grants are made to executive members. The number of units to be granted is dependent on the executive's base salary, level of the executive and the market price of the common shares on the grant date. Payment of PSU's is performance based consisting of four elements; compound average growth rate in earnings per share, compound average growth rate in Property, Plant & Equipment and total Shareholder return.

d. Vehicle: Each member of the executive team is provided with the use of a company-leased vehicle, the value of which has a pre-determined maximum based on the position. All normal lease, maintenance and operating costs are paid by FBC. The cost of this is included in the O&M base upon which delivery rates are calculated.

2. Management & Exempt Employees: Please refer to the response to BCUC IR 1.222.3 for a description of the components of FBC's compensation program for M&E employees.

3. Unionized Employees: Please refer to the response to BCUC IR 1.223.1.2 for a description of the components of FBC's compensation programs for unionized employees.

Summaries of the benefit programs (including time off programs) provided for each affiliation of employees are included as CONFIDENTIAL Attachment 13.1, which has been filed confidentially as it includes detailed information about FBC benefit programs which could provide a competitive advantage to organizations competing for similar talent.

The benefit programs for executives and M&E employees are part of the aligned benefits platform available across FBC, FEU, and FHI. Benefit programs for IBEW, COPE and COPE Customer Service employees of FBC are dependent on the negotiated terms of the applicable collective agreement.

13.2 Please provide any planned changes in compensation packages for the categories of employees during the PBR period.

Response:

FBC is planning to transition executive employees to a new health and welfare benefits plan (including post-retirement health and welfare benefits) as of January 1, 2014. The plan is a non-flex plan and is generally representative of plans at this level.

13.3 How are compensation packages adjusted in a non-PBR period as compared to a PBR period?

Response:

FBC maintains a consistent approach to its compensation package adjustments whether the Company is within a cost of service period or within a PBR period. FBC adjusts its compensation packages on an annual basis to be competitive with its peer companies in the labour market.

14. Reference: Page 115, Lines 18 to 21

Reference is made to pension practice of FortisBC:

"FortisBC's current pension practice of including incentive pay as pensionable, mirrors the treatment of incentive earnings and pension, practiced by the majority of companies of FortisBC's referenced group and more specifically, is the practice in the regulated utility industry."

Is there more opportunity for incentive earnings during the PBR period than in a non-PBR period in terms of the potential compensation for executives?

<u>Response:</u>

The executive compensation package is consistent regardless of whether FBC is within a cost of service period or within a PBR period.

Please also refer to the response to BCMEU IR 1.13.3.

15. Reference: Page 115, Line 26

"In dealing with management and exempt employees, it is provided that pay increases and incentive opportunities for all employees are linked to individual and company performance." Are opportunities for pay increases and incentive opportunities increased during a PBR than in a non-PBR period?

Response:

The management and exempt employees' compensation package is consistent regardless of whether FBC is within and cost of service period or within a PBR period.

Please also refer to the response to BCMEU IR 1.13.3.

16. Reference: Page 117, Line 28

FortisBC provides an underlying principal of PBRs that the regulatory construct should align the interests of customers in a utility company. Please describe how customer and utility interests are not aligned during a non-PBR period?

Response:

Under cost of service regulation, there is still alignment of interests in the sense that it is in the long term interest of both customers and the utility to operate efficiently, and provide safe and reliable service since the long term success of the business depends on it. That said, cost of service regulation limits the types of opportunities to reduce costs based on the expected time between the RRA periods. Under PBR, delaying rebasing and the opportunity to share in a portion of savings before rebasing provides the utility with additional incentive to invest in initiatives that might not otherwise be cost effective for the company.

Attachment 13.1

FILED CONFIDENTIALLY