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December 6, 2013

Via Email
Original via Mail

Commercial Energy Consumers Association of British Columbia
c/o Owen Bird Law Corporation
P.O. Box 49130, Three Bentall Centre
2900 – 595 Burrard Street
Vancouver, BC
V7X 1J5

Attention: Mr. Christopher P. Weafer

Dear Mr. Weafer:

Re: FortisBC Energy Inc. (FEI)

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

**Response to the Commercial Energy Consumers Association of British
Columbia (CEC) Information Request (IR) No. 2, Responses Related to the PBR
Methodology**

Filed as Response to FEI CEC IR No. 3a

On June 10, 2013, FEI filed the Application as referenced above. FEI submitted its response to CEC IR No. 2 on November 26, 2013, noting that the responses to CEC IRs No. 2, questions 9.8, 20 series, 21 series, 22 series, 24.1 through to 24.8, 24.11, 24.12, 25 series, 26 series, 38 series, 48 series, 49.8, 49.9, 51 series, 58.2, 99 series, 100.1, 104 series, 105 series and 106 series related to the PBR Methodology, and would be submitted with the PBR Methodology IRs.

In an effort to differentiate the IR responses relating to the PBR Methodology which are the subject of the oral portion of the hearing jointly for FEI and FortisBC Inc. (FBC) from those IR responses which relate to other matters for the written portion of the hearing individually for each of FEI and FBC, FEI will mark these IR responses as FEI CEC IR No. 3a.

FEI respectfully submits these CEC IR No. 3a responses related to the PBR Methodology.

If further information is required, please contact the undersigned.

Sincerely,

FORTISBC ENERGY INC.

Original signed:

Diane Roy

Attachment

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

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Reference: CEC 1.11.4

Table C4-1: 2013 Project Portfolio Benefits

Project Name	Value \$ (000s)	Integration	Customer Service	Growth	Safety	People	Financial Benefits (000s)	Risk
GeoSpatial Program - eForms	\$2,400				✓	✓	\$2,800	✓
Geospatial Program - GIS Toolset Refresh	\$2,800	✓	✓	✓	✓	✓	\$1,000	✓
Customer Portal and Bill Redesign	\$1,600	✓	✓		✓	✓	\$2,500	✓
Knowledge Management Program - SharePoint Upgrade and Migration	\$1,307	✓					\$1,700	✓
Knowledge Management Program - Integrated Intranet	\$1,277	✓	✓		✓	✓		✓
Financial Consolidation & Enterprise Reporting Solution	\$1,148			✓	✓	✓	\$1,000	✓
Incident Management System	\$1,000	✓			✓	✓	\$1,075	✓
Knowledge Management Program - New Business Solutions	\$800	✓	✓		✓	✓	TBC	✓
Knowledge Management Program - Small & Medium New Builds	\$600	✓	✓		✓	✓		✓
2013 Customer Service Enhancement	\$1,971	✓	✓	✓			\$750	✓
ClickSchedule Business Enhancement	\$512		✓		✓		\$585	✓
2013 SAP BI-BW Enhancement	\$231				✓	✓		✓
2013 GIS (GE Smallworld) and Mobile GIS (Tensing) Enhancement	\$225				✓			
2013 Operations Enhancement	\$220		✓					✓
Contractor Access to Planning Systems	\$143			✓	✓		\$100	✓
2013 Supply Chain Enhancement	\$133	✓	✓					✓
2013 Finance Enhancement	\$120			✓		✓		✓
2013 BC One Call Enhancements (includes DCRS)	\$110				✓			
2013 Meter Management Enhancement	\$108	✓	✓	✓	✓			✓
Web optimization templates and mobile	\$99	✓	✓	✓	✓	✓		
2013 FileNet Enhancement	\$90				✓			
2013 Forecasting Enhancement	\$85	✓	✓					✓
2013 WINS Enhancement	\$55			✓				
2013 Entegate Enhancement	\$25				✓	✓		✓
2013 McLaren Enterprise Engineer Enhancement	\$22	✓	✓		✓			
	\$17,081						\$11,510	

9.8 Please confirm that FEI's proposed process is to have an incentive to share only in cost reductions.

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1 **Response:**

2 Not confirmed. The 50/50 earnings sharing mechanism in the PBR is symmetrical above and
3 below the BCUC-approved ROE. While it is FEI's intention to pursue efficiencies and find
4 reductions in its O&M and capital expenditures throughout the PBR term, if the actual ROE falls
5 below the BCUC-approved level in any year, FEI and customers will share equally in that
6 shortfall. This is the same treatment of earnings sharing that was included in FEI's 1998-2001
7 and 2004-2009 PBR Plans.

8

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1 **20 Reference: CEC 1.34.2 and CEC 1.34.3**

17 It is very common, if not universal, to refer to PBR formulas as I-X formulas. This recognizes
18 that inflation is a central concept in PBR. In addition, it is cost effectiveness in the utilities'
19 particular circumstances and not "least cost benchmarks" that should be the focus of the
20 efficiency improvement projects as least cost benchmarks may not even be accessible for a
21 utility because of the varying local economic, regulatory and legislative conditions specific to
22 each utility. By removing inflation, the Company not only is challenged to become more
23 productive through the X-factor, but without the ability to address the increase in input costs, the
24 Company may be forced to find cost savings that are beyond efficiency.

2

3 20.1 Please provide data with respect to what happens to wage rates for private
4 sector competitive businesses during recessionary times for the last 20 years.

5

6 **Response:**

7 Attached below is a table extracted from a BC Stats spreadsheet providing 10 years (2003-
8 2012) of information on average weekly wage changes for BC and Canada (in nominal and
9 constant dollar terms). The table pasted in below is reproduced from the spreadsheet tab
10 labeled "page 1". The full BC Stats spreadsheet can be found at the following link:
11 [http://www.bcstats.gov.bc.ca/Files/68316f41-5683-42e1-9f29-
12 a188a979fb15/EarningsandEmploymentTrendsData1310.xls](http://www.bcstats.gov.bc.ca/Files/68316f41-5683-42e1-9f29-a188a979fb15/EarningsandEmploymentTrendsData1310.xls)

13 The 10-year period in the table includes the recessionary period of 2008 and 2009. An
14 observation with respect to weekly wage rates in the 2008 and 2009 period for both BC and
15 Canada is that they continued to rise in both nominal and constant dollar terms. The only
16 exception in the most recent five years was in 2011 where both BC and Canada saw marginal
17 weekly wage rate decreases in constant dollar terms at -0.6 percent and -0.5 percent
18 respectively. However, this was followed by a rebound in 2012 of 0.9 percent and 1.6 percent in
19 constant dollars for BC and Canada respectively. Nominal weekly wage rates saw positive
20 increases throughout the 10-year period for both BC and Canada. As such, it seems that wage
21 rates in BC and Canada were not negatively impacted by the recessionary period of 2008 and
22 2009.

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1	SUMMARY TRENDS										
				Average Weekly Wage Rate				Employment Growth		Unemployment Rate	
		Consumer Price Index		Current Dollars		Constant Dollars		Seasonally Adjusted		Seasonally Adjusted	
		B.C.	Canada	B.C.	Canada	B.C.	Canada	B.C.	Canada	B.C.	Canada
		% Change		% Change		% Change		% Change		(%)	
	2003	2.2	2.8	2.3	2.0	0.1	-0.8	2.3	2.4	8.0	7.6
	2004	2.0	1.8	0.4	2.6	-1.5	0.7	1.7	1.7	7.2	7.2
	2005	2.0	2.2	2.6	3.4	0.5	1.2	2.9	1.3	5.8	6.8
	2006	1.7	2.0	3.0	3.5	1.3	1.5	2.6	1.8	4.8	6.3
	2007	1.8	2.2	2.9	3.2	1.2	1.0	3.5	2.4	4.3	6.0
	2008	2.1	2.3	4.1	4.2	2.0	1.8	2.0	1.7	4.6	6.1
	2009	0.0	0.3	2.6	2.8	2.6	2.5	-2.1	-1.6	7.7	8.3
	2010	1.3	1.8	3.1	2.1	1.8	0.2	1.7	1.4	7.6	8.0
	2011	2.4	2.9	1.8	2.4	-0.6	-0.5	0.8	1.6	7.5	7.4
	2012	1.1	1.5	2.0	3.2	0.9	1.6	1.7	1.2	6.7	7.2
2012	Jan	1.7	2.5	2.8	2.4	1.1	-0.1	1.7	0.7	7.0	7.5
	Feb	1.7	2.6	3.8	2.8	2.0	0.1	1.9	0.7	7.0	7.4
	Mar	1.6	1.9	3.7	2.7	2.1	0.8	1.6	1.2	7.0	7.2
	Apr	1.6	2.0	2.0	2.5	0.3	0.5	2.1	1.3	6.3	7.3
	May	1.3	1.2	0.5	3.1	-0.7	1.8	1.9	1.2	7.3	7.3
	Jun	1.5	1.5	1.3	3.5	-0.1	1.9	2.3	1.1	6.6	7.2
	Jul	1.1	1.3	1.7	4.0	0.5	2.7	1.5	0.8	6.9	7.3
	Aug	1.0	1.2	1.3	4.1	0.2	2.8	2.3	1.0	6.6	7.3
	Sep	0.7	1.2	1.8	3.7	1.1	2.5	1.3	1.1	6.9	7.3
	Oct	0.5	1.2	2.7	4.1	2.2	2.9	1.2	1.3	6.6	7.4
	Nov	0.1	0.8	1.4	2.7	1.3	1.8	1.1	1.7	6.7	7.2
	Dec	0.4	0.8	1.5	2.3	1.1	1.4	0.8	1.8	6.4	7.1
2013	Jan	0.3	0.5	3.4	2.3	3.2	1.8	0.1	1.6	6.3	7.0
	Feb	0.9	1.2	1.9	1.9	0.9	0.7	0.7	1.9	6.3	7.0
	Mar	0.5	1.0	1.1	2.2	0.6	1.2	0.1	1.2	7.0	7.2
	Apr	-0.8	0.4	3.9	3.0	4.8	2.6	-0.3	0.9	6.4	7.2
	May	-0.6	0.7	4.7	2.3	5.4	1.5	-0.2	1.4	6.8	7.1
	Jun	-0.5	1.2	2.2	2.2	2.7	1.1	-0.1	1.4	6.3	7.1
	Jul	0.0	1.3	4.6	1.7	4.6	0.4	0.1	1.3	6.7	7.2
	Aug	-0.1	1.1	4.4	1.6	4.5	0.5	-0.3	1.4	6.6	7.1
	Sep	0.0	1.1	3.7	1.8	3.7	0.7	-0.7	1.2	6.7	6.9
	Oct	-	-	3.1	1.9	-	-	-0.5	1.2	6.5	6.9
	Nov										
	Dec										
Monthly percent changes are calculated as month over same month previous year											
Prepared by: BC Stats						Source: Statistics Canada Labour Force Survey					

20.2 In a recession do the wages respond to economic recessions, in that inflation can slow down and the wages decrease as the economy drops below full capacity employment?

Response:

Recessions put downward pressure on wage rates in competitive labour markets. In the case of highly skilled labourers, such as electric and gas utility employees, there is little downward

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pressure on wage rates because of the shortage of qualified employees. Additionally, the presence of existing multi-year collective bargaining agreements can have an effect of prescribing wage increases for multiple years, which may further result in wage rate changes that are out of step with those normally experienced during economic recessions. Slower inflation may mean slower rates of growth in labour rates but by no means do labour rates decline.

20.3 Given a future period of 5 years would FEI expect the level of wages to remain stable should a recession take hold?

Response:

The Collective Agreements in place between FEI and the unions representing its employees are as follows:

- COPE Local 378 – expires March 31, 2015 (wage adjustment April 1, 2014 = 2.0%)
- IBEW Local 213 – expires March 31, 2014 (wage adjustment April 1, 2013 = 2.0%)
- COPE Local 378, Customer Services – expires March 31, 2014 (wage adjustment April 1, 2013 = 1.5%)

FEI is committed to reaching fair and reasonable collective agreement settlements that maintain market competitiveness and balance the needs of employees and customers. Market information regarding recent settlements and CPI information is utilized to determine general wage proposals. Ultimately, however, wage rates are negotiated with the respective unions; the final rates must be jointly agreed.

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1 **21 Reference: CEC 1.35.1**

20 The EUCPI is geared towards electric utilities, and therefore was not considered as an index for
21 FEI's proposed PBR. Generally, a firm's inflation rate is compared to that of the broader
22 economy. This is consistent with the selection of the BC-CPI, which is a measure of inflation for
23 the overall BC economy. However, EUCPI has a narrow focus on electric utilities, which is in
24 contrast to how a firm should be evaluated.

25 In addition, the selection of AWE is consistent with that of the Alberta Utilities Commission
26 recent decision to use AWE as a measure of labor inflation in their PBR implementation.

4 21.1 Has the company considered using a core inflation index rather than AWE and
5 CPI as an appropriate measure of inflation?

7 **Response:**

8 The 2004 PBR Plan included the BC CPI, and the inclusion of the AWE was an improvement
9 identified in canvassing the AUC PBR proceeding. FEI has not considered using a core inflation
10 index. FEI believes that its proposed weighted I-Factor using BC-CPI and BC-AWE meets the
11 key criteria for a cost inflation factor in PBR. Of central importance is that FEI's weighted I-
12 Factor is reflective of the price changes in labour and non-labour input costs that the Company
13 faces. Additionally, FEI's weighted I-Factor also meets other important considerations such as
14 being transparent (i.e., simple to understand and calculate) and being based on readily
15 available information from reputable independent agencies. FEI does not believe there is
16 anything material to be gained by using an inflator based on a core inflation index and some of
17 the foregoing benefits of FEI's weighted I-factor may be lost or at least diminished under an
18 approach that uses a core inflation index.

21 21.2 Please provide a core inflation index for consideration as an alternative along
22 with historical data for the index.

25 **Response:**

26 Please refer to the response to CEC IR 3a.21.1.

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1 21.3 Has the company considered estimating future inflation based on real return
2 market bonds and would the company consider looking at this and other
3 alternatives for measuring and estimating inflation other than CPI and AWE.

4

5 **Response:**

6 No. Please refer to the response to CEC IR 3a.21.1.

7

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1 22 **Reference: CEC 1.36.1 and CEC 1.36.2**

7 FEI investigated the possibility of using alternative sources of labor-related inflation other than
8 the BC AWE. However, an alternative source that represented BC's economy-wide labor
9 inflation is not available, and the BC AWE remains the most appropriate measure of BC labor-
10 related inflation.

2

3 22.1 Would alternatives such as core inflation Core CPI, Core CPI-XFET and or CPIW
4 be better measures of inflation? (Please see graphic below for measures and the
5 historical data.)
6

7 **Response:**

8 No, please refer to the response to FEI CEC IR 1.21.1 (Exhibit B-8).
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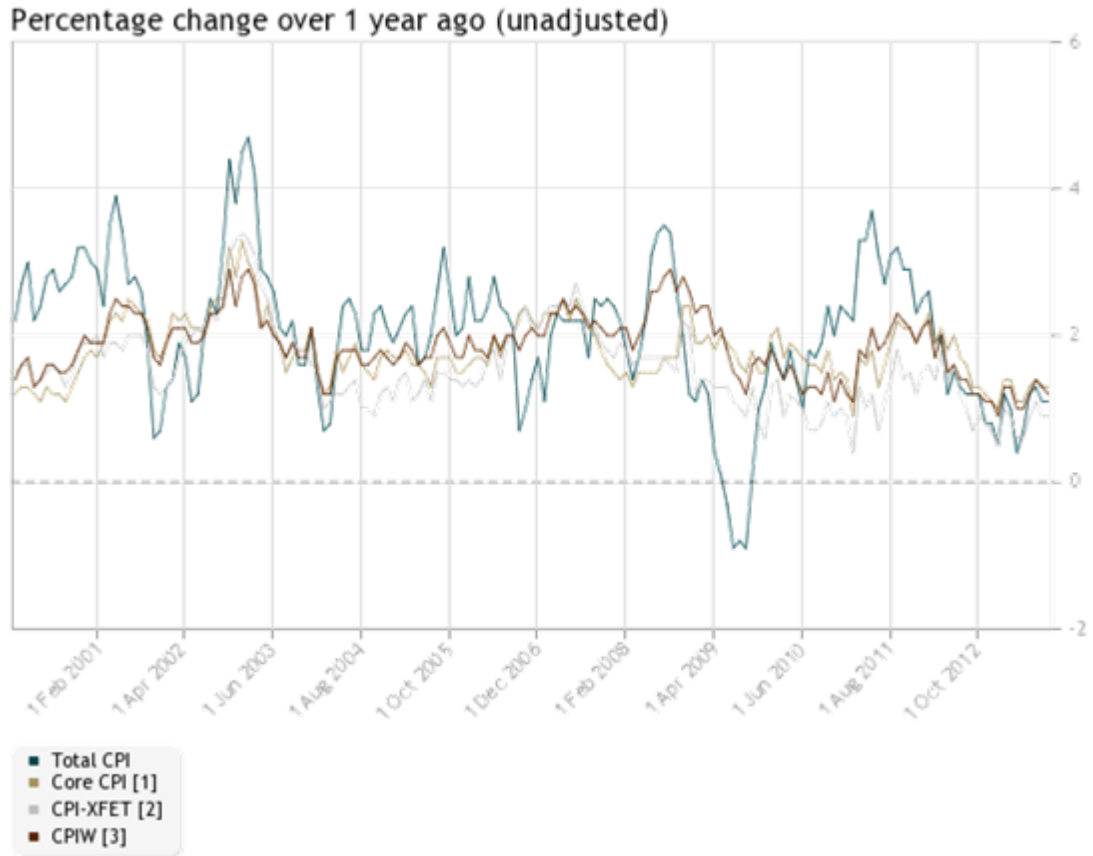
14

15

22.2 As the forecasts for the BC and Canadian economy have been trimmed recently
isn't it the case that inflation is considerably lower than the company is showing?
Please comment and provide recent data on inflation to support views.

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4 **Response:**

5 The normal pattern in the PBR term will be to update the I-factor components (CPI-BC and
6 AWE) with the most current forecasts at the time of Annual Review each year. Typically this will
7 be occurring in October of each year. Current forecasts of CPI and AWE compared with those
8 included in Application are as follows:

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1

UPDATED B.C. Inflation (CPI)

Source	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	Forecast Publish Date
Conference Board of Canada	1.90%	2.20%	2.00%	2.10%	2.10%	November 2013
B.C. Ministry of Finance	1.90%	2.10%	2.10%	2.10%	NA	June 2013
BMO	1.40%	1.90%	2.00%	2.00%	2.00%	November 2013
RBC Financial Group	1.40%	NA	NA	NA	NA	September 2013
Toronto Dominion Bank	1.70%	2.40%	NA	NA	NA	October 2013
CIBC	1.60%	NA	NA	NA	NA	October 2013

Average CPI	1.65%	2.15%	2.05%	2.10%	2.10%
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B.C. Inflation (CPI) Included in the Application

Source	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	Forecast Publish Date
Conference Board of Canada	1.90%	2.10%	2.00%	2.10%	2.10%	November 2012
B.C. Ministry of Finance	2.00%	2.10%	2.10%	2.10%	NA	February 2013
BMO	1.70%	2.00%	2.00%	2.00%	2.00%	May 2013
RBC Financial Group	1.60%	NA	NA	NA	NA	April 2013
Toronto Dominion Bank	2.00%	NA	NA	NA	NA	April 2013
CIBC	1.80%	NA	NA	NA	NA	January 2013

Average CPI	1.83%	2.07%	2.03%	2.07%	2.05%
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Updated Average Weekly Wages & Salaries Per Employee (\$, Industrial Composite)**

Source	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	Forecast Publish Date
Conference Board of Canada	2.44%	2.63%	2.57%	2.58%	2.48%	November 2013

****Note included in the economic assumptions of FEI's 2014-2018 PBR Filing, Average Weekly Earnings (AWE) Labour Inflation was provided based on the November 2012 Conference Board of Canada (CBOC) Provincial Outlook publication. Since that time, the CBOC has renamed the AWE to the Average Weekly Wages & Salaries Per Employee (\$, Industrial Composite) pursuant to the November 2013 CBOC Provincial Outlook publication.**

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1

BC Average Weekly Earnings Included in the Application

Source	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast	Forecast Publish Date
Conference Board of Canada	2.70%	2.70%	2.60%	2.60%	2.50%	November 2012

2

3

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1 **24 Reference: CEC 1.42.1**

9 Customer additions and design day demand forecasts are the key drivers of the O&M and
10 capital costs incurred by FEI in serving its customers. As existing customers' peak load
11 requirements change along with new customer additions the timing for when new capacity is
12 needed may be impacted and for when incremental operations and maintenance would be
13 required.

2

3 24.1 Please explain why peak load and customer additions would drive incremental
4 operations and maintenance needs.

5

6 **Response:**

7 B&V provides the following response.

8 Peak load growth is a proxy for added delivery capacity. Added delivery capacity requires
9 additional investment in capital facilities that must be maintained for operations purposes. A
10 similar circumstance exists for adding new customers.

11

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14 24.2 Please provide the number of new customers per year as a % of the total
15 customer base for the last five years and for the future 5 years.

16

17 **Response:**

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Net Additions	9,199	5,090	6,869	5,344	4,743	4,631	4,982	5,328	5,443	5,344	5,173
Average Customers	825,693	832,751	839,017	845,282	834,888	840,722	845,496	850,621	856,002	861,403	866,682
Percent of New Customers	1.1%	0.6%	0.8%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%

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22 24.3 Please provide the total costs of capital additions directly required for customers
23 versus the total rate base for the last 5 years and for the future 5 years.

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25 **Response:**

26 FEI assumes that the reference to capital additions directly required for customers refers to
27 growth capital. Please refer to the table below for growth capital compared to rate base for the

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- 1 last 5 years (2008-2012) and future 5 years (2014-2018). For continuity, FEI has also included
2 2013 projections.

(\$000's)	2008 Actual	2009 Actual	2010 Actual	2011 Actual	2012 Actual	2013 Projection
Growth Capital	32,237	19,704	20,317	20,632	24,200	23,262
Total Rate Base	2,474,447	2,462,143	2,525,219	2,563,640	2,692,824	2,702,240

(\$000's)	2014 Forecast	2015 Forecast	2016 Forecast	2017 Forecast	2018 Forecast
Growth Capital	25,398	26,769	27,651	27,878	28,022
Total Rate Base	2,788,993	2,845,893	2,897,879	2,933,369	2,961,788

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10 **Response:**

- 11 The following table shows the FEI peak demand requirement for the system for the last five
12 years and the forecast peak demand for the next five years based on gas years (i.e. November
13 to October). The peak demand includes contracted demand by the Burrard Thermal generation
14 plant and requirements by FEVI, which flow through the FEI system.

FEI Peak Day Demand										
(TJs/d)	Estimated Actual					Forecast (2013/2014 ACP)				
	2008/2009	2009/2010	2010/2011	2011/2012	2012/2013	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018
Peak Demand	1828	1823	1793	1777	1772	1791	1799	1808	1816	1823

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- 24.5 Please provide the capital upgrades required on the system for the last 5 years
and for the future 5 years as forecast.

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1 **Response:**

2 Please refer to the table below for the capital expenditures required for system upgrades for the
3 last 5 years (2008-2012) and for the future 5 years (2014-2018). For continuity, FEI has also
4 included 2013 projections. All historical and forecast capital upgrades are related to system
5 improvements for Distribution Plant (i.e. intermediate and distribution pressure mains).

6 While FEI attempts to forecast system improvements to address capacity issues in a timely
7 manner, requirements often change as a result of new information from developers and
8 municipalities. Furthermore, all areas of the distribution system do not see steady growth and
9 all systems are not located in ideal geography causing fluctuations in actual expenditures. FEI
10 also attempts to coordinate its work with municipal infrastructure work and this also causes
11 fluctuations in expenditures and variances from initial plans.

12 Station upgrades for capacity increases have not been included in the table as often, for cost
13 effectiveness, the work is scheduled and undertaken with other work at the same site and thus
14 extracting the actual or planned costs for such work is very difficult and not practicable.

(\$000's)

	2008	2009	2010	2011	2012	2013
	Actual	Actual	Actual	Actual	Actual	Projection
Scheduled System Improvements	3,254	3,903	1,205	354	283	1,865

	2014	2015	2016	2017	2018
	Forecast	Forecast	Forecast	Forecast	Forecast
Scheduled System Improvements	1,855	600	1,559	2,992	3,478

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1

20 Please refer to the response to CEC IR 1.42.2 below for a discussion of revenue requirement
21 impacts overall. It is important to recognize that when customers are added there are both
22 direct and indirect costs added to the system. If the prices and technology for providing service
23 to added customers were the same as the average embedded costs in rates it would be
24 reasonable to talk about fixed costs that decline with added output. They are not because
25 embedded costs are a function of prior period prices and technology. Costs are added at
26 today's prices and technology that exceed the costs in rates whether it is O&M or capital. New
27 customers impact cost at the marginal cost for today not the embedded cost in rates as implicitly
28 assumed in the question. If marginal nominal cost exceeds the embedded costs, O&M costs
29 increase by the nominal marginal cost. As FEI notes, customer count is a proxy for both
30 capacity and customers. This is appropriate for the O&M adjustment because the largest part of
31 growth in output is related to small customers who can be served with the smallest size of pipe
32 and the associated costs.

2

3 24.6 Please confirm that, while the above discussion is true with respect to
4 incremental costs and embedded costs, the percentage of fixed costs in the
5 system will influence the degree to which rate increases are required versus
6 having a system with all variable costs linearly related to customer count.

7

8 **Response:**

9 B&V provides the following response.

10 The hypothetical circumstance of all variable cost is far too unrealistic to have developed any
11 basis for comparison. If fixed costs change over time, revenue requirements and hence rates
12 will also change. Rates are biased upward as the result of past inflation as well as current
13 inflation as it impacts the replacement cost of the capital in service. The portion of fixed costs in
14 the system is only one of several determinants of rate increases and literally has an impact in a
15 number of areas that drive rate increases such as increased costs of replacement capital,
16 increased depreciation expense, increased property related taxes and so forth.

17 In addition, what are being referred to as fixed costs may only be fixed in the short or medium
18 term. For instance, even in the case of a constant rate base, the average depreciation rate
19 could be increased after a depreciation study, resulting in an increase to depreciation expense,
20 which is normally considered a fixed cost in utility rate making.

21

22

23

24

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1 Administrative costs for Finance, Human Resources, Governance and Corporate Administration
2 are temporarily fixed and average cost would decline with increasing number of customers. But
3 these costs will increase with general inflation from year to year.

24.7 Please confirm that it is not necessary for these costs to increase from year to year with general inflation, particularly if they are run more efficiently and continue to take advantage of the economies of scale and scope possible with a company of the nature of FEI?

Response:

B&V provides the following response.

To the extent that more efficient operations require a better labor force, costs may actually increase at a rate greater than inflation which is partially offset by improved productivity. Scale and scope have no impact on the portion of these costs that include benefits such as medical costs, insurance expense and other items included in these accounts. Further, corporate administration may also include outside services, such as external contractors. These costs are likely to change with the amount of work i.e. any work that has been outsourced to external contractors.

24.8 In BCPSO 1.18.1 the cost drivers for O&M are discussed and related to customer counts, capacity and peak demand, while the assertion is made that they are not related to throughput. Please discuss why FEI does not have rates, which relate to the cost drivers of capacity and peak demand for customers.

Response:

Please note that FEI uses demand charges for General Firm Service customers (Rate Schedules 5 and 25) and industrial customers (Rate schedules 22, 22A and 22B); however for reasons such as lack of gas demand metering it is difficult and impractical to implement demand-related rates for small volume residential and most commercial customers .

B&V provides the following response regarding the historical reasons for volumetric rates.

Historically rate forms were limited by the cost to meter, bill and administer rates. See for example the history of rates before metering and with ampere meters as discussed by Caywood in Electric Utility Rate Economics. A similar conclusion applies for the gas industry. Initial gas

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1 rates were based on a per burner charge that was billed quarterly. When meters became
2 available, the initial rate was a straight-line meter rate. Even today, not all services are metered
3 for services such as gas lights which are billed on a flat rate basis. Given the long history of
4 volumetric rates it is difficult and costly to change to more modern rate designs for general
5 classes of service. To do so requires overcoming a variety of objections from various interests
6 groups. However, some jurisdictions have adopted Straight Fixed Variable rates for general
7 service customers.

8
9
10
11 24.11 Please confirm that when FEI filed rate applications for 2010 to 2011 and 2012 to
12 2013 that a number of cost drivers had little to do with customers/capacity or
13 peak load requirements but were related to accounting changes, regulatory
14 changes, and other non-system related issues.

15
16 **Response:**

17 Confirmed. However, under PBR cost changes of the type mentioned in the question would
18 most likely be considered exogenous factors and separate recovery would be sought through
19 application in the annual review process if appropriate. In addition, FEI notes that although
20 accounting changes drive the classification of costs between O&M and capital, they do not
21 actually drive costs themselves.

22
23
24
25 24.12 Please provide the quantitative analysis of the cost and rate increases provided
26 in those RRA applications defining and quantifying the drivers for costs, which
27 were filled by FEI.

28
29 **Response:**

30 The following table contains information filed by FEI in the 2010-2011 RRA and 2012-2013
31 RRA. The table provides a breakdown by cost driver of incremental O&M as described and filed
32 for each of the years 2010 through 2013 along with the delivery rate impact thereon.



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Cost Driver	2010		2011		2012		2013	
	Cost	Rate Impact	Cost	Rate Impact	Cost	Rate Impact	Cost	Rate Impact
Labor Inflation and Benefits	2,816	0.5%	5,344	1.0%	8,416	1.5%	2,448	0.4%
Government Policy	592	0.1%	113	0.0%				
Codes and Regulations	5,297	1.0%	2,059	0.4%	1,738	0.3%	769	0.1%
Customer and Stakeholder Expectations	4,526	0.9%	599	0.1%	656	0.1%	3,483	0.6%
Demogrpahics	817	0.2%	216	0.0%	374	0.1%	224	0.0%
Accounting Changes	(3,141)	(0.6%)	(506)	(0.1%)				
Service Enhancements	3,604	0.7%	1,734	0.3%	4,971	0.9%	3,990	0.7%
Total Incremental O&Mas filed	14,511	2.7%	9,559	1.8%	16,155	2.8%	10,914	1.9%

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1 25 **Reference: CEC 1.42.2**

21 Economies of scale may be defined as declining long-run average cost curves under the
22 assumptions of fixed technology and input prices. Cost curves relate costs to units of output
23 typically measured as throughput. As we have shown, throughput is not a relevant measure of
24 output for delivery service. Instead, the measure of output is capacity and customers. Thus,
25 under the economic definition of economies of scale, cost would decline as the number of
26 customers and capacity increased for fixed technology and input prices. Since we are
27 measuring utility costs over periods when both input prices and technology have changed the
28 result is an upward shift in the long-run cost curve as the result of adding customers and
29 capacity even in the presence of economies of scale. This is always a confusing issue because
30 the utility industry does benefit from economies of scale in the sense that increasing capacity of
31 a pipeline from 2-inch to four-inch results in dramatically lower costs per unit of capacity (the
32 scale economies concept). However, the revenue requirement would increase overall because
33 both the first year revenue requirement and the nominal cost of the pipe would likely exceed the
34 embedded cost of capacity reflected in current rates.

2

3 25.1 Please discuss whether or not the fact that capacity use per customer has
4 declined and is declining, essentially frees up capacity to meet demand
5 throughout the system without the need for expenditure on additional capacity. Is
6 this a form of the economy of the scale of operation because there are common
7 components of the system for most users allowing freed up capacity to be
8 redeployed to new customer use without additional investment.

9

10 **Response:**

11 B&V provides the following response.

12 The declining capacity requirements for customers has the effect of reducing the cost per
13 customer only where the added customer is on the same main segment where the capacity is
14 added, and further requires that capacity per customer is declining. In some situations, this may
15 not be the case at all because existing customers are adding loads as the appliance saturation
16 for gas appliances increases because more households have multiple appliances such as
17 cooking and drying or larger appliances such as tankless water heating. New customers always
18 require some level of new investment that exceeds the embedded cost of capital for those new
19 requirements such as meter and service. Further the new high efficiency loads such as heat
20 pumps often require the same peak day capacity for backup gas service while having lower
21 annual demand.

22

23

24

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25.2 Does this 'capacity reduction related to throughput decline', as a fact, influence capital requirement potentials versus not having a declining use per customer?

Response:

B&V provides the following response.

The question as posed cannot be answered because the answer depends on other factors and assumptions. For example, if the existing system is a two inch main, it will in all likelihood be replaced by two inch main and the new main will certainly cost more than the average cost for existing two inch main. Additionally, if customer density increases, that uses up the capacity reduction on the existing system and may ultimately require larger facilities. There is not a simple answer except that it depends on many more circumstances than contained in the question. Further there is a general relationship, but cost reductions on one area will be offset by cost increases in other growing areas.

Please also refer to the response to FEI CEC IR 3a.25.1.

25.3 Please confirm that adding new customers to the system involves an incremental cost for the addition but very likely will not require upgrading of the entire system capacity.

Response:

B&V provides the following response.

This question cannot be answered as posed. If by entire system the question means portions of the system not physically connected to the customer the answer is obviously yes. As far as the facilities installed between the city gate and the customer premise the answer depends on the existing pressure drop over that system and the impact of the customer load on that design day pressure drop. The system may or may not need reinforcement. Think of the straw that broke the camel's back, it actually depends on where the customer locates and if there are multiple new customers at the same general location. Further there may be conservation in one area and load growth from additions in another area. In this situation system capacity additions are required where the load growth is occurring but there is no decrease in the physical system capacity in the area where the conservation is occurring.

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25.4 Please confirm that the embedded rates carry embedded costs for the whole system and therefore have the potential to deliver as much in incremental revenue as the incremental cost of addition of the customer and where this is the case there can be limited pressure on rate increases required for customer additions.

Response:

In addition to the comments of B&V below the following conclusions were summarized in the Application Volume 2, Appendix E5 - Customer Addition Variance (Page 1):

1. For residential and commercial customers, any variation in the customer demand from what has been forecast in rates has no impact on the gross margin earned from a new customer because of the RSAM mechanism.
2. Due to the main extension (MX) test and resulting CIAC and also the Service Line Cost Allowance (SLCA) that is applicable to residential and small commercial customers, capital cost exposure to the rate base is limited when adding customers.
3. There is a relatively small variance on the earned return from the effect of the incremental capital cost of adding or not adding a customer. In all scenarios there is a positive impact on the earned return when adding a customer that was not forecast and conversely a negative impact to earned return when not adding a customer that was forecast.
4. Any increase or decrease in earned return is temporary until the next time delivery rates are reset.

An important point to note is that the MX test and Service Line Cost Allowance helps to ensure that only new economic customers are connected to the system and in certain conditions new customers will be required to make a Contribution In Aid of Construction (CIAC). The potential CIAC requirement balances the increased capital asset costs and impact on revenue requirements to the expected incremental margin revenue that the new customer will provide.

B&V provides the following response.

While it is true that the current rates carry the embedded cost of the whole system, the answer is again not simple. For example if the added cost of meter, service and main is \$3,000 per average new customer and the embedded cost per existing customer is \$2,500 each new customer puts upward pressure on rates. In addition, if total new capital investment for main replacement plus new customers exceeds the annual depreciation expense rate base grows

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1 and there is upward pressure on rates. The fundamental point is that customer growth drives
2 new costs and this is particularly true for infrastructure replacement where costs increase but
3 output does not change.

4
5
6
7 25.5 Please provide a quantitative analysis of the above issues (declining customer
8 capacity use and proportion of incremental cost for new customers to total
9 embedded system costs) to determine the degree to which they moderate the
10 cost drivers of customer count, capacity and peak load.

11
12 **Response:**

13 No such study has been conducted. FEI notes that the important point of the PBR Plan is to
14 use information external to the Company to break the correspondence between costs and
15 revenues. This question appears to be seeking information such that rates could be determined
16 by a cost of service formula not a PBR Plan.

17
18
19
20 25.6 Would it be correct to say that at a minimum the relationship of costs to drivers
21 should not be linear when there are other mitigating factors?

22
23 **Response:**

24 The PBR formulas (for O&M and most capital) are structured around the entire customer base,
25 including existing customers and new customers. For example FEI experiences inflationary cost
26 pressures on the whole O&M but FEI has to absorb that through the X-Factor. O&M cost
27 pressures are not limited to a cost driver related to just customer growth. By focusing on
28 linearity the question appears to be attaching undue importance to the approximately 1 percent
29 annual customer growth and not enough importance to the productivity (i.e. the negative TFP
30 plus a large implicit stretch factor) that has to be found in relation to the approximately 99
31 percent of existing customers.

32 B&V provides the following response.

33 The concept of a linear relationship between costs and drivers is not empirically correct. For
34 example, the relationship between size of main and capacity is a quadratic equation where the
35 dependent variable capacity is given by the independent variable size of main raised to

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approximately the 2.5 power. This equation is consistent with the concept of economies of scale for main capacity given that the cost of a main double in size is rarely double in installed costs and thus the unit cost declines.

25.7 Please identify all the other mitigating factors that moderate the FEI selected drivers of costs and provide analysis to determine the quantitative degree to which they may or could influence future cost projections.

Response:

Please refer to the responses to CEC IRs 3a.25.5 and 3a.25.6.

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1 **26 Reference: CEC 1.42.3**

8 The question cannot be confirmed or denied. Given that systems do not experience uniform
9 load increases or decreases, capacity constraints will move around based on the location on the
10 system where these changes take effect. This occurs because even where there is a general
11 load decrease driven by a decline in use per customer and flat customer growth, this will not
12 occur equally everywhere on the system. Additionally, sections of the system still face
13 significant local growth, like Surrey. As a result, it is true that a system facing these two
14 scenarios would have different costs. It is also true that a system facing these two scenarios
15 may need to continue to manage issues not related to customer growth. Further, it is true that
16 use per customer has no impact on system costs in either case. The issues for the system
17 costs are defined by customers and capacity on a design day.

2

3 26.1 Please consider that the assertions in this response cannot be true, stating that
4 use per customer has no impact on system costs. An illustration of this fallacy
5 comes from considering a situation where a customer attaches to the system and
6 requires a capacity to serve of 1 unit but 10 other customers have reduced their
7 requirements by 1/10th of a unit and therefore there are zero requirements for any
8 upgrades to the system jointly serving these customers. Contrast this with the
9 same customer addition requiring 1 unit of capacity to serve the customer's
10 needs but each of the other 10 customers being served by the same joint system
11 requires 1/10th more capacity to serve increased use of the system. In the latter
12 case there can be system upgrade capital investments required and in the former
13 case there may be no 'system upgrade' capital investments required. Was the
14 response to the question predicated on the assumption that declining use per
15 customer does not necessarily have to be related to a declining use of system
16 capacity by the customer?

17

18 **Response:**

19 B&V provides the following response.

20 The premise of the question is incorrect because the response is completely accurate. Use per
21 customer is the measure of throughput which has no impact on system costs. The costs, as
22 stated in the response, are driven by the design day capacity requirement (not the customer
23 load factor) and the number of customers or density. The problem in the question arises from
24 the misuse of the of the term use per customer which denotes a volumetric measure not a
25 capacity measure. The system may not have to upgrade every line that a new customer
26 attaches to as explained in the original response. The contra-example also ignores the system
27 costs of attaching the new customer which requires capital investment. Finally, no system
28 upgrade may be required even if the new customer requires one GJ of design day capacity and
29 10 other customers add 1/10th of a GJ per customer. The determination of a capacity upgrade

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depends on the resulting pressure drop under design day conditions for the effected pipe segment, the current operating pressure and the maximum allowable operating pressure. As a result there is no need to change the response originally provided it is true as filed.

26.2 Please identify the percentage of declining use per customer that is accompanied by a declining requirement for capacity on the system versus the percentage of declining use per customer that occurs only off the peak requirement and therefore is not associated with capacity requirements.

Response:

B&V provides the following response.

The question cannot be answered as posed since there are no particular facts related to the declining use per customer. The impact on design day capacity depends on the factors affecting the design day that include appliance efficiencies, thermal envelope efficiencies, system design efficiencies and behavioral and demographic assumptions. Please refer to the response to CEC IR 3a.25.1.

- Declining Use per Customer
While FEI continues to attract new customers, there is a downward trend in average UPC for new customers, which is expected to continue over the forecast period. The average UPC has been declining due to factors such as, but not limited to, shifts in housing stock to higher density, multi-family dwellings, more energy efficient homes and appliances, together with tighter building thermal envelopes.

Exhibit B-1, Page 160

26.3 For the above explanations for declining use per customer please provide an explanation as to whether or not the specific type of cause for declining use per customer comes with decreased capacity requirements from the system or not relative to the average historical use per customer and their capacity requirements.

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1 **Response:**

2 B&V provides the following response.

3 Assuming the same behavioral patterns on peak days and the same demographic assumptions,
4 each of the listed factors individually would reduce design day requirements. However, it is an
5 oversimplification that higher density, multi-family dwellings would over all reduce the design
6 day capacity requirements on a pipe segment as the number of service lines off a main segment
7 is part of the formula for calculating design day capacity requirements. In addition, more
8 efficient appliances may be offset by higher saturations of gas appliances as well as by
9 behavioral and demographic characteristics leading to higher temperature settings.

10

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1 **38 Reference: CEC 1.2.3**

23 New efficiencies may be found in a number of ways. In some cases the efficiencies will be found
24 through discovery of better ways of doing the work with little or no incremental expenditure
25 involved. In other cases, where incremental expenditures are required to achieve the new
26 efficiencies the incremental costs may be either a capital or an O&M expenditure. In cases that
27 involve a capital expenditure to achieve new efficiencies, the capital will be considered a normal
28 rate base addition that will be recoverable in rates as capital additions are under conventional
29 cost-of-service ratemaking. O&M expenditures to produce efficiency savings will also be
30 recoverable, as they are under conventional cost-of-service ratemaking. The PBR changes the
31 manner in which rates are determined (i.e. using formulas) in order to incent the Company to
32 pursue efficiencies but the actual expenditures that are made will be recorded as utility
33 expenditures in the normal fashion.

34 A key selling feature of PBR is that it extends the period before rebasing, which allows the utility
35 to invest in measures and obtain a payback of the investment in circumstances where rebasing
36 after a typical test period of one or two years would otherwise preclude the utility from

1 recovering that investment. In short, it opens new possibilities for the utility to achieve
2 efficiencies to the benefit of both the utility and customers.

38.1 In defining one of the reasons for an alternative to the Cost of Service regulation
FEI poses that an extended period before rebasing would allow the utility to
obtain a payback on investment. The CEC would like to explore why FEI may
want or need an extended period for a payback.

Response:

B&V provides the following response.

The extended period for payback allows a different set of projects to be considered for improving efficiency. Under traditional cost of service, projects that increase efficiency but require a longer period than the period between cost of service reset periods are not economic for shareholders. Thus a number of potential efficiency investments are not within the set of economically efficient investments with a shorter time horizon between cost of service reset periods when compared to PBR. In addition, some projects associated with efficiency may have a different risk profile and require a higher return on the investment. PBR also provides this type of opportunity for investments since the utility has an opportunity to earn a greater return under PBR. In either case, management would have less incentive to make such an investment under cost of service because at the reset, all of the benefits flow to customers resulting in under earnings for the shareholder. Effectively, shareholders would be subsidizing lower rates for customers.

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38.2 Please confirm that if the utility has not planned for an investment, including the costs in its rate base and into its revenue requirements, such that its rates will recover the costs the utility would be at risk for not recovering its cost if it made an investment during such a period before it would have the opportunity to incorporate the costs into its cost of service recovery (rebased).

Response:

B&V provides the following response

To the extent that the utility has not included an investment in the cost of service test year the utility is at risk for cost recovery until such time as the costs are included in a test year. This is exactly the reason that PBR is superior to cost of service because the utility has an opportunity to recover this cost through efficiency improvements throughout the PBR term and for a combined total of five years in the PBR term and applicable portion of ECM period. This opens new investment opportunities for efficiency gains. Please refer to the response to CEC IR 3a.38.1.

38.3 Please confirm that for a longer period of regulation without cost of service rebasing the incentives to invest in anything not already allowed for in the cost recovery approach would lead to increased risks for the utility.

Response:

Please refer to the responses to CEC IRs 3a.38.1 and 3a.38.2.

38.4 If the above description is not a correct description of this problem please provide additional description of the problem the company is referring to when it proposes a benefit to having a greater payback period.

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Response:

Please refer to the responses to CEC IRs 3a.38.1 and 3a.38.2.

38.5 Could this problem be overcome if the utility was able to place the costs of such investments into a deferral account for collection from customers in a later rebasing decision by the Commission?

Response:

Under PBR, Company management will have more freedom to be innovative and find creative ways to run their particular area of the business more efficiently. The deferral account approach would stifle this innovative opportunity. Another concern with the deferral account approach is it would make utility staff default to a cost-of-service approach to doing business. Even though it may be possible to establish a deferral account approach to dealing with longer payback periods on efficiency initiatives, in FEI's view this approach would not be a practical alternative to the incentives and flexibility of the PBR plan. FEI believes that a deferral account approach would involve more regulatory process and would run counter to the objectives under PBR of streamlining the regulatory process and aligning the interests of customers with the interests of the utility. Also, the approach suggested by the question may be possible to establish for larger scale efficiency initiatives but would be more difficult and less practical to employ in cases where there are many smaller scale programs arising from individual managers' efforts to run their departments more efficiently.

38.6 What would be required for such a deferral account to be established within a Cost of Service regulatory context to avoid the negative incentive for investment?

Response:

The main problems associated with the use of a deferral account approach for the purpose of efficiency improvement investment are the lack of flexibility and loss of regulatory efficiencies. The finding of efficiency opportunities is an ongoing dynamic process and it is not possible to pre-determine the types of opportunities that will be discovered or the amount of investments that will be required; while in a deferral account approval process the regulator generally

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1 requires that the utility provides in advance a precise definition of the type of activity involved
2 and the amount of costs that are going to be included in the account. These issues may also
3 prolong the regulatory approval process and lead to lost efficiency opportunities. Therefore the
4 primary conditions needed for the use of a deferral account as an approach to avoid the
5 negative incentive under cost-of-service regulation for efficiency investments are twofold:

- 6 1. A more flexible framework for the deferral account (in terms of the types and amounts of
7 the costs permitted in the account) and
- 8 2. Faster regulatory approval process.

9 Further, the costs accrued in the deferral account should be subject to AFUDC which will be
10 deferred along with the rest of the costs until the next revenue requirement application, at which
11 time the costs would be amortized and recovered in rates over an approved period of time.

12

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1 **48 Reference: CEC 1.27.1**

17 All three categories were escalated using I-X formulas and there were incentives attached to
18 Categories A and C, but not to Category B. The Category A incentives were unit cost-based,
19 based on established target costs (\$/metre of main installed, \$ per service line and \$ per meter
20 for measurement). The incentive for Category C was based on spending less than an overall
21 lump sum allowance.

2

3 48.1 Why would it make sense for Category A, Mains, Services and Measurement, to
4 have its unit cost based incentives?

5

6 **Response:**

7 FEI would not advocate that approach as part of the present PBR Plan.

8 The 1998-2001 PBR came about through a negotiated settlement process in which FEI (then
9 BC Gas Utility Ltd.) and other NSP participants agreed to the unit cost approach for the
10 Category A capital incentives as part of the overall settlement package. The incentive benefit or
11 penalty associated with beating or falling short of the unit cost targets was done as a side
12 calculation and was a relatively weak incentive mechanism. The incentive or penalty involved a
13 rate base return only on a notional rate base addition or deduction that was phased out over a
14 three-year period.

15 While it is fair to say that the Company believed at the outset that it could manage capital
16 spending within the unit cost allowances for main, services and meters there were a number of
17 challenges in meeting the targets and the results of the Category A incentive mechanism over
18 the four-year term of the PBR were mainly a penalty for FEI.

19

20

21

22 48.2 Do the unit cost based incentives essentially provide an assurance of completion
23 of a unit of service for each unit of expenditure?

24

25 **Response:**

26 In theory, unit cost based incentives could work as suggested in the question; however, there
27 are many complications in the unit cost approach that make it unworkable in practice. For
28 example, the unit costs of mains and services in the 1998-2001 PBR assumed a certain mix of
29 construction in different regions of FEI's service territory based on then-recent historical
30 experience. Growth patterns changed and a greater share of activity began to occur in the more
31 densely populated Lower Mainland (which is also a more costly construction area). Thus unit

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costs increased for reasons that were uncontrollable by the utility. Other uncontrollable factors can also affect unit construction costs such as construction in rocky areas, construction in frost conditions, differing municipal requirements and others.

Because of the numerous complications and uncontrollable aspects of the unit cost approach FEI believes, based on its experience in the 1998-2001 PBR, that either the unit cost approach would likewise have to be quite complicated to accommodate uncontrollable elements, or there would be a significant potential for windfall gains or losses in a simpler approach to a unit cost-based capital incentive mechanism.

48.3 Why was Category B, Transmission and Integrity Distribution, left out of the incentives process at that time?

Response:

The exclusion of Category B capital expenditures from the capital incentive was an element of the negotiated settlement package for FEI's 1998-2001 PBR, so it would not be appropriate to elaborate on what was discussed. FEI can say that the 1998-2001 PBR was the first case for FEI of including a capital incentive mechanism in its RRA (or PBR in this case) and there was a desire to proceed with caution regarding the Category B capital.

48.4 How would the Category C, All Other Capital, Buildings, IT and other general, spending be reasonably anticipated given that these types of decisions can typically be discrete and require significant justification?

Response:

The spending in Category C consisted of smaller projects that would be likened to sustaining capital or recurring capital and did not include large scale facilities or IT projects.

In addition to the formula-based spending in Categories A, B and C, the 1998-2001 PBR had provisions for filing CPCN applications for larger projects outside of the formulas. A number of these larger projects filed as CPCN applications were in the same asset categories as the Category C spending. Examples included the 1998 IBIS CPCN (Order C-8-98) in which the approval was granted for FEI to implement a new integrated financial system based on SAP and

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1 the 1998 Coastal Facilities CPCN (Order C-14-98) which approved the construction of new
2 office and operations facilities in Surrey and the Lochburn site in Burnaby. These and other
3 CPCN applications filed during the 1998-2001 PBR term included the detailed analysis and
4 justification required by the Commission to grant the CPCNs.

5 The lump sum allowance for Category C spending was agreed to in the PBR negotiated
6 settlement process. To inform the negotiated settlement process, FEI had provided information
7 in the preceding regulatory process that supported the Category C spending levels, such as
8 historical spending trends and forecast spending during the PBR period.

9

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1 **49 Reference: CEC 1.27.2**

HISTORICAL FEI CAPITAL EXPENDITURES (\$ THOUSANDS)

	1997	1997	1998	1998	1999	1999	2000	2000
	Actual	Approved	Actual	Approved	Actual	Approved	Actual	Approved
Total Gross Base Capital Expenditures	80,368	71,564	73,213	87,017	82,593	79,500	88,428	87,343
	2001	2001	2002	2002	2003	2003	2004	2004
	Actual	Approved	Actual	Approved	Actual	Approved	Actual	Approved
Total Gross Base Capital Expenditures	72,778	76,017	72,671	N/A	81,186	87,528	91,644	85,378
	2005	2005	2006	2006	2007	2007	2008	2008
	Actual	Approved	Actual	Approved	Actual	Approved	Actual	Approved
Total Gross Base Capital Expenditures	95,409	90,611	83,591	97,985	73,158	101,570	89,998	99,660
	2009	2009	2010	2010	2011	2011	2012	2012
	Actual	Approved	Actual	Approved	Actual	Approved	Actual	Approved
Total Gross Base Capital Expenditures	90,968	94,208	86,287	93,511	103,610	93,597	108,421	116,408

Notes:

1. N/A - FEI withdrew the 2002 RRA Application, therefore approved base capital expenditures are not applicable for that year.
2. Base capital expenditures are not available for the years 1994 to 1996.
3. Base Capital Expenditures exclude CPCNs, retirements & CIAC.
4. 2010-2012 Approved figures have been provided for informational purposes only as PBR was not in effect for this period.

2

3 49.8 How can one distinguish between an over forecast or over provision for capital
4 expenditures by a formula and the efficient use of capital?

5

6 **Response:**

7 The capital formula includes a productivity factor and will be applied to an approved 2013 Base
8 Capital amount. If the utility spends less than the formula amount during the term of the PBR,
9 then it is exceeding the productivity factor and by an objective and preapproved measure is
10 using its capital efficiently. See Section 6.2.2.2 of the Application regarding FEI's proposed
11 productivity factor.

12 As indicated in Appendix D-4 of Exhibit B-1-1, regardless of the source of capital savings,
13 customers benefit. At the very least, prudent deferral of capital spending creates a present
14 value benefit for customers that increases with each added year of deferral.

15

16

17

18

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49.9 Without a measure of the service provided for the capital expenditures how can it be determined that capital is being used more efficiently?

Response:

Similar to its view on productivity metrics for O&M, FEI believes capital productivity improvements and their sustainment should be measured and tracked at the highest and most beneficial level which is by the company's total capital year-over-year, with consideration for sustainment capital required to maintain system integrity and reliability.

It is also important to recognize that the proposed PBR provides a balanced set of incentives for both O&M and capital, and the flexibility to find trade-offs between the two. This combination and balance in the incentive structure will lead to a beneficial result for customers through the PBR. While assessing capital efficiency is of some value examining it in isolation may miss some of this interplay.

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1 **51 Reference: CEC 1.28.2**

22 As stated in the response to CEC IR 1.28.1, the savings during the PBR Period are expected to
23 come from permanent reductions, as opposed to deferrals. This is consistent with the past
24 experience of PBR.

25 Considering the response to CEC IR 1.28.1 and the information provided in Appendix D4 with
26 respect to benefits to customers of deferring capital expenditures, FEI does not see significant
27 value in developing a guideline around the time period that would move a capital item from
28 being a "deferral" to a "permanent savings" item. Benefits are generally provided to ratepayers
29 in either case.

2

3 51.1 Please show the benefit of a permanent elimination of the need for a capital
4 expenditure versus the deferral of the timing of the expenditure of capital.
5 (Please use a \$1 million expenditure with a life of 10 years and a deferral of 5
6 years for timing.)

7

8 **Response:**

9 A comparison of the benefits of permanent elimination of capital against a 5-year deferral of
10 capital spending is shown in the following table.

Line #		NPV 15 Years ⁴ '000\$
1	Option 1: Permanent Elimination	
2	Capital Expenditure Cost of Service ^{1,3}	1,105
3	Permanent Elimination ⁵	0
4	Net Benefit (Line 2 – Line 3)	1,105
5		
6	Option 2: Deferral 5 Years	
7	Capital Expenditure Cost of Service ^{1,3}	1,105
8	Deferral 5 Years ^{2,3}	812
9	Net Benefit (Line 7 – Line 8)	293

11 **Notes**

- 12 ¹ Capital Spending based on \$ 1 million in capital expenditures in rate base in 2014
13 ² Capital spending is deferred for 5 years, \$1 million in capital spending in rate base in 2019.
14 ³ 10% Depreciation rate
15 ⁴ NPV of Cost of Service over 15 years: 2014 – 2028
16 ⁵ Capital is permanently deferred or project is \$1 million less costly
17
18
19

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51.2 Please confirm that these two situations are very different in terms of the benefits provided.

Response:

Yes, the level of benefit is predictably greater from permanent elimination of capital (or reducing the cost of capital projects) than it is from a capital deferral. However, the example in CEC IR 3a.51.1 shows benefits in both cases. While FEI will makes effort to find lasting capital efficiencies, the proposed PBR will enable FEI to pursue benefits of either kinds.

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1 **58 Reference: CEC 1.70.1**

6	FEI is not able to provide data that is comparable to the one presented in Figure C4-1, page 209
7	for the US Natural Gas Pipeline due to the following reasons:
8	• FEI operates transmission pipelines of various diameters and in recent history has not
9	undertaken this work in a significant amount.
10	• Most of the transmission pipeline work consists of pipeline replacements that have been
11	of very short length.
12	• Other activities such as pipeline valve assemblies and upgrades, and station upgrades
13	are generally non-routine and the scope and complexity varies from site to site.

2

3 58.2 Please confirm in these circumstances it becomes more difficult to provide a
4 formula to drive an expectation or forecast of work needs and is much more
5 difficult to determine what level of service has been provided for the level of
6 expenditure.

7

8 **Response:**

9 The employment of a capital formula is not attempting to suggest that capital expenditures for
10 individual projects or even projects of a single type will fit perfectly into a formula. Rather FEI will
11 manage its portfolio of projects and capital work within the spending envelope provided by the
12 capital formulas. The level and quality of service will also be managed at the portfolio level. It is
13 in FEI's current and long-term interest to maintain and sustain the natural gas system and
14 provide safe, reliable and cost effective utility service, and it will be FEI's priority to carry out its
15 capital programs to do so.

16

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99 Reference: Exhibit B-1, FEI Application page 81

Mid-term Review and Off Ramps	A mid-term assessment review was held prior to the end of the third year of the PBR (2009). Any party could request a Commission review of the PBR Plan if the achieved ROE (after earnings sharing) was more than 150 basis points above or below the allowed ROE.	are considered to be informational indicators. A mid-term assessment review is proposed prior to the end of the third year of the PBR (2016). A review of the PBR Plan may be triggered by either a 200 basis point ROE variance above or below the allowed ROE, or sustained serious degradation of service quality as measured by the SQIs.
-------------------------------	---	---

99.1 What was the largest difference in ROE (after earnings sharings) above or below the allowed ROE that occurred under the other PBR term and when did it occur?

Response:

The largest difference between actual ROE (after earnings sharing) and the allowed ROE was in 2009 when the allowed ROE was 8.99 percent and the actual ROE after earnings sharing was 10.44 percent for a difference of 1.45 percent.

99.2 Was the 150 point threshold reached under the earlier PBR period?

Response:

No, the 150 point threshold was not reached under the 2004-2009 PBR period.

99.3 If so, under what years did it occur?

Response:

Please refer to the response to CEC IR 3a.99.2.

99.3.1 Did any party request a Commission review of the PBR plan, and what were their results of the request?

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1 **Response:**

2 No parties requested a Commission review of the PBR plan given the response to CEC IR
3 3a.99.2.

4

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1 **100 Reference: Exhibit B-8, CEC 1.6.1 and Exhibit B-1, page 48**

18 In summary, it isn't the fact that the rates are increasing that shows the focus on customers and
19 productivity, but rather the fact that the increase is only 1% given the overall circumstances.
20 The 1% increase is the result of a number of influences affecting FEI's costs and revenues, but
21 important among them are the controllable expenditures (O&M and capital). The base level of
22 O&M in particular (including the proposed adjustment for sustainable savings) helps to keep the
23 increase to 1%, which is less than half of the 2.31%¹ composite inflation for 2014.

2 **Table B6-3: BC AWE Forecasts for the PBR Period¹⁰**

BC Average Weekly Earnings Forecast	2014	2015	2016	2017	2018
AVERAGE	2.70%	2.70%	2.60%	2.60%	2.60%

3 Based on these tables, the 2014 BC-CPI and BC-AWE rates are forecasted to be 1.83 percent
4 and 2.70 percent respectively. As such, FEI proposes to use an I-Factor of 2.31 percent
5 (calculated as $(45\% \times 1.83\%) + (55\% \times 2.70\%)$) for 2014.

6 As part of the PBR Annual Reviews, FEI will update both the BC-AWE and BC-CPI rates (using
7 the same sources referenced above) to determine the value of the I-Factor for the 2015 through
8 2018 years. FEI proposes that the composite's weighting remain constant throughout the PBR
9 Period.

10 100.1 Would FEI propose to maintain the weighting in the event that the proportion of
11 labour to non-labour changes throughout the PBR period?

12 **Response:**

13 FEI proposes to hold the weighting for the labour to non-labour components constant
14 throughout the PBR term for the following reasons:

- 15 1. It is unlikely that a material change in the proportion of labour to non-labour costs
16 throughout the PBR term would occur;
- 17 2. Holding the weightings constant upholds the principle of simplicity with respect to the
18 administration of the PBR plan; and
- 19 3. It will ensure that the company's incentives will not be influenced by the relative rates of
20 inflation between the components in the I-Factor.

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1 **104 Reference: CEC 1.6.1**

17 It is this 1% delivery rate increase that FEI references in this response.

18 In summary, it isn't the fact that the rates are increasing that shows the focus on customers and
19 productivity, but rather the fact that the increase is only 1% given the overall circumstances.
20 The 1% increase is the result of a number of influences affecting FEI's costs and revenues, but
21 important among them are the controllable expenditures (O&M and capital). The base level of
22 O&M in particular (including the proposed adjustment for sustainable savings) helps to keep the
23 increase to 1%, which is less than half of the 2.31%¹ composite inflation for 2014.

2

3 104.1 Please confirm that this 1% increase in delivery rates would be subject to a
4 number of changes from other sources during the time period.

5

6 **Response:**

7 To clarify, on September 6th, 2013, FEI filed a second Evidentiary Update for this Application
8 which adjusted the requested 2014 delivery rate increase to 1.4 percent for the reasons
9 described in that filing. The 1.4 percent delivery rate increase, if approved by the Commission
10 as requested, would not be subject to any changes in 2014 as suggested by this question.

11 However, the PBR Application includes the request for an Annual Review process at which time
12 items such as margin, deferrals, other revenues, etc., as discussed in Section 6.3.2, would be
13 subject to re-forecasting. Additionally, the O&M and capital formulas will be subject to some
14 annual adjustment based on changes to the number of customers and inflation rates over that
15 time period. These changes could result in different forecast delivery rate increases for 2015
16 through 2018 than those provided within the Application.

17 In addition, CPCN projects and applications other than this one will impact delivery rates over
18 the PBR Period.

19

20

21

22 104.2 Please provide a list of other sources of changes and the potential direction of
23 the change.

24

25 **Response:**

26 Please refer to the response to CEC IR 3a.104.1.

27

28

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104.3 Please confirm that this result is largely inherent in the forecast data and would be potentially available regardless of the regulatory methodology, although there would be some differences.

Response:

Please refer to the response to CEC IR 3a.104.1. In regards to the items discussed in Section 6.3.2 of the Application, these items would be included on a forecast basis regardless if the Company used a cost of service model or the requested PBR application. However, if the Company had filed a multi-year revenue requirement that did not include an annual rate-setting process through the Annual Review, the forecasted amounts for future years would be “locked-in” for the term of the revenue requirement. The annual rate-setting process allows these amounts to be re-forecast on an annual basis.

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1 **105 Reference: CEC 1.7.2**

7 FEI will continue to propose deferral accounts during the term of this PBR if required and as
8 appropriate. The actual and forecasted balances for existing and new accounts will be adjusted
9 each year during the Annual Review process while setting rates for the following year. These
10 balances will affect the cost of service for rate setting purposes throughout the PBR period.

2

3 105.1 Please confirm that the implementation of new deferral accounts would be a
4 source of changes to costs and rates under either Cost of Service or PBR
5 methodology.
6

7 **Response:**

8 Confirmed. Regardless of whether FEI had applied for revenue requirements using a cost of
9 service methodology or a formula-based PBR, new deferral accounts would be treated the
10 same in either case.
11

12

13 105.2 Please describe whether or not, to the extent that deferral accounts reduced
14 spending in a particular year, that FEI would be seeking to share in the effect
15 (this may be a methodology question and can be left to the next round of
16 questions if FEI likes).
17

18 **Response:**

19 Deferral accounts do not “reduce spending in a particular year.” Rather, deferral accounts are
20 usually created (i) to capture actual variances from forecasted costs embedded in the
21 Company’s rates for that year, (ii) to capture costs which may be uncertain in nature or outside
22 the control of the Company, or (iii) to capture O&M related costs of a significant amount to
23 smooth the impact of the costs on customer rates or to better match the periods that the costs
24 benefit.

25 In all cases, the amounts are captured in the deferral and amortized or returned to customers in
26 a future period. As FEI’s amortization is set based on the forecasted balances in rate base
27 deferral accounts, no variance will exist between the forecasted and actual amortization and,
28 therefore, there is nothing to share with customers (customers will realize 100 percent of the
29 costs or revenues). However, any variance between the actual mid-year balance and the
30 forecasted mid-year balance in the deferral for the current year will create a minor rate base
31 return impact for the forecast year that will be shared equally with customers.

32

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1 **106 Reference: CEC 1.76.1**

8 Prior to 2010, which includes the 2004-2009 PBR period and the prior periods before that,
9 depreciation commenced at the start of the year after the asset was placed into service. In 2010
10 through 2013, depreciation commenced the month after the asset was available for service
11 (which for FEI is the same as when the asset is placed into service).

2

3 106.1 When filing a revenue requirement what assumption does FEI make for when the
4 capital projects will come into service for the purpose of rate setting?

5

6 **Response:**

7 When filing a revenue requirement under cost of service, or an annual review under a PBR plan,
8 capital additions, other than CPCN projects, are assumed to come into service on a mid-year
9 basis for determining the value of the Rate Base which impacts the determination of the earned
10 return and income tax expense. This does not impact depreciation expense as, under FEI's
11 proposal, depreciation would commence January 1 of the following year.

12 For CPCN projects, FEI is proposing to treat CPCNs in the same manner as in the last PBR
13 (2004 – 2009) whereby only approved CPCNs are included in the Rate Base. CPCN projects,
14 for regulatory purposes, would be treated as held in Work-In-Progress until January 1st of the
15 following year after the Project has gone into service. The CPCN would then be treated as
16 having been in Rate Base for the entire year following the year the CPCN project has gone into
17 service.

18

19

20

21 106.2 Please confirm that to the extent that projects are delayed in timing from the
22 assumption in the revenue requirements application that FEI's shareholder can
23 benefit in terms of increased profitability.

24

25 **Response:**

26 There are two reasons why FEI cannot confirm the statement.

27 First, profitability is affected by more than the timing of when projects actually enter service. The
28 actual amount of expenditures can affect the measurement of the ROE, the timing of
29 expenditure can impact revenues, property taxes, operating and maintenance expenses,
30 income taxes which all could enhance or negate profitability from a project or projects being

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- 1 delayed. However, with FEI's proposed treatment of depreciation expense, there would be no
2 impact on depreciation expense from a delay in timing of a project.
- 3 Second, during the PBR any delay in a CPCN project entering into service within the year will
4 have no impact on profitability as the cost of the CPCN is not included until the following year.
5 The CPCN is not included in the rate setting for the year it is going into service as the projected
6 costs of the CPCN are not included in the Rate Base.
- 7 In addition, the Earnings Sharing Mechanism and Efficiency Carryover Mechanism have the
8 potential to mitigate the effect on profitability. Please refer to the response to FEI BCUC IR
9 1.148.2 (Exhibit B-11).