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March 3, 2014

**Via Email**  
**Original via Mail**

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

Attention: Ms. Tannis Braithwaite, Acting Executive Director

Dear Ms. Braithwaite:

**Re: FortisBC Energy Inc. (FEI) and FortisBC Inc. (FBC) (collectively the Companies)**  
**Applications for Approval of a Multi-Year Performance Based Ratemaking Plan**  
**for 2014 through 2018 (the Applications)**  
**Rebuttal Evidence to the Evidence of Russ Bell, CMA on behalf of the British**  
**Columbia Public Interest Advocacy Centre on behalf of the British Columbia**  
**Pensioners' and Seniors' Organization *et al* (BCPSO)**

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The Companies respectfully submit the attached Rebuttal Evidence to the Evidence of Russ Bell, CMA, on behalf of BCPSO, in accordance with British Columbia Utilities Commission (BCUC or the Commission) Orders G-9-14 and G-10-14 establishing the Regulatory Timetable for the above noted proceedings.

If further information is required, please contact the undersigned.

Sincerely,

**FORTISBC ENERGY INC. and**  
**FORTISBC INC.**

***Original signed by: Diane Roy***

**For:** Diane Roy and Dennis Swanson

Attachments

cc (email only): Registered Parties

**FortisBC Energy Inc. (FEI) and FortisBC Inc. (FBC) (collectively FortisBC or the  
Companies  
Applications for Approval of  
Multi-Year Performance Based Ratemaking Plans for  
2014 through 2018**

**Rebuttal Evidence  
of FortisBC  
to Evidence of Russ Bell, CMA (BCPSO et al)**

**March 3, 2014**

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

2 A1: The purpose of this Rebuttal Evidence is to provide FortisBC's response to the evidence  
3 of Mr. Russ Bell filed in FEI Exhibits C5-6, C5-12, C5-13, C5-15 and C5-16, and FBC  
4 Exhibits C3-7, C3-12, C3-13, C3-15 and C3-16, filed on behalf of British Columbia Public  
5 Interest Advocacy Centre on behalf of the British Columbia Pensioners' and Seniors'  
6 Organization *et al* (BCPSO). FortisBC disagrees with a number of aspects of Mr. Bell's  
7 evidence. Our silence on particular matters in that evidence should not be construed as  
8 agreement.

9 **Q2: Mr. Bell identifies several concerns that he has with respect to FortisBC's**  
10 **proposed 2014-2018 PBR Plans on page 11 of his evidence (FEI Exhibit C5-6; FBC**  
11 **Exhibit C3-7). His first claim is that "the incentives in the building block model are**  
12 **not significantly different than cost of service regulation" (FEI Exhibit C5-6; FBC**  
13 **Exhibit C3-7, p. 11, response A13). What is FortisBC's response to this**  
14 **statement?**

15 A2: While FortisBC's building block models retain elements of cost-of-service ratemaking for  
16 flow-through revenue and expenses, significant components of the utility expenditures  
17 are subject to the formula. The controllable costs that are the focus of the PBR formulas  
18 over the five year term account for 37% of FEI's annual delivery revenue requirement on  
19 average<sup>1</sup> and for 27% of FBC's annual non-power purchase revenue requirement on  
20 average<sup>2</sup>. However, these figures only provide part of the story. The annual capital  
21 expenditures and capital incentive that are included within the controllable costs provide  
22 lasting benefits that extend over many years, so that viewing this on an annual revenue  
23 requirement or cost of service basis does not demonstrate the full extent of the impacts.  
24 The incentives associated with the proposed PBR formula are significantly different than  
25 under conventional cost-of-service regulation.

26 It makes sense that, irrespective of regulatory structure, the flow through and non-  
27 controllable costs should be treated the same, and should not be part of the incentive  
28 given the nature of those costs and the benefit to customers of the current treatment of  
29 those costs. In the past PBR, which the Commission has noted was effective (see quote  
30 at FEI Exhibit B-1, page 4), these costs were treated in the same manner as they are in  
31 this proposal.

32 Beyond the impact of including a significant component of the revenue requirement  
33 under the I-X mechanism, the proposed term (i.e. 5 years) for the 2014 PBR Plan  
34 provides a much greater incentive to pursue efficiencies than under cost-of-service  
35 regulation where any efficiencies gained will be rebased in the next revenue requirement  
36 hearing one or two years later. The prospect of imminent rebasing in cost-of-service

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<sup>1</sup> Response to BCUC IR 3.51.3 (FEI/FBC Exhibit B2-8, page 186)

<sup>2</sup> Response to BCUC IR 1.21.1 (FBC Exhibit B-7, pages 49-50)

1 regulation serves as a disincentive to pursue efficiency initiatives that have payback  
2 periods that exceed the test period. The five-year term, combined with the formula-  
3 based approach to O&M and regular capital, gives FortisBC a known and stable  
4 framework in which to pursue efficiency investments and cost savings.

5 The proposed Efficiency Carryover Mechanism or ECM strengthens the power of this  
6 incentive because it effectively ensures that there is a five year period before rebasing  
7 for all investments in efficiency, including those that are identified in the later years of the  
8 Plan.

9 FortisBC disagrees with Mr. Bell's characterization of the FortisBC PBR formulas as  
10 providing "specific funding for O&M and Capital" (FEI Exhibit C5-6; FBC Exhibit C3-7,  
11 page 15) and that "the FEI and FBR proposals do not break the link, but instead use a  
12 formula to forecast capital and operating costs for each year in the PBR term" (FEI  
13 Exhibit C5-15; FBC Exhibit C3-15, response to BCUC IR 2.3.1). FortisBC will be using  
14 formulas to establish the O&M and capital spending allowances for rate setting purposes  
15 in each year of the PBR term but these are not "forecasts" in the sense of representing  
16 budgets of planned expenditures in these areas<sup>3</sup>. The link is also broken by the fact that  
17 there will be a five year period (either within the PBR term or via the ECM) before  
18 rebasing occurs.

19 Mr. Bell is operating under a misconception that a building block approach to a revenue  
20 cap model does not qualify as a PBR Plan. There is no significant difference in  
21 performance-driven results between a revenue cap approach that starts with total  
22 revenues and excludes flow-through items (such as those listed by Mr. Bell in his  
23 response to BCUC IR 2.4.1 (FEI Exhibit C5-15; FBC Exhibit C3-15, page 8)), and a  
24 building block approach that starts with the controllable revenue requirement and adds  
25 flow-through items to get to total revenues. The advantage of the building block  
26 approach is that it allows for a more tailored approach for the utility's specific  
27 circumstances.

28 **Q3: Mr. Bell identifies several concerns that he has with respect to the Companies'**  
29 **proposed 2014-2018 PBR Plans on page 11 of his evidence (FEI Exhibit C5-6; FBC**  
30 **Exhibit C3-7). His second claim is that "the inclusion of a growth factor in**  
31 **Controllable O&M may not be warranted" (FEI Exhibit C5-6; FBC Exhibit C3-7, p.**  
32 **11, response A13). What is FortisBC's response to this statement?**

33 A3: Mr. Bell expands on his contention that the inclusion of a growth factor in Controllable  
34 O&M is not warranted in response A15 of his testimony (FEI Exhibit C5-6; FBC Exhibit  
35 C3-7, p. 13). His assessment for FBC is based on a review of FBC's O&M per customer  
36 in the response to BCPSO IR 1.37.3 (FBC Exhibit B-11, p.62-63). His assessment for

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<sup>3</sup> In contrast, FEI and FBC presented high level forecasts of their planned O&M and capital expenditures over the 2014-2018 period in sections C3 and C4, and C4 and C5 of their Applications, respectively.

1 FEI is based on a review of FEI's O&M per customer in the response to BCPSO IR  
2 1.16.2 (FEI Exhibit B-6, p.30-31).

3 FortisBC disagrees that Mr. Bell's high level review of historical O&M per customer is a  
4 reasonable basis for assessing the proposed O&M formula, including the  
5 appropriateness of inclusion of an allowance for growth. The simple fact that the results  
6 are provided on a per customer basis means that customer growth is reflected implicitly  
7 in the calculations already.

8 A simple example will illustrate this (FortisBC has made this an extreme example to  
9 illustrate the point). Take two utilities – Utility A and Utility B. Both utilities start out in  
10 year 1 with one customer and \$100 in O&M, and continue to add one customer for each  
11 of the following four years, and both utilities experience annual inflation of 2%. The  
12 difference is that in Utility A the O&M cost for each customer added is \$100 per year,  
13 whereas in Utility B there are no annual O&M costs to add a customer. In comparing the  
14 cost per customer for the two utilities, the results would look as follows:

15

	<b>Annual O&amp;M per Customer</b>				
	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Utility A	100	102	104	106	108
Utility B	100	51	35	27	22

16

17 It is clear that the O&M per customer for FEI and FBC does not follow the pattern of  
18 Utility B (the utility where customer growth is not a driver of cost). Although FEI's and  
19 FBC's costs per customer are more similar in pattern (although exaggerated) to those of  
20 Utility A, other factors will come into play over the period. A valid analysis cannot be  
21 based on a simple review of historical results, as they are highly dependent on the time  
22 period chosen and the assumptions made.

23 For example, the O&M per customer for the historical period of 2008 through 2012  
24 considered by Mr. Bell in response A15 was influenced by a number of accounting  
25 changes. Among these was the adoption of US GAAP for FEI and FBC in 2012  
26 replacing Canadian GAAP used prior to 2012 (and avoiding uncertainty around the  
27 adoption of IFRS.) Another change that impacted both capital and O&M costs was the  
28 implementation of HST by the province of British Columbia in July 2010 and then  
29 reversion to a PST / GST sales tax framework in April 2013. O&M has also been  
30 affected by the changes in regulations, codes and standards, as well as the changes in  
31 technology, that have occurred over the period. The historical impact of these factors  
32 has been incorporated in the 2013 Base O&M, and although these factors will continue  
33 to occur over the PBR period, they will either be subject to flow through treatment, or will  
34 be accommodated within the proposed formula that recognizes that O&M costs will be  
35 subject to inflationary pressures (even without customer growth) and that adding new  
36 customers is also a driver of cost increases.

1 Mr. Bell's statements may be influenced by his experience which has been focused in  
2 Alberta. The linkage between customer growth and O&M cost increases is more direct  
3 for FortisBC than for the Alberta utilities to which Mr. Bell's PBR experience pertains.  
4 This comes from the fact that FEI and FBC are more vertically integrated than the  
5 Alberta utilities subject to PBR, including having responsibility for the relationship with  
6 customers (e.g. billing and customer care) which is not handled by the Alberta utilities.  
7 Each added customer for the Companies brings about higher costs for billing and other  
8 customer care activities, as well as other direct and indirect cost increases related to  
9 serving that new customer.

10 Further, Mr. Bell's comments do not recognize that the BCUC has approved O&M  
11 formulas for FEI and FBC of the same or very similar nature dating back to the mid-  
12 1990s. While there have been refinements in the approved O&M formula over time the  
13 same basic structure of O&M escalation from a base level based on customer growth  
14 and inflation less a productivity factor has been used in numerous PBR and revenue  
15 requirement applications since then. Prior O&M formulas have also recognized that  
16 certain categories of O&M costs are not controllable and should be outside the formula  
17 or subject to a deferral account. There have also been allowances in past O&M formulas  
18 for O&M changes due to non-controllable exogenous factors. Consideration of O&M on  
19 a per customer basis has been a regular theme of information requests in revenue  
20 requirements and PBR proceedings, including this one, since the introduction of the  
21 O&M formula, suggesting that there is general acceptance that customers served is a  
22 key driver of costs.

23 Changing the O&M formula by removing growth, as advocated by Mr. Bell, is tantamount  
24 to increasing the productivity improvement requirements imposed on the Companies.  
25 FortisBC's proposed X-Factor of 0.5% already includes a significant stretch factor and  
26 adding another (indirect) productivity challenge by removing the growth factor is  
27 inappropriate. Further to this, FortisBC believes the structure of the O&M formula should  
28 remain the same as it has been in the past so that the productivity improvement  
29 requirements are clearly set out in the X factor, and not disguised in some combination  
30 of the X-Factor and growth or other elements of the formulas.

31 **Q4: Mr. Bell identifies several concerns that he has with respect to FortisBC's**  
32 **proposed 2014-2018 PBR Plans on page 11 of his evidence (FEI Exhibit C5-6; FBC**  
33 **Exhibit C3-7). His third claim is that "the inclusion of a growth factor in non-CPCN**  
34 **capital may not be warranted" (FEI Exhibit C5-6; FBC Exhibit C3-7, p. 11, response**  
35 **A13). What is FortisBC's response to this statement?**

36 A4: Mr. Bell's supporting discussion for his contention that the inclusion of a growth factor in  
37 non-CPCN capital is not warranted is found in response A16 of his testimony (FEI  
38 Exhibit C5-6; FBC Exhibit C3-7, p. 13-14).

1 With respect to FBC's proposed capital formula Mr. Bell makes the statement "Total  
2 Capital does not track customer additions. Similarly, Distribution sustainment capital  
3 does not track customer growth" (FEI Exhibit C5-6; FBC Exhibit C3-7, page 14). This  
4 statement is evidence of a misunderstanding of the FBC capital formula. FBC's capital  
5 formula is based on the total customer count (i.e. average number of customers in each  
6 year (FBC Exhibit B-1, pages 55-59)) rather than customer additions. The growth  
7 component in the annual capital expenditures derived from the FBC capital formula is  
8 less than 1% per year (based on the forecast customer growth) and less than 5%  
9 cumulatively over the five year period. The FBC capital formula recognizes that as the  
10 customer base grows there is an overall larger system, both in terms of customers  
11 served and system capacity, that requires incrementally more activity, including  
12 sustaining capital activity, to continue to provide safe and reliable electricity service.

13 Likewise, Mr. Bell's responses to BCUC IRs 1.3.4 and 1.3.5 (FEI Exhibit C5-12; FBC  
14 Exhibit C3-12, pages 9-10) also demonstrate a misunderstanding of FEI's capital  
15 formulas for non-CPCN capital expenditures.

16 Mr. Bell's response to BCUC IR 1.3.4 states "Like FBC, for FEI, the inclusion of a growth  
17 factor reduces the incentive properties of the PBR plan." FortisBC disagrees. The  
18 incentive properties with respect to the formula-based capital arise from FEI and FBC  
19 pursuing efficiencies and capital cost reductions relative to the formula-allowed  
20 expenditure levels. Making changes to the capital formula, such as removing growth  
21 from the formula, changes the target that the Companies must achieve to result in a  
22 positive incentive but it does not change the relative incentive power of the proposed  
23 capital formulas and treatment of capital in the PBR plans.

24 Mr. Bell's response to BCUC IR 1.3.5 suggests that he has misunderstood FEI's two-  
25 part capital formula for non-CPCN capital. FEI's proposed capital formulas were  
26 developed by separating the regular (i.e. non-CPCN) capital spending into two  
27 components – one which pertains directly to the capital expenditures for adding new  
28 customers to the system and the second which pertains to ongoing system sustainment  
29 and other general capital spending, which uses total customers as the cost driver. The  
30 rationale for separating the non-CPCN capital into two formulas is straightforward and is  
31 described in section B6.2.5 of the Application (FEI/FBC Exhibit B-1). This two-part  
32 formula for capital spending is essentially the same as the approach successfully  
33 employed in FEI's 2004-2009 PBR Plan. The growth capital is related directly to adding  
34 incremental customers to the system, as described in Section C4.5 of the Application  
35 (FEI Exhibit B-1) where it states that "these expenditures are for the installation of new  
36 mains, services, meters and regulators". The one change proposed in the 2014 PBR  
37 growth capital formula is that forecast service line additions (calculated as a percentage  
38 of forecast gross customer additions) is used as the cost driver for this component where  
39 forecast customer additions was used as the cost driver in the 2004 PBR, but otherwise  
40 the formulas in the 2014 PBR are conceptually identical to the 2004 PBR. FEI believes  
41 that Mr. Bell's assertions in the response to BCUC IR 1.3.5 that a growth component is

1 unjustified are contradictory and based on a lack of understanding of the way in which  
2 the capital formulas were developed.

3 FortisBC believes that similar comments to those made above regarding the  
4 inappropriateness of excluding growth from the O&M formula are warranted with respect  
5 to excluding growth from the capital formulas. For those components of the capital  
6 formulas that use total customers as the cost driver (Sustainment and Other capital for  
7 FEI and all base capital for FBC) excluding growth from the capital formula is like adding  
8 an additional productivity challenge beyond what is already required by the X-Factor in  
9 the formula and the same comments as those discussed for O&M above are valid for  
10 this portion of the capital allowance. It is obvious in the case of growth capital that  
11 adding a customer will result in incremental capital (for example a service line and a  
12 meter). FEI's focus under the I-X mechanism will be to accomplish this more efficiently.  
13 To remove FEI's growth capital from the formula entirely would simply be punitive and  
14 may result in FEI being unable to recover its prudently incurred costs. As stated above,  
15 FEI's capital formulas have been calibrated based on separating the non-CPCN capital  
16 spending into two categories, Growth capital and Sustainment and Other capital.  
17 Removing the Growth capital portion from FEI's overall formula-based capital would  
18 amount to an unjustified reduction in the base capital spending allowance of between  
19 15% and 20% of the total (see section B6.2.5 of the FEI Application (FEI Exhibit B-1)).

20 **Q5: In response to BCUC IR 2.1.2 (FEI Exhibit C5-15; FBC Exhibit C3-15, page 1) Mr.**  
21 **Bell's response in comparing FortisBC's proposed CPCN process to the AUC**  
22 **capital tracker process focuses on differences between the two processes but**  
23 **completely ignores the similarity in the fundamental purpose of these two**  
24 **processes. What is FortisBC's response to this omission in Mr. Bell's response?**

25 A5: While FortisBC agrees that there are differences in the rules or guidelines and  
26 administration of the AUC capital tracker provisions relative to the FortisBC CPCN  
27 process the fundamental purpose of the two processes is the same. Both processes  
28 provide a means for utilities to bring forward capital projects that are beyond those that  
29 are covered by the I-X formulas. FortisBC's capital formulas have been set up (i.e.  
30 calibrated) to cover base capital spending excluding anticipated or possible CPCN  
31 capital and therefore it is appropriate to use the long established and familiar CPCN  
32 process to bring forward these large projects.

33 **Q6: Mr. Bell states in response to BCUC IR 2.1.3.1 (FEI Exhibit C5-15; FBC Exhibit C3-**  
34 **15, page 2) that, if desired by the Commission, the capital formula could**  
35 **accommodate CPCN costs by making an appropriate adjustment to the base**  
36 **capital. What is FortisBC's response to this statement?**

37 A6: Attempting to incorporate CPCN capital into the capital formulas would be problematic  
38 and FortisBC believes it would be inappropriate to try to do so. The projects that may be



1 brought forward as CPCNs for either FEI or FBC are larger projects that have a number  
2 of uncertainties associated with them. There are uncertainties in the scope of the  
3 potential CPCN projects, as well as uncertainties in project costs and timing. As CPCN's  
4 are not common, in frequency, timing or size, attempting to incorporate such large  
5 projects in some fashion into the capital formulas would be prone to creating large  
6 variances between the actual capital spending and the formula-based allowances that  
7 are unrelated to efforts to find efficiencies and savings in base capital spending<sup>4</sup>.  
8 FortisBC's proposed CPCN process is based on long-established practices in BC both  
9 under PBR and conventional cost-of-service, and provides the appropriate balance  
10 between Company and customer interests in pursuing these larger capital projects.

11 **Q7: Mr. Bell states at several points in responses to information requests that there**  
12 **are no growth factors in AUC PBR formulas for distribution utilities (see FEI**  
13 **Exhibit C5-12; FBC Exhibit C3-12, BCUC IR responses 1.2.6, 1.3.2, 1.7.1 and 1.7.2).**  
14 **What is FortisBC's response to these repeated claims?**

15 A7: While FortisBC agrees that the AUC PBR formulas do not explicitly make references to a  
16 growth factor, an allowance for growth is inherent in the very nature of both the revenue  
17 cap **per customer** model for natural gas distribution utilities and the price cap model for  
18 electric distribution utilities.

19 The fact that the Alberta PBR formulas include an allowance for growth can be deduced  
20 from elements of the AUC 2012-237 Decision and cost-of-service ratemaking principles.

21 • Paragraph 91 of AUC Decision requires the Alberta utilities to use their 2012  
22 approved rates as the going-in rates for their PBR period commencing in 2013. (The  
23 AUC also permitted certain limited adjustments to the 2013 going-in rates for items  
24 that it considered to be "in the nature of a correction to the going-in rates" (see AUC  
25 Decision, paragraphs 89 and 116).)

26 • The approved 2012 rates for each utility have been set by the AUC in a cost of  
27 service regulatory proceeding to recover their respective 2012 revenue  
28 requirements.

29 • The 2012 revenue requirements for each utility were composed of all of the cost-of-  
30 service elements accepted by the AUC such as, for example, operating and  
31 maintenance (O&M) expenses, depreciation expenses, return on rate base (debt  
32 interest and return on equity), property and income taxes and any other AUC-  
33 permitted categories of expense. The approved 2012 rates (by customer class) were  
34 set to generate revenues that in aggregate would recover the overall 2012 revenue  
35 requirements. This is nothing other than standard cost-of-service ratemaking.

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<sup>4</sup> Whether CPCN capital was added to the formulas as an annual average allowance or there was an attempt to forecast CPCN spending in each of the five years, the potential for variances due to timing, scope or costs of the CPCN projects would be significant.

- 1           • If the 2012 revenue requirements are considered on a per customer basis (i.e.  
2 approved revenue requirements divided by the number of customers), the revenues  
3 to be collected from each customer can be said to be making a pro-rata contribution  
4 to each of these cost-of-service components that make up the 2012 revenue  
5 requirements.
- 6           • Therefore, the revenue per customer PBR formula applicable to natural gas utilities  
7 allows, in effect, the same level of recoveries of the various cost-of-service elements  
8 as those embedded in the 2012 revenue requirements used as the base in the PBR.  
9 (The base is then escalated each year by the I-X formula.)
- 10          • As the customer base grows, the gas utility is allowed to increase its overall revenue  
11 collection by this per customer amount (as adjusted by the I-X formula) **for each**  
12 **new customer that is added**. Thus, it can be said that there is an allowance for  
13 growth in all the cost-of-service elements that make up the distribution revenue  
14 requirements.
- 15          • In his response to BCUC IR 2.2.3 (FEI Exhibit C5-15; FBC Exhibit C3-15, page 4)  
16 Mr. Bell appears to acknowledge in a general way that there is an accommodation  
17 for growth in the AUC PBR formulas. Based on the reasoning in the preceding  
18 paragraphs FortisBC notes that growth would apply to the O&M component of  
19 revenue requirements, as it would to all of the other cost of service components  
20 making up the revenue requirements. Thus, the AUC PBR formulas can be said to  
21 increase the O&M component of the revenue requirements by both (I-X) and growth,  
22 which is effectively what the FortisBC O&M formulas do. While Mr. Bell accepts the  
23 AUC PBR models as reasonable, including the implicit allowance for growth, he  
24 states that a growth factor in the FortisBC formulas is not appropriate. FortisBC  
25 disagrees. Inclusion of an allowance for growth in FortisBC's PBR formulas is  
26 appropriate and consistent with past practice in BC, as well as being an accepted  
27 element in PBR theory.
- 28          • Similar reasoning can be employed to demonstrate that the AUC's price cap model  
29 for electric distribution utilities also implicitly allows for growth; however the logic  
30 must use an electric rate billing determinants analysis rather than a per customer  
31 analysis since the I-X formulas will be applied to the various rate components (i.e.  
32 the billing determinants). For the electric distribution utilities the AUC price cap PBR  
33 model includes an allowance for growth in all aspects of the rate structures (e.g.  
34 number of customers, electricity use per customer, peak capacity usage, etc.)

35 **Q8: Mr. Bell identifies several concerns that he has with respect to FortisBC's**  
36 **proposed 2014-2018 PBR Plans on page 11 of his evidence (FEI Exhibit C5-6; FBC**  
37 **Exhibit C3-7). His fourth claim is that "the inclusion of an ECM factor is**  
38 **inappropriate" (FEI Exhibit C5-6; FBC Exhibit C3-7, p. 11, response A13). What is**  
39 **FortisBC's response to this statement?**

1 A8: Mr. Bell's supporting discussion in response A17 of his testimony (FEI Exhibit C5-6; FBC  
2 Exhibit C3-7, p. 14-15) of his contention that the inclusion of an ECM factor is  
3 inappropriate suggests that he has misunderstood how FortisBC's proposed ECM will  
4 work and how the balance is struck in the proposed PBR between O&M and capital  
5 spending. For instance Mr. Bell states "(t)he majority of the capital for productivity  
6 improvements may well be included in the Capital generated by the formula. As  
7 such, customers will be paying for the cost of the productivity investments in rates  
8 through the building block model."

9 • Mr. Bell does not provide the basis for his suggestion that the majority of the capital  
10 for productivity improvements is generated by the formula. However, even if it is  
11 accepted that the formulas include an allowance for productivity-related capital  
12 spending, FEI and FBC will actually have to spend that capital in order to achieve the  
13 anticipated productivity improvements. Thus, if the capital is spent there will be no  
14 capital incentive to be carried forward under the proposed ECM because formula and  
15 actual capital spending for those particular elements will be the same. A capital  
16 incentive under the ECM would only be achieved if FEI or FBC found a better (or  
17 less expensive) way to achieve the same productivity improvements.

18 • Mr. Bell focuses on the productivity-related capital allowances that may be in the  
19 capital formulas but does not acknowledge that there are O&M productivity  
20 improvements required by the I-X O&M formulas. There is no basis for saying that  
21 the productivity improvements enabled by the capital formulas are greater than the  
22 O&M productivity improvements that FEI and FBC must achieve under the O&M  
23 formulas. In order to generate an ECM benefit for the Companies, FortisBC must find  
24 additional O&M savings beyond what is required by the formulas. Further to this, if a  
25 productivity-related capital expenditure is undertaken, the Companies will have to be  
26 diligent in achieving the planned O&M productivity improvements, or the ECM impact  
27 may actually be negative.

28 • FortisBC also disagrees with Mr. Bell's claim in his response to BCUC IR 2.3.2 (FEI  
29 Exhibit C5-15; FBC Exhibit C3-15, page 5) that the incentives to spend less than the  
30 formula-allowed O&M and capital "will remain the same with or without an ECM". It is  
31 clear as FortisBC has explained in the Applications (FEI Appendix D6 (FEI Exhibit B-  
32 1-1) and FBC Appendix D5 (FBC Exhibit B-1-1)) and elsewhere that without an ECM  
33 the incentive to pursue additional savings diminishes throughout the PBR term since  
34 the time remaining in which to recover any costs and achieve benefits is shorter for  
35 initiatives that begin later in the term. The ECM overcomes this by creating the same  
36 degree of incentive to pursue savings in each year of the PBR term.

37 **Q9: Mr. Bell states that the experience of ENMAX Power Corporation (EPC) with what**  
38 **was called a Formula Based Ratemaking model provides a basis for**  
39 **recommending that the Commission should consider a price cap model for FBC**

1 **and FEI (FEI Exhibit C5-6; FBC Exhibit C3-7, page 11, response A13). What is**  
2 **FortisBC's response to Mr. Bell's statement?**

3 A9: FortisBC disagrees with Mr. Bell's statement.

4 First, there are key differences in the circumstances to which the ENMAX transmission  
5 and distribution Formula Based Ratemaking (FBR) models are applied relative to those  
6 facing FBC and FEI. The first key difference is seen in the fact that the FBRs for  
7 ENMAX's Transmission and Distribution divisions functioned separately from each other  
8 and applied narrowly to electricity transmission and electricity distribution respectively.  
9 By contrast there is much more vertical integration in FEI's and FBC's utility operations  
10 that will function under the proposed 2014 to 2018 PBRs. FEI has storage, transmission,  
11 distribution and customer care, along with corporate functions and general plant needed  
12 to support these functions, all within the PBR. Similarly, FBC has generation,  
13 transmission, distribution and customer care, along with corporate functions and general  
14 plant needed to support these functions, all within its PBR. The greater scope and  
15 variety of operations and business activity within a vertically-integrated utility make it  
16 more difficult to develop an acceptable price cap model than it is for utilities providing  
17 service within a narrow functional band in the energy delivery value chain.

18 Second, the suggestion that a price cap model would be an appropriate PBR model to  
19 adopt in BC takes no account of the provincial policy and legislative circumstances  
20 within which the PBR models must function. For instance, public utilities in BC must  
21 prepare and file integrated resource plans with the BCUC for review and acceptance by  
22 the Commission. Also, public utilities in BC must pursue all cost-effective energy  
23 efficiency and conservation activities (referred to in the Clean Energy Act as "demand  
24 side measures"). While such energy efficiency and conservation activities may pass the  
25 approved Demand Side Management tests and thresholds, such as the Total Resource  
26 Cost test, they may actually result in increases to the public utility's rates. A price cap  
27 model cannot readily accommodate complexities such as these legislative requirements  
28 affecting public utilities in BC. Thus FortisBC disagrees with Mr. Bell and submits that a  
29 price cap model is not appropriate for either of their respective PBR plans.

30 **Q10: Mr. Bell states that "[i]n FBC's response to BCPSO 1.16.2 (Exhibit B-11), it states**  
31 **"[t]he goal of a PBR is to emulate a competitive firm operating in a competitive**  
32 **market." Not only is that the goal of PBR, but the intent of regulation in general."**  
33 **(FEI Exhibit C5-6; FBC Exhibit C3-7, p. 11-12, response A14). What is FortisBC's**  
34 **response to Mr. Bell's statement?**

35 A10: The particular quote of Mr. Bell's is from FBC BCPSO IR 1.26.1, rather than FBC  
36 BCPSO IR 1.16.2 (FBC Exhibit B-11), and is taken out of context. The quoted statement  
37 included in the response to BCPSO IR 1.26.1 was made in the context of an IR which  
38 asked about why EUCPI was not used as the I-Factor for capital costs. (FBC  
39 acknowledges that the quoted sentence from the response to BCPSO IR 1.26.1 should

1 have been more nuanced, saying something like “One of the results of a PBR is to  
2 emulate a competitive firm operating in a competitive market”.)

3 FBC’s direct response to BCPSO’s question of whether the Company would confirm that  
4 one of the principles of PBR is to emulate the incentive forces that are experienced  
5 under a competitive market in order to improve efficiencies is found in the response to  
6 BCPSO 1.13.3 (FBC Exhibit B-11) as quoted below:

7 *“In the Alberta PBR proceeding, the AUC identified the emulation of competitive*  
8 *market forces, to the greatest extent possible, as a principle for their PBR Plan in*  
9 *AUC Decision 2012-237. Specifically, Principle 1 on page 7 of AUC Decision*  
10 *2012-237 reads:*

11 *“A PBR plan should, to the greatest extent possible, create the same*  
12 *efficiency incentives as those experienced in a competitive market quote”*

13 FBC considers the emulation of incentive forces under competitive market  
14 conditions to improve efficiencies as more of a result of a comprehensive PBR  
15 plan than a principle. PBR effectively decouples prices from the cost of service  
16 and therefore creates the intended PBR incentives for utilities to optimize the  
17 various inputs of production to operate efficiently, similar to firms in competitive  
18 markets. However, certain regulatory safeguard mechanisms that are essential to  
19 PBR plans, (such as deferrals, SQL’s and off-ramps), do not conform to  
20 competitive market behavior. Therefore, FBC believes that emulating efficiency  
21 incentives as those experienced in competitive markets, to the greatest extent  
22 possible, is implicit in a comprehensive PBR plan.”

23  
24 FortisBC believes the objectives it has articulated for PBR in its Applications are the  
25 appropriate objectives. While emulation of competition may be a result of PBR, FortisBC  
26 does not believe the objective, as stated by AUC, is applicable due to the regulated  
27 nature of utilities.

28 **Q11: Does this conclude your rebuttal evidence?**

29 A11: Yes.

30