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March 10, 2014

Via Email

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) and FortisBC Inc. (FBC) (collectively the Companies)

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

Supplemental Rebuttal Evidence of the Companies to the Evidence of Dr. Mark Lowry, on behalf of the Commercial Energy Consumers Association of British Columbia (CEC)

Further to the British Columbia Utilities Commission letter dated March 4, 2014 (FEI Exhibit A-31, FBC Exhibit A-36), the Companies respectfully submit the attached Supplemental Rebuttal Evidence to the Evidence of Dr. Mark Lowry, on behalf of CEC.

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

Attachment

cc (email only): Registered Parties

FortisBC Energy Inc. (FEI) and FortisBC Inc. (FBC) Application for Approval of a Multi-Year Performance Based Ratemaking Plan for 2014 through 2018

Supplemental Rebuttal Evidence of FortisBC

to the Evidence of Dr. Lowry (FEI Exhibit C1-21-1; FBC Exhibit C6-20-1) filed on behalf of the Commercial Energy Consumers Association of BC (CEC) on March 4, 2014

March 10, 2014

Q1: What is the purpose of this Supplemental Rebuttal Evidence?

A1: The purpose of this Supplemental Rebuttal Evidence is to provide FEI's and FBC's ("FortisBC" or "the Companies") response to aspects of the evidence of Dr. Lowry on behalf of CEC that was included in his updated response to BCSEA IR 2.16.1 (FEI Exhibit C1-21-1) filed on March 4, 2014. FortisBC disagrees with a number of aspects of Dr. Lowry's evidence in this updated response pertaining to FortisBC's proposed Efficiency Carryover Mechanism (ECM) and possible alternatives. We have responded to notable parts of that evidence, but our silence on particular aspects of Exhibit C1-21-1 should not be construed as agreement.

Q2: Dr. Lowry provides a list of concerns regarding FortisBC's proposed ECM on page 2 of the updated response to BCSEA 2.16.1. These concerns are quoted below for ease of reference.

- **The mechanisms are quite complex. The granting of revenue based on *incremental* rather than *total cost* variances is a noteworthy source of the complexity.**
- **By measuring performance based on a comparison of actual costs to index-based benchmarks, the proposed ECMs make compensation sensitive to f1uctuations in external cost drivers such as weather conditions.**
- **It is unclear what happens when and if Fortis costs exceed the benchmarks.**
- **Dr. Lowry has not taken the time to consider whether the incentives for O&M [and] capital cost containment are properly balanced.**

What is FortisBC's response to Dr. Lowry's list of concerns?

A2: FortisBC will address each of these in turn.

The underlying principle of FortisBC's proposed ECM is straightforward. The proposed ECM provides the same incentive for the Companies to pursue O&M and capital expenditure savings in each year of the PBR term. With the proposed ECM, the incentive to pursue savings remains the same in years 2 through 5 as it would be in year 1. That is, the Earnings Sharing Mechanism and the ECM work together to provide the same 5 year 50.50 sharing of benefits for all capital and O&M savings achieved, no matter what year in the term they are achieved. This effectively ensures that the productivity incentive of the PBR Plan is maintained for the Companies right through to the last year of the PBR term. The result of this is that customers benefit from lower rates coming out of the PBR than without the ECM.

While Dr. Lowry correctly notes that the proposed ECM is based on the incremental savings in each year, the information required to confirm and verify the Companies' ECM annual benefit or penalty will be readily available each year as part of the Annual Review process. Using an incremental cost variance approach as opposed to a total cost variances approach overcomes the concern with respect to diminishing incentives for the Companies to pursue further savings as the PBR term progresses. The total cost variances approach would not have the same desired result. As an extreme example of the total cost variances approach, the utility could make great efforts to achieved savings in the first year of the Plan and then allow its costs to increase for subsequent years by the year-to-year cost changes arising from the I-X formulas. The utility would thus have maintained the first year savings for five years, but created no incremental savings in the second through fifth years. A total cost variances approach to the ECM would then have provided an ECM benefit to the utility even though all the benefit was generated in the first year. This is in contrast to FortisBC's proposed incremental cost approach where there would be no incremental benefit achieved in the second through fifth years, and therefore no ECM after the PBR term.

FortisBC disagrees with Dr. Lowry's second concern that the proposed ECM is sensitive to external cost drivers such as weather variations. Weather variations will cause changes in natural gas or electricity throughput, but only a very small percentage of FEI's or FBC's O&M costs could be impacted by these factors[1]. Since FortisBC's ECM deals only with controllable O&M and capital expenditures, the Companies can manage any minor fluctuations in weather or throughput-related cost variations within the formula-based allowances and still pursue incremental savings in each year in other areas.

FortisBC also disagrees with Dr. Lowry's third concern that it is unclear what occurs when FortisBC exceeds the benchmarks. FBC stated in the response to CEC IR 1.29.3 (FBC Exhibit B-10, page 51):

[1] As B&V notes in FEI Appendix D2, page 2, throughput-related costs are a very small percentage of costs for gas utilities and limited to items like company fuel use or odorant. A similar statement is made in FBC Appendix D2, page 2 with respect to electric distribution utilities where only very minor costs are throughput related, such as line losses. These statements hold true for FEI and FBC.

> "The ECM is symmetrical in its treatment of benefits and losses. If the benefits were lost in a subsequent year within the PBR term the effect of the loss would also be carried forward in the ECM for four additional years."

The illustrative examples provided in FEI Appendix D6, page 3 and FBC Appendix D5, page 3 both contain examples of where the O&M or capital target is missed and the corresponding ECM effect is carried forward for an additional four years.

Dr. Lowry's fourth concern is that he has not taken the time to assess whether the incentives to contain O&M and capital spending are properly balanced. As stated above and elsewhere, the FortisBC ECM maintains the incentive to contain spending in either category at the same level for each year in the PBR term. The balance between the incentive to contain O&M spending and the incentive to contain capital spending also remains the same throughout the term with the proposed ECM is in place.

Q3: In part 3 of his updated response to BCSEA 2.16.1 Dr. Lowry states that the ultimate goal of an ECM is to encourage utility behavior that reduces the initial rates for the next PBR plan. Dr. Lowry then provides two possible approaches to an ECM that he claims are simpler. What are FortisBC's views on Dr. Lowry's proposed alternatives?

A3: There is not enough information for the two proposals to come to any firm conclusion about the merits of either approach. However, FortisBC notes Dr. Lowry's final comment that these are ideas for alternative simpler approaches and not to be taken as specific proposals. FortisBC believes they should be taken simply as that. There has been discussion in this proceeding about alternative approaches to ECM as well as whether the 2014-2018 PBRs should be followed by a cost of service revenue requirement application, or an extension to the PBR, or whether it would be possible to move right into another PBR period with some form of rebasing. All of these possible outcomes are speculative and it is really only the FortisBC PBR plans (including the proposed ECM) that constitute specific proposals. Nevertheless FortisBC provides these specific comments on Dr. Lowry's alternative proposals:

- The first alternative, in which the utility receives a one-time 50% bonus (or penalty) of the difference between the hypothetical one-year extension of the I-X formula-based revenue requirement and the forward test year revenue requirement appears to be a form of the total cost variance approach discussed above. FortisBC believes this approach would not maintain the incentive for the utility to continue pursuing cost containment in the later years of the PBR term.

- The second alternative assumes that the utility would move into a second PBR term right after the current plan ended, and that the I-X formulas would be retroactively recalculated based on adding an extra 50[2] basis points to the X factor to form the going-in revenue requirement for the next PBR term. This second alternative is highly speculative in assuming that one PBR term can roll right into the next. It also assumes that setting revenue requirements in the 1st year of the 2nd PBR term using a cumulative X-factor difference of approximately 300 basis points (50 basis points x 6 years) can lead to just and reasonable rates and provide the utility the opportunity to earn a fair return on its investment. Achieving this target may be extremely difficult, particularly if there is already a large stretch factor in the X-Factor in the first PBR term even before the extra 50 basis points per year is added.

FortisBC does not believe there is any basis to conclude that either of Dr. Lowry's ECM alternatives would or could serve the intended purpose of an ECM as well as FortisBC's proposed ECM, which has been specifically designed to fit into FortisBC's overall PBR proposal.

Q4: Does this conclude your rebuttal evidence?

A4: Yes.

[2] FortisBC assumes the reference in Dr. Lowry's response to adding "an additional 0.50 basis points" to the X-Factor was a mistake and that it was intended that there would be an extra 50 basis points added.