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BY E-MAIL

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

Attention: Erica Hamilton
Commission Secretary

Dear Sirs/Mesdames:

Re: FortisBC Energy Inc. (FEI)

Code of Conduct and Transfer Pricing Policy for Affiliated Regulated Businesses Operating in a Non-Natural Monopoly Environment (ARBNNM)

FEI Pre-Hearing Conference Submission on Items 5 and 6

We are legal counsel for FortisBC Energy Inc. ("FEI" or the "Company"), the applicant in the above proceeding.

Introduction

The Commission's letter of August 18, 2014 (Exhibit A-3) requested written submissions from FEI on the following two issues in advance of the pre-hearing conference:

> 5) FEI is required to explain why it does not accept Corix's characterization of FEI departing from the Commission directives in the AES Inquiry Report.
>
> 6) FEI is requested to address, for each area in the Application where significant differences remain, the specific facts and circumstances that support FEI's departure from the Guidelines and Recommendations outlined in the AES Inquiry Report.

We are writing to provide FEI's submissions on these two related issues.

In summary, the AES Inquiry Report (the Report) distinguished among "directives", "guidelines" and "recommendations". These distinctions have legal significance, which Corix is not acknowledging. The "guidelines" and "recommendations" cited by Corix cannot foreclose full consideration of the issues. FEI submits:

- FEI's proposal adheres to all directives in the AES Inquiry Report and gives appropriate consideration to all "guidelines" and "recommendations", and
- the circumstances warrant departing from the "guidelines" and "recommendations" in limited instances.

B. Due Consideration Given to Guidelines and Recommendation

Section B of this letter addresses item 5 on the Commission's agenda. We explain below why Corix's July 14, 2014 letter (Exhibit C1-1), in which Corix challenges FEI's proposal on the basis that it departs from the AES Inquiry Report in some instances, mischaracterizes the outcome of the AES Inquiry as precluding further consideration of the issues of employee sharing and cost allocation. The Company's proposal adheres to all binding directives in the AES Inquiry Report and gives appropriate consideration to all "guidelines" and "recommendations".

The Proper Characterization of the Outcome of AES Inquiry Report

The first point in response to Corix's submission is that the examples cited by Corix in its July 14, 2014 letter where FEI has deviated from the AES Inquiry Report were identified by the Commission as being either a "guideline" or a "recommendation", not *directives*.[1] In particular:

- The passages quoted by Corix regarding the sharing of common resources and employees appeared in a list of "Guidelines" set out on pp. 25-26 of the Report.
- Cost sharing was addressed by the AES Inquiry Report as a "recommendation". The passage to which Corix refers ("Sharing of service among affiliates should be done on the basis of the higher of market pricing or the fully allocated cost in accordance with the Principles and Guidelines and an approved Code of Conduct and Transfer Pricing Policy.") appeared under the heading "Other Recommendations" in Appendix H.

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[1] See AES Inquiry Report, Appendix H.

It is self-evident from the Report that the Commission's use of the different terms "recommendations", "guidelines" and "directives and determinations" was deliberate and that the Commission intended each term to have a different meaning. In Section 2 of the Report, the Commission set out a number of "principles" and "guidelines" intended to guide all public utilities or firms looking to undertake AES or New Initiatives. In Section 3, the Commission applied the "principles" and "guidelines" outlined in Section 2 to AES activities and New Initiatives through a number of "directives" and "recommendations". Section 4 provided "directives" regarding specific issues that were raised in the course of the AES Inquiry. Appendix "H" to the Report provided separate summary lists of TES-related "directives and determinations", "recommendations", "other findings and determinations" and "other recommendations".

In considering FEI's present Application, it remains necessary to distinguish among these concepts because they each have different legal significance:

- ***Direction:*** "Direction" is a term used in the *Utilities Commission Act* ("UCA") to describe a type of Commission determination that imposes an enforceable requirement on the object of the direction to act or not act. See, for instance, section 112:

  > In construing and enforcing this Act, or a rule, regulation, order or direction of the commission, an act, omission or failure of an officer, agent or other person acting for or employed by a public utility, if within the scope of the person's employment, is deemed in every case to be the act, omission or failure of the utility. [Emphasis added.]

  There were four "directives" in the AES Inquiry Report relating specifically to the provision of thermal energy in Appendix H (p.3). None of those four "directives" related to cost allocation, transfer pricing or codes of conduct. FEI has complied with those directives, and other directives and determinations in the body of the Report.

- ***Recommendation:*** In common parlance, a "recommendation" is inherently non-binding. A "recommendation", unlike a "direction", is also not a concept referenced in the UCA. The Commission's "recommendations" thus represented an expression of the Commission's views based on the evidentiary record before it. As a practical matter, a utility like FEI would be unwise to dismiss a "recommendation" out of hand without due consideration; however, the Commission's "recommendations" do not raise issues of compliance/non-compliance and are not capable of being enforced. FEI has given due

consideration to all of the "recommendations", proposing to deviate in a particular way for reasons that FEI has articulated in a transparent manner.

- ***Guidelines:*** A guideline is a unique creature. It differs from a "recommendation" in that it takes the form of a binding order. However, a binding order is not the same as a directive to act or not act; while the Commission is permitted to issue binding guidelines, it is not permitted to apply its guidelines as if they were law. Under the UCA there is no *res judicata* or *stare decisis*. Section 75 imposes a positive obligation on the Commission to consider the facts of each case: "The commission must make its decision on the merits and justice of the case, and is not bound to follow its own decisions." A guideline may be legally challenged independently of its application if it is written in language that would unduly fetter the discretion of future tribunal members in determining the matters before them. This point has been made unequivocally in the *Thamortharem* decision of the Federal Court of Appeal:[2]

> [62]Nonetheless, while agencies may issue guidelines or policy statements to structure the exercise of statutory discretion in order to enhance consistency, administrative decision makers may not apply them as if they were law. Thus, a decision made solely by reference to the mandatory prescription of a guideline, despite a request to deviate from it in the light of the particular facts, may be set aside, on the ground that the decision maker's exercise of discretion was unlawfully fettered: see, for example, Maple Lodge Farms, at page 7. This level of compliance may only be achieved through the exercise of a statutory power to make "hard" law, through, for example, regulations or statutory rules made in accordance with statutorily prescribed procedure.
>
> [63]In addition, the validity of a rule or policy itself has sometimes been impugned independently of its application in the making of a particular decision. Ainsley is the best known example. That case concerned a challenge to the validity of a non-statutory policy statement issued by the Ontario Securities Commission setting out business practices which would satisfy the public interest in the marketing of penny stocks by certain securities dealers. The policy also stated that the Commission would not necessarily impose a sanction for non-compliance on a dealer under its "public interest"

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[2] *Thamotharem v. Canada*, 2007 FCA 198, para. 62. http://reports.fja.gc.ca/eng/2008/2007fca198.html

> jurisdiction but would consider the particular circumstances of each case.
>
> [64]Writing for the Court in Ainsley, Doherty J.A. adopted [at page 110] the criteria formulated by the trial Judge for determining if the policy statement was "a mere guideline" or was "mandatory," namely, its language, the practical effect of non-compliance, and the expectations of the agency and its staff regarding its implementation. On the basis of these criteria, Doherty J.A. concluded that the policy statement was invalid. He emphasized, in particular, its minute detail, which "reads like a statute or regulation" (at page 111), and the threat of sanctions for non-compliance. He found this threat to be implicit in the Commission's pronouncement that the business practices it described complied with the public interest, and was evident in the attitude of enforcement staff ,who treated the policy as if it were a statute or regulation, breach of which was liable to trigger enforcement proceedings.

Published Commission guidelines (e.g., CPCN Guidelines) typically contain provisions to clarify that the Commission will consider future matters on a case by case basis, having regard to the guidelines. The AES Inquiry Report did not make that proviso express in this case, but the Report's "guidelines" would only be valid guidelines if the "case by case" proviso is implied.

FEI understands that the AES Inquiry Report "recommendations" and "guidelines" merit careful consideration by FEI, stakeholders and future Commission panels (including this one). As discussed below, FEI has given due consideration to the AES Inquiry Report. However, the Commission cannot lawfully give effect to Corix's demand. The Commission Panel hearing the AES Inquiry would have unlawfully fettered its jurisdiction by purporting to bind this Panel. Similarly, this Panel would unlawfully fetter its jurisdiction by declining to consider FEI's proposal on the basis that it was bound to follow prior "recommendations" and "guidelines" (or even "directives" for that matter[3]).

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[3] While FEI is not seeking to revisit any "directives" here, it is worth noting that even "directives" can be revisited if circumstances warrant.

Collaborative Process to Consider Stakeholder Input and AES Inquiry Report

One of the Commission's "recommendations" was to initiate a collaborative process for updating its Code of Conduct ("CoC") and Transfer Pricing Policy ("TPP").[4] FEI submits that the purpose of the collaborative process was to consult with interested stakeholders on how the CoC and TPP should be revised, taking into consideration the "principles" and "guidelines" in the AES Inquiry Report. The recommended collaborative process would have been unnecessary if the task was limited to replicating the wording included in the AES Inquiry Report. FEI has taken into consideration all relevant components of the AES Inquiry Report. Each of the issues identified by Corix has been captured in the Application as "Sections Where Significant Differences Remain".[5] Where FEI's proposed wording is different than the relevant Principles and Guidelines in the AES Inquiry Report, FEI has provided its reasons along with other stakeholder comments and rationale supporting FEI's proposed wording for the Commission's understanding and review.

FEI submits that there is merit to departing from the Commission's "recommendations" and "guidelines" in the instances cited by Corix. This is the subject of the next section of this letter.

C. Circumstances Where Departure from AES Inquiry Report Warranted

We address below Item 6 in Commission Letter dated August 18, 2014, which requested that FEI address "for each area in the Application where significant differences remain, the specific facts and circumstances that support FEI's departure from the Guidelines and Recommendations outlined in the AES Inquiry Report." There are two main areas where departure from the AES Inquiry Recommendations is warranted, and they are referenced in the Application under the heading "Sections Where Significant Differences Remain".[6] These were referenced by Corix in its July 14, 2014 letter. FEI will address each circumstance in turn.

Code of Conduct Section 2 - Shared Services and Personnel

FEI's proposed wording with respect to sharing of services and personnel with an ARBNNM is appropriate. It precludes the sharing of business development staff, but

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[4] See AES Inquiry Report, Appendix H, p.4.

[5] Application, pp. 6 – 9

[6] Application, starting at p.6.

otherwise provides flexibility for resource sharing arrangements that benefit both FEI ratepayers and ARBNNM ratepayers.

The Commission's AES Inquiry Report "guidelines" applicable to the use of an affiliated regulated business to pursue a new regulated business activity were set out on p.25-26 of the Report. The two quoted by Corix, and about which there is debate, are as follows:[7]

> The sharing of any common resources between a natural monopoly affiliate and an affiliate that is a regulated business in a non-natural monopoly environment, however, should be much more limited. As a rule, resource sharing should be limited to corporate services and should not include any operational services except possibly emergency services.
>
> Sharing of employees should not be allowed where the employee has access to confidential information, routinely participates in making decisions with respect to the provision of traditional utility services or how utility services are delivered, routinely deals with or has direct contact with customers of the utility or is routinely involved in planning or managing the business of the traditional utility.

FEI's proposal narrows the scope of the prohibition in a manner that is both operationally practical and focussed on the key concern when it comes to employee sharing. The proposal is quoted below for ease of reference:

> 2. Shared Services and Personnel
>
> a) This Code recognizes the potential benefits to the [FortisBC Energy] and ARBNNM regulated ratepayers in sharing resources.
>
> b) [FortisBC Energy] may provide shared services and personnel noted in section (c) below to ARBNNMs while ensuring that its ratepayers will not be negatively impacted by [FortisBC Energy]'s involvement. The costs of providing such services will be as agreed upon by both [FortisBC Energy] and the ARBNNM and be in accordance with the Commission approved [FortisBC Energy] Transfer Pricing Policy for ARBNNMs.
>
> c) ARBNNMs may contract for corporate services including senior management and operating personnel from [FortisBC Energy] using the Commission approved [FortisBC Energy] Transfer Pricing Policy for ARBNNMs, providing [FortisBC Energy] complies with Section 3 of this Code, Provision of Information by [FortisBC Energy], and no conflict of interest exists which will negatively impact ratepayers.

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[7] AES Inquiry Report, p. 25

There are three main reasons why FEI's proposal is appropriate.

First, FEI's proposed approach precludes the sharing of business development personnel (since they are not listed as a resource that may be shared in item c). This was the primary objection raised in the past by stakeholders when it came to sharing of personnel. With the proposed language, FEI has in effect established an appropriate degree of separation for its interaction with FAES for business development personnel.

Second, the Commission's Report guidelines quoted above are worded in a manner that is overly broad for use as wording for a CoC and as a result extends restrictions to instances where concerns should not arise. A CoC should be focussed on a realistic potential for commercially sensitive information to be transmitted to the ARBNNM to the detriment of the utility or unjust benefit of the ARBNNM. The general wording would preclude sharing of resources in circumstances where customers of both utilities can realistically only benefit from sharing, and where there is little risk that confidential information could be abused by the ARBNNM. For example:

- The wording of the second guideline quoted above would exclude most FEI managers from being shared irrespective as FEI managers are involved in some way in planning or managing the business of the traditional utility. Most managers outside of business development, such as those working in the IT, Finance, or Human Resources departments, are unlikely to have any truly commercially sensitive information.

- Precluding the sharing of all operational services other than emergency services is not justifiable from a ratepayer perspective, particularly when appropriate transfer pricing mechanisms are in place. These operational services are typically provided by unionized employees "on the ground" in service vehicles etc. FEI customers benefit from the optimization of FEI employees and TES customers of FAES benefit from the opportunity to lower costs. Operational employees are unlikely to have, or transmit, commercially sensitive information that should be the focus of a CoC.

The only parties that benefit under the arrangement contemplated by the "guideline" are competitors that (a) wish to add costs to FAES' operations and (b) are not subject to similar CoC restrictions.

Third, FEI's proposed wording is consistent with the wording contained in FEI's existing Code of Conduct for Non-Regulated Businesses (NRBs) which have served to adequately protect FEI ratepayers from the misuse of utility information for many years. FEI's Code of Conduct for NRBs provides:

2. **Shared Services and Personnel**

a) This Code recognizes the need for and potential benefits to the Utility of employee transfers and human resource sharing.

b) [FortisBC Energy] may provide shared services to NRBs, including supervision and management, while ensuring that ratepayers will not generally be negatively impacted by Utility involvement. The costs of providing such services will be as agreed upon by both parties and be in accordance with the Commission approved [FortisBC Energy] Transfer Pricing Policy.

c) NRBs may contract for any Utility personnel using the Commission approved [FortisBC Energy] Transfer Pricing Policy, providing the Utility complies with Section 4 of this Code, Provision of Information by [FortisBC Energy Inc.], and no conflict of interest exists which will negatively impact on ratepayers.

The Commission found in the AES Inquiry Report that "many of the objectives and principles of Retail Markets Downstream of the Utility Meter (RMDM) Inquiry remain relevant and applicable today. In this Report, the Commission Panel has generally based its findings on RMDM…".[8] There is no principled rationale why the obligations imposed by the CoC for ARBNNM should be more onerous than those approved by the Commission for NRBs following the RMDM inquiry.

Transfer Pricing Policy – Section 1 Pricing Rules, (ii) and Section 2 Determining Costs

An AES Inquiry "recommendation" / "guideline" was that the transfer pricing should be based on "the higher of market price or fully allocated cost",[9] which is the same approach as in FEI's current TPP for NRBs. FEI proposes a transfer pricing policy based on the use of "no greater than full cost" instead of "the higher of market price or fully allocated cost". FEI submits that its proposed approach:

- better reflects the need to protect the interests of customers of FAES as well as customers of FEI;
- is consistent with cost causality; and
- better reflects the scope of the Commission's jurisdiction.

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[8] AES Inquiry Report, Appendix H, p.5 identified it as a "recommendation". On p.33, it was characterized as a "guideline".

[9] AES Inquiry Report, Appendix H, p.4.

On the first point, FEI's proposed wording of "no greater than full cost" for setting of transfer prices for services provided to ARBNNMs is positioned between an incremental cost and fully allocated cost approach. This incremental cost plus approach recognizes the need to prevent cross subsidization (i.e. recovering the incremental costs) and to provide a fair pricing structure which recognizes the interests of both sets of regulated ratepayers (FEI's gas customers and FAES' thermal energy customers). An approach contemplating "higher of" is not in the interests of FAES customers and does not promote the efficient use of FEI's resources either.

The fact that FAES is a regulated public utility with customers equally deserving of the Commission's consideration distinguishes this situation from the relationship between FEI and a non-regulated affiliate (NRB). Charging higher than FEI's full cost is tantamount to expressing a preference for natural gas customers to the detriment of thermal energy customers. By analogy, the Commission would never entertain encouraging the British Columbia Hydro and Power Authority (BC Hydro) to deliberately overcharge FortisBC Inc. for electricity under BC Hydro Rate Schedule 3808 to the detriment of FortisBC customers, and this should be no different. The appropriate outcome is one that is fair to the customers of both regulated entities.

On the second point, the AES Inquiry Report specified as a Key Principle "The basis of cost allocation is cost causality." In making this recommendation in the AES Inquiry Report, the Commission expressly stated its concern that transfer pricing must be free of all forms of cross-subsidization:

> For those new business activities provided through a Regulated or Non-Regulated Affiliated Business or a Separate Class of Service, costs are to be allocated to the new business or shareholder, on the basis of the higher of market price or the fully allocated cost, and be free of all forms of cross-subsidization from the traditional utility.[10] [emphasis added]

There is no way to justify charging more than FEI's full cost based on principles of cost causality. The concern with cross-subsidization would be fully addressed by the requirement to charge affiliates for services on a "fully allocated cost" basis. Requiring FEI to charge FAES the higher of fully allocated cost or "market price" represents a deliberate cross subsidy of FEI customers by FAES customers by requiring FAES customers to pay more for services than it costs FEI to provide those services.

FEI's third point is that the Commission would exceed its jurisdiction by requiring transfer pricing based on the "higher of market price or the fully allocated cost". The

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[10] AES Inquiry Report, p. 33.

Commission in the AES Inquiry Report expressly acknowledged that the regulation of Competition was not the role of the Commission:

> While the Commission does not regulate competition per se, the Panel accepts that it should not act to hinder competition, where competition is feasible. In this regard, the Commission Panel confirms that there must be no cross-subsidization when a utility purports to enter a competitive market."[11] [emphasis added]

The legal impediment to implementing a TPP based on the "recommendation/guideline" is that, since cost causality is addressed, and cross subsidization eliminated, by full cost alone, requiring FEI to charge the "higher of" full cost and market price can only be explained by a policy of actively promoting competition, i.e., a concern that even the fully allocated cost of service provided by traditional utilities might give FAES an advantage if other providers of TES cannot provide services at that rate. This is, in effect, an implicit subsidy of FAES' competitors at the expense of FAES and its customers. The Commission should be regulating to ensure that FAES's customers are treated fairly, which this "guideline" approach does not do.

FEI's proposal in this regard is supported by all stakeholders other than those representing FAES' competitors. Stakeholder comments documented in Appendix B1 Proposed FEI Code of Conduct May 15, 2014[12], echo all three of the above points.

- ***BCOAPO:*** BCOAPO commented that the use of Higher of Market Price or Fully Allocated cost would benefit competitors and hurt ratepayers. The interest of ratepayers on both sides of the FEI/FAES divide are best advanced by requiring FAES to pay the LOWER of market or fully allocated cost as long as FEI recovers incremental cost plus a premium. It's clearly not beneficial when the system disadvantages FEI/FAES relative to those operating only in non-monopoly environments. Receiving the LOWER of market or fully allocated cost benefits FAES ratepayers relative to having a non-monopoly company get the business because they can charge less. That is, shutting FAES out of the business, or preventing them from competing on equal terms does not advance the interests of FAES ratepayers. BCOAPO's interest is to see the market develop in a way that benefits ratepayers and involves all players, and FEI/FAES should not be disadvantaged. There are a lot of efficiencies to be gained from sharing services. We need to deviate from RMDM model as it was not in the best interest of ratepayers.

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[11] AES Inquiry Report, p.14.

[12] See pages 6 – 10.

- ***BC Sustainable Energy Association (BCSEA)***: BCSEA commented that if customers are all regulated, then the Commission has the responsibility for protecting both sets of customers and ensuring appropriate prices are used. BCSEA noted that cross-subsidization can go both ways and there is a need to be careful that FAES does not end up subsidizing FEI. Sharing of resources between two large utilities, such as FEI and BC Hydro, will benefit both sets of ratepayers. It's more an issue of how to value the service. BCSEA's principal interest is in promoting innovative energy solutions in B.C.

- ***The Commercial Energy Consumers Association (CEC):*** CEC expressed concern about using Market Price and was not sure there is a Market Price, or way to discover a Market Price. This is more a cost allocation issue for ratepayers affected. Customers of regulated utilities have rights.

- ***The Canadian Office and Professional Union local 378 (COPE):*** COPE commented that the Commission has no obligation to non-regulated customers but does to regulated customers. The Commission's decisions can suffocate development of alternative energy in B.C. The RMDM was designed to maximize every benefit for gas ratepayers by ensuring ratepayers got every nickel they could out of expansion of the sphere of the utility. If FEI is required to charge higher of market price or full cost, the introduction of a notional surcharge indicates a form of cross-subsidization from FAES to FEI.

  The COPE comments further that the Commission should not venture into a role outside its jurisdiction. The BCUC does not have a role in the market development of the Thermal Energy Services marketplace. Some parties are claiming to be seeking more open competition but may be actually constraining the development of the Thermal Energy Services marketplace. Constraints are being placed on the domestic utility but not on Corix, so not a level playing field. By not allowing FEI to share resources with its regulated affiliate, the victims would be ratepayers who would be required to pay for the duplication of resources.

- ***FAES:*** FAES suggests the overarching principle of Cost Causality stated in the AES Inquiry Report is inconsistent with the principle of using Higher of Market Price or Fully Allocated Cost for the Transfer Price, also found in the AES Inquiry Report.

FEI has also noted in the Application, Appendix B1 Proposed Code of Conduct May 15, 2014, pages 6 -10, that in most cases, given FEI's market-based compensation policy, for FEI's resources being provided and costs, their market price is the same as the fully allocated cost. FEI referred stakeholders to Slide 56 included in the April 24 workshop

material where FEI's fully loaded labour rates for the type of labour resources being provided are compared to the labour rates available in the marketplace. As a result of its market based approach, FEI labour rates charged are consistent with the market price or fully allocated cost. Given this, removing the reference to market pricing in the Code of Conduct would be more consistent with the cost causality principle and address some stakeholder concerns that using Higher of Market Pricing or Fully Allocated Cost would benefit competitors and hurt FAES' customers.

Further Comments

At the time of the AES Inquiry in 2011 and 2012, the TES business was being developed entirely within FEI and the focus of the Inquiry was on FEI's venture into new areas of business. The thermal energy business was nascent. The ratepayers represented by intervener groups were invariably gas customers, not thermal energy customers, and tended to express concern about (or opposition to) FEI's involvement in developing thermal energy projects. Although only two years has passed since the AES Inquiry concluded, much has changed:

- FEI is no longer in the TES business.
- FAES is a separate regulated utility.
- The Commission has affirmed that thermal energy projects provide a regulated utility service.
- Municipal rules have changed, giving rise to a more concrete potential for a significant number of energy users being thermal energy customers and not gas customers in the not too distant future.
- Transfer pricing is being addressed in this process in a clear and transparent manner.
- Stakeholders other than those representing FAES' competitors are expressing support for the shared use of employees because of the efficiencies and benefits that it brings to both gas and thermal energy customers.
- Stakeholders other than those representing FAES' competitors are expressing concerns that such strict code of conduct rules may actually be impeding thermal energy market development.

FEI submits that the adoption of the suggested wording as outlined in the AES Inquiry Report would be difficult to operationalize and severely limit the opportunities and resources being shared. FEI's customers will benefit when employees can be optimized. At the same time, FAES and its customers would be deprived of benefiting from economies of scope, while the shareholders of FAES' competitors get the benefit of what amounts to a subsidy of their business. FEI's proposed wording is adequate as the onus is on FEI to operate accordingly. Commission oversight exists to ensure compliance.

D. Third Area of Disagreement: Code of Conduct Section 8 Financing and Other Risks

The third area of disagreement is one where FEI's proposal is consistent with the Commission's AES Inquiry Report, and the Coalition (an intervener representing thermal energy competitors of FAES) is seeking to impose a more onerous requirement. FEI submits that its proposal is appropriate and should be accepted for the reasons described below.

AES Inquiry Report Principle and Guideline

In the AES Inquiry Report, under the heading "Principles and Guidelines for Determining Cost Allocation for Regulated Utilities,[13] the Commission set out the following one and only "Key Principle":

> "The basis of cost allocation is cost causality."

The Guidelines included:

- Allocation of costs is to reflect appropriate compensation for any benefit derived by the new business activity as a result of its affiliation with its parent or other businesses. This should include compensation for additional cost or risk related to the addition of incremental debt to the parent utility for the new products or services.

The Commission also provided Guidelines under the heading "Principles and Guidelines for Determining Allocation of Risk for Regulated Utilities"[14]

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[13] AES Inquiry Report, p. 33

[14] AES Inquiry Report, p. 35

- The risk of unrecovered costs (including, but not limited to, start up, operating and capital costs) is to be borne by the Affiliated Regulated Business or Separate Class of Service or the shareholder. If costs related to the new business activity cannot be recovered from new business customers in a reasonable period of time (as approved by the Commission) these costs will be borne by the shareholder.
- All proposals for new business activities should be accompanied by a risk management plan. The risk management plan should address:
  - The anticipated level of risk that would be faced by the traditional ratepayer, the new business ratepayer, and the shareholder; and
  - How the incremental costs from these risks will be allocated among these groups.

FEI's proposed wording reflects these Guidelines and Key Principle. It provides:

8. Financing and Other Risks

Unless approved by the Commission, [FortisBC Energy] will not undertake any financing or other financial assistance on behalf of an ARBNNM that exposes [FortisBC Energy] ratepayers to additional costs or risks, unless appropriate compensation is received by [FortisBC Energy] for such financing or other financial assistance, including compensation for additional cost or risk related to the addition of incremental debt to [FortisBC Energy] for a project carried out by the ARBNNM.

The Coalition believes a prohibition on lending to affiliates by FEI is warranted.

Rationale for Developing a Provision Consistent with Guideline

There is a compelling rationale for adopting FEI's proposal:

- First, it is consistent with the key principle of cost causality.
- Second, there is no harm to natural gas ratepayers and no cross-subsidization of either FEI or FAES, as there is compensation for any additional cost or risk. Debt issuance by FAES, whether with a third party or an affiliate, is reviewed and approved by the Commission under section 50 of the UCA on a case-by-case basis.

Response to Commission Staff Proposal

Commission Staff have indicated that they agree with the proposed wording from FEI. However, they have suggested two additional paragraphs referencing: 1) The risk of

unrecovered costs is to be borne by the Affiliated Regulated Business or Separate Class of Service or the shareholder; 2) All proposals for new business activities should be accompanied by a risk management plan. FEI submits these additions are not appropriate.

- Regarding Commission Staff's first suggested addition, it is not lawful to pre-judge the recovery of costs. As established by appellate legal authorities, and as the Commission has previously recognized, a utility's costs are subject to a rebuttable presumption of prudency, and a review of a utility's costs should follow the two-part test arising from *Enbridge Gas v. Ontario*. The suggested addition violates these well-established legal principles regarding cost recovery for public utilities.

- Regarding Commission Staff's second suggested addition, the Code of Conduct is intended to govern ongoing interactions between FEI and ARBNNMs. It is not intended to provide guidance to a hypothetical future situation, and pre-determine the structure and risk mitigation required (if any) from a new line of business. If FEI decides to venture into a new regulated line of business, it will likely have to seek Commission approval, for instance for a CPCN or for rates to be charged. Therefore, inclusion of the need for a risk management plan as part of the Code of Conduct is neither appropriate nor necessary.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

Yours truly,

FASKEN MARTINEAU DuMOULIN LLP

[Original signed by:]

Matthew Ghikas

MTG/fxm