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**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER** G-20-07

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**IN THE MATTER OF
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473**

and

**FortisBC Inc.
2006 Annual Review, 2007 Revenue Requirements and
Negotiated Settlement Process**

BEFORE: L.F. Kelsey, Commissioner
L.A. Zaozirny, Commissioner February 22, 2007

O R D E R

WHEREAS:

- A. Commission Order No. G-58-06 approved for FortisBC Inc. ("FortisBC" or "Company") a Performance Based Regulation Settlement for the years 2007 to 2009 (the "PBR Settlement"). The PBR Settlement requires FortisBC to hold an Annual Review, Workshop and Negotiated Settlement Process ("NSP") each November with a goal of achieving firm rates by December 1st for the following year; and
- B. The Annual Review compares the Company's actual performance for the recently completed year to the approved targets for the Performance Standards and to determine whether the Company is entitled to an incentive payment. The Revenue Requirements Workshop is to focus on future test periods and the NSP is to establish rates for the following year; and
- C. One of the items in the PBR Settlement required that for 2006, FortisBC was to continue to record Construction Work in Progress ("CWIP") subject to Allowance for Funds Used During Construction ("AFUDC") in rate base with a reduction to revenue requirements by the amount of the AFUDC. Beginning in 2007, FortisBC was to include only CWIP not subject to AFUDC in rate base and calculate interest expense and cost of equity only on Plant in Service and other costs approved for rate base treatment; and

- D. By Order No. G-118-06, the Commission established a Regulatory Timetable for the 2006 Annual Review and a 2007 Revenue Requirements Workshop on November 9, 2006, followed by an NSP on November 10, 2006; and
- E. On September 29, 2006, FortisBC filed its Preliminary Revenue Requirements which sought a 2.9 percent (revised in the November 1, 2006 Update to a 2.1 percent) general rate increase effective January 1, 2007 and proposed to delay the removal of CWIP subject to AFUDC from rate base as required by the PBR Settlement until such time that the change becomes revenue neutral or appropriate in the context of the relevant revenue requirements application. FortisBC forecasts that removing CWIP subject to AFUDC from rate base in 2007 and the associated reduction to revenue requirements would increase rates by a further 2.1 percent. In the responses to information requests (BCUC IR 3.1 and 3.2), FortisBC was unable to estimate what year the removal of CWIP subject to AFUDC could occur or the threshold percentage rate increase that represented rate shock; and
- F. A proposed Settlement Agreement, which included a delay in the removal of CWIP subject to AFUDC from rate base for 2007 only to allow for further study, was agreed to by FortisBC and some Intervenors, with the participation of Commission staff. Letters of support to the proposed Settlement Agreement were received from the British Columbia Old Age Pensioners' Organization et al ("BCOAPO") and from FortisBC; and
- G. In its letter of comment the Interior Municipal Electrical Utilities ("IMEU") stated that it is in agreement with all parts of the proposed Settlement Agreement except for the proposed treatment of CWIP and AFUDC. The IMEU sees no reason to deviate from the treatment CWIP and AFUDC treatment established in the PBR Settlement. The IMEU also expects that the FortisBC general rate increase for 2007 will be less than 2 percent when the British Columbia Hydro and Power Authority final rates are flowed through. The IMEU estimates that future FortisBC rate increases will be in the range of 4 to 5 percent therefore 2007 is the optimal time to absorb the rate impact of the CWIP and AFUDC treatment change without rate shock; and
- H. In view of the IMEU submission, FortisBC, BCOAPO and the IMEU advised the Commission that they would support a severing of the treatment of CWIP and AFUDC from the proposed Settlement Agreement for a separate determination by the Commission. No letters of comment were received from registered intervenors who did not participate in the settlement process; and

**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER** G-20-07

3

- I. By Order No. G-162-06, the Commission approved the Settlement Agreement, except for the proposed delay in the removal of CWIP subject to AFUDC from rate base; and
- J. Order No. G-162-06 also determined that the proposed delay in the removal of CWIP subject to AFUDC from rate base would be examined separately and the Commission established a timetable for written submissions on this issue with submissions due from FortisBC by January 5, Intervenor comments by January 12, and FortisBC reply by January 17, 2007; and
- K. The Commission has reviewed the submissions received on the proposed delay in the removal of CWIP subject to AFUDC from rate base and finds that a determination is required.

NOW THEREFORE the Commission orders as follows with Reasons for Decision attached as Appendix A:

- 1. The Commission is not persuaded that a further delay is appropriate for the removal of CWIP subject to AFUDC from rate base as required under the PBR Settlement and that FortisBC's proposal should be denied.
- 2. FortisBC is to increase its customer rates by 2.1 percent effective with its next monthly billing to recover over the remainder of 2007 the additional revenue requirement of \$4.135 million that results from the removal of CWIP subject to AFUDC from rate base, as identified in FortisBC's January 5, 2007 submission.
- 3. Any unrecovered balance of the additional revenue requirement of \$4.135 million that results from the removal of CWIP subject to AFUDC from rate base is to be recorded by FortisBC in a non-rate base deferral account bearing interest at its short term interest rate to be recovered in customer rates over 2008.
- 4. FortisBC is to advise its customers of the rate increase by way of an appropriate notice in customers' bills.
- 5. The Commission will accept, subject to timely filing, amended Electric Tariff Rate Schedules in accordance with the terms of this Order.

DATED at the City of Vancouver, in the Province of British Columbia, this 9th day of March 2007.

BY ORDER

Original signed by:

L.F. Kelsey
Commissioner

Attachment

FortisBC Inc.
2006 Annual Review, 2007 Revenue Requirements and
Negotiated Settlement Process
Proposed Delay in the Removal of Construction Work in Progress subject to Allowance for Funds Used
During Construction from Rate Base

REASONS FOR DECISION

1.0 INTRODUCTION

1.1 2007 Preliminary Revenue Requirements

On September 29, 2006, FortisBC Inc. (“FortisBC”, the “Utility”) filed its 2007 Preliminary Revenue Requirements (“2007 Revenue Requirements”) in accordance with the 2007-2009 Performance Based Regulation Settlement (the “PBR Settlement”) approved by Commission Order No. G-58-06 and the regulatory timetable established by Order No. G-118-06. The PBR Settlement requires FortisBC to hold an Annual Review, Workshop and Negotiated Settlement Process (“NSP”) each November with a goal of achieving firm rates by December 1st for the following year. The 2007 Revenue Requirements sought a 2.9 percent (revised in the November 1, 2006 Update to a 2.1 percent) general rate increase effective January 1, 2007.

The Commission approved PBR Settlement provides that beginning in 2007, FortisBC is to include only Construction Work in Progress (“CWIP”) not subject to Allowance for Funds Used During Construction (“AFUDC”) in rate base and calculate interest expense and cost of equity only on Plant in Service and other costs approved for rate base treatment. The 2007 Revenue Requirements, however, did not include this required change in the treatment of CWIP subject to AFUDC. FortisBC estimates that the change with the associated reduction to revenue requirements would increase rates by a further 2.1 percent and, therefore, proposed to delay the removal of CWIP subject to AFUDC from rate base as required by the PBR Settlement until such time that the change becomes revenue neutral or appropriate in the context of the relevant revenue requirements application. FortisBC, however, could not be more precise as to when, in the future, the required change could occur or when the projected percentage rate increase would be less significant (BCUC IRs 3.1 and 3.2).

1.2 2006 NSP, Proposed Settlement Agreement and 2007 Rates

In accordance with Order No. G-118-06, the 2006 Annual Review and a 2007 Revenue Requirements Workshop were held on November 9 followed by an NSP on November 10, 2006. At the NSP a proposed Settlement Agreement, which included a delay in the removal of CWIP subject to AFUDC from rate base for 2007 only to

allow for further study, was agreed to by FortisBC and some Intervenor, with the participation of Commission staff. Letters of support to the proposed Settlement Agreement were received from the British Columbia Old Age Pensioners' Organization et al ("BCOAPO") and from FortisBC. No letters of comment were received from registered intervenors who did not participate in the Settlement process.

In its letter of comment, the Interior Municipal Electrical Utilities ("IMEU") stated that it is in agreement with all parts of the proposed Settlement Agreement except for the proposed treatment of CWIP and AFUDC. The IMEU saw no reason to deviate from the CWIP and AFUDC treatment established in the PBR Settlement. The IMEU also expected that the FortisBC general rate increase for 2007 will be less than 2 percent when the British Columbia Hydro and Power Authority ("BC Hydro") final rates are flowed through. The IMEU estimated that future FortisBC rate increases will be in the range of 4 to 5 percent and suggested, therefore, that the circumstances in 2007 are optimal to absorb the rate impact of the CWIP and AFUDC treatment change without rate shock. The IMEU believes that spending the next year studying the impacts of the CWIP change will eliminate the ability to take advantage of a unique opportunity.

In view of the IMEU submission, FortisBC, BCOAPO and the IMEU advised the Commission that they would support a severing of the treatment of CWIP and AFUDC from the proposed Settlement Agreement for a separate determination by the Commission.

By Order No. G-162-06, the Commission approved the Settlement Agreement, except for the proposed delay in the removal of CWIP subject to AFUDC from rate base (the "Settlement Agreement"). Order No. G-162-06 also determined that the proposed delay in the removal of CWIP subject to AFUDC from rate base would be examined separately and the Commission established a timetable for written submissions on this issue with submissions due from FortisBC by January 5, Intervenor comments by January 12 and FortisBC reply by January 17, 2007.

The Settlement Agreement reflects a 2.1 percent general rate increase based on the FortisBC November 1, 2006 Update and approved interim rates for BC Hydro and British Columbia Transmission Corporation ("BCTC"). The Settlement Agreement provided that if the final rate increases for BC Hydro and BCTC were approved by the Commission on or before November 30, 2006 then FortisBC would flow-through the difference between the interim and permanent rates for BC Hydro and BCTC when calculating the FortisBC permanent January 1, 2007 rates. By Order No. G-139-06 dated November 9 and Order No. G-143-06 dated November 10, 2006, the Commission approved final F2007 rates for BCTC and BC Hydro respectively.

On December 22, 2006, FortisBC filed 2007 permanent rate schedules for a 1.2 percent general rate increase to be effective January 1, 2007 in accordance with Order No. G-162-06 and reflecting the flow-through of the approved final F2007 rates for BCTC and BC Hydro. The Commission reviewed the FortisBC 2007 rate calculations and by letter dated December 22, 2006 approved the filed rates.

2.0 SUBMISSIONS ON THE PROPOSED DELAY IN THE REMOVAL OF CWIP SUBJECT TO AFUDC FROM RATE BASE

2.1 FortisBC's Submission

FortisBC proposes to delay the removal of CWIP subject to AFUDC from rate base for the following reasons:

- The timing and magnitude of the Utility's capital expenditure program gives rise to a higher AFUDC value in 2007 than in previous years (FortisBC Submission, p. 2).
- A further delay in implementation may reduce the one-time rate impact as a result of a lower AFUDC value and the growth in revenue requirements due to customer and load growth (FortisBC Submission, p. 3).
- Regardless of the year when the removal of CWIP subject to AFUDC from rate base occurs, an increase in shareholder earnings may result in that year (approximately \$2.7 million in 2007) and may impact shareholder earnings on an ongoing basis (FortisBC Submission, pp. 3, 6, Table 1).
- By including CWIP subject to AFUDC in rate base the revenue requirements and income statement produce the same results and provides a transparency in accounting which is the principal reason the Utility recommended a continuation in 2006 of its existing method. By excluding CWIP subject to AFUDC from rate base produces different results on revenue requirements compared to the income statement (FortisBC Submission, pp. 5-6, Table 1).
- Implementing the change in 2007 will increase revenue requirements by \$4 million and increase rates by 2.1 percent (FortisBC Submission, p. 6).
- Even if the IMEU's projections of future annual rate increases in the range of 4 to 5 percent over the remainder of the PBR term are borne out, the mitigation of future rate increases should not be the predominate issue under consideration. If at the time of implementation, the rate increase is onerous it could be deferred and amortized over multiple years (FortisBC Submission, p. 7).
- The Utility cannot predict with certainty the year in which the rate impact from implementing the change in the treatment of CWIP would be acceptable. FortisBC provided Table 2 which estimated the potential change in incremental revenue requirement for the years 2001 to 2007 that would have occurred by excluding CWIP from rate base (FortisBC Submission, pp. 8-9, Table 2).

FortisBC concluded that while the Utility is not averse to adopting a revenue requirements methodology consistent with other provincial utilities, the change may result in significant unintended impacts for customers and the shareholder that will be mitigated by delaying the implementation. FortisBC's 2007 revenue requirements would increase by \$4.135 million if CWIP subject to AFUDC is excluded from rate base (FortisBC Submission, p. 12).

2.2 Intervenor Submissions

By letter dated January 11, 2007, BCOAPO supported FortisBC's January 5, 2007 submission. BCOAPO understood the IMEU's concerns about implementing the change in a year in which an annual rate increase is significantly higher than that agreed to in 2007, but submitted that there was not sufficient evidence at the negotiated settlement to assess either the potential level of rate increase for 2008 and beyond nor the impact of making the change in 2008 and beyond. BCOAPO also submitted that further study of the issue is required and that the IMEU's assumptions about ratepayer impact in future years may well be wrong. Accordingly, BCOAPO submitted that the removal of CWIP subject to AFUDC from FortisBC's rate base should not proceed for 2007 and that the issue should be revisited after further study in FortisBC's 2008 Revenue Requirements Application.

By letter dated January 15, 2007, the IMEU confirmed that it had nothing further to add to its November 30, 2006 Letter of Comment to the proposed Settlement Agreement, which had noted that FortisBC is unable to provide any comfort around when the CWIP change would have no impact, nor was an opinion offered by FortisBC with respect to what rate shock constitutes (Commission Order No. G-162-06, Appendix A, p. 8).

2.3 FortisBC Reply

On January 17, 2007 FortisBC filed its reply to the Intervenor submissions. FortisBC noted BCOAPO's support for the delay in the removal of CWIP subject to AFUDC from rate base and the Utility indicated its intent to provide an analysis of the impact of changing its treatment of CWIP subject to AFUDC for 2008 during the 2007 Annual Review and 2008 Revenue Requirements Application, and if required, in subsequent years.

FortisBC acknowledged the IMEU's submissions of November 30, 2006 and January 15, 2007 where the IMEU estimated annual rate increases of 4 to 5 percent during the term of FortisBC's PBR Settlement and the IMEU's stated preference for a change in treatment of CWIP in 2007, given the low rate increase of 1.2 percent. FortisBC submitted that the IMEU's estimate of future rate increases is unsupported and should not form the basis for the decision on this issue.

The Utility also submitted that while the change in treatment of CWIP subject to AFUDC is desirable from a consistent utility treatment perspective, it would result in a significant customer impact with little or no associated customer benefit and, therefore, is not in the interests of customers at this time.

3.0 COMMISSION DECISION

In accordance with Article 24 of the 2007-2009 PBR Settlement, Appendix I to Commission Order No. G-58-06, “CWIP Attracting AFUDC in Rate Base”, it was agreed by all parties, and approved by the Commission, that “Beginning in 2007 the Company will change to the method used by other utilities”. Article 24 notes that “FortisBC includes CWIP subject to AFUDC in Rate Base, and reduces Revenue Requirements by the amount of AFUDC and that other Canadian utilities include only CWIP not subject to AFUDC in Rate Base and calculate interest expense and the cost of equity only on Plant in Service and other costs approved for Rate Base treatment”.

While the PBR Settlement contemplated that CWIP attracting AFUDC would be included in Rate Base for 2006, it required that this would not occur in 2007 and the issue before the Commission now is FortisBC’s request to further delay the removal of CWIP subject to AFUDC from Rate Base as required in the PBR Settlement “until such time as the change becomes revenue neutral or appropriate in the context of the relevant revenue requirements application”.

In evaluating FortisBC’s proposal to delay, the Commission has considered the Utility’s reasons to delay the removal that are summarized in Section 2.1 of these Reasons for Decision and the submissions of other parties.

FortisBC attributes the timing and magnitude of its capital expenditure program as giving rise to a higher AFUDC value in 2007 and proposes a further delay to reduce the one-time impact (FortisBC Submission, pp.; 2-3). The Commission notes that if the change in treatment in CWIP had occurred as recently as 2006, the increase in revenue requirement would have been approximately \$1.1 million (FortisBC Submission, p. 9, Table 2).

FortisBC cites transparency in accounting as a reason to continue its existing treatment. In the Commission’s view, this is somewhat theoretical since FortisBC, in its response to BCUC IR 53.1.2 of the 2006 RRA, confirmed that the Utility provides a reconciliation of its financial statements to its regulatory schedules in its Annual Report to the BC Utilities Commission with adjustments, as required, for revenues, expenses, assets and liabilities including items for Walden Power Partnership and incentive adjustments.

FortisBC also suggests that the change in treatment may result in an increase in shareholder earnings in that year (approximately \$2.7 million in 2007) and may impact shareholder earnings on an ongoing basis (FortisBC Submission, pp. 3, 6, Table 1). The Commission notes that the \$2.7 million cited by FortisBC in Table 1 is a change in the income statement net earnings. Since the Commission approves changes in rates based on approved changes in revenue requirements, including the cost of capital, the identified change in net income is not significant. The Commission notes that while the removal of CWIP subject to AFUDC in rate base would result in an increase in FortisBC's 2007 Revenue Requirements, there is also a reduction in the cost of debt and cost of equity (FortisBC Submission, p. 12).

FortisBC states that it cannot predict with any certainty the year in which the rate impact from implementing the change in treatment of CWIP would be more acceptable and that it intends to provide an analysis of the impact of changing its treatment of CWIP subject to AFUDC for 2008 during the 2007 Annual Review and 2008 Revenue Requirements Application, and if required, in subsequent years (FortisBC Submission, p. 8 and FortisBC Reply Submission). Without a forecast from the Utility of which year the rate impact would be acceptable, the Commission does not find that FortisBC has made a persuasive argument to delay removing CWIP subject to AFUDC from rate base.

The Commission notes FortisBC's submission that the IMEU's estimate of future rate increases is unsupported and should not form the basis for a decision. The Commission, however, also finds that FortisBC has not provided compelling evidence or reasonable comfort as to whether and when a further delay in implementation "may reduce the one-time impact" and when "it is probable that the impact of the change in treatment will be lower at some future time, compared to 2007 (January 5 Submission, pp. 3 and 9 – Emphasis added). The Commission is also not persuaded that a further period of study will provide significant assistance in this regard to justify a further delay.

In these circumstances, therefore, the Commission considers that it would be more prudent to proceed now with the change than to wait another year or years to find a more optimal year which may or may not occur for some time. Furthermore, the Commission does not take comfort in FortisBC's proposition that, should be IMEU's projections of future annual rate increases be borne out and the rate increase at the time of implementation is onerous, it could be deferred and amortized over multiple years.

The Commission considers that the identified rate increase of 2.1 percent that would result if the change in treatment of CWIP occurs in 2007, combined with the permanent rate increase of 1.2 percent approved by Commission Order No. G-126-06, represents a rate increase of some significance (and is certainly higher than had it been made in 2006). The Commission also considers, however, that it is in the best interests of FortisBC's customers that the change not be further delayed.

The Commission considers that the change required by the PBR Settlement, as agreed to by the parties to the PBR Settlement, is appropriate, and consistent with the approach used by other regulated utilities in B.C.

Order No. G-162-06 provided that the "2007 revenue requirement impact, if any, of the Commission determination on the proposed delay in the removal of CWIP subject to AFUDC from rate base is to be effective from January 1, 2007 and is to be recovered on a prospective basis." Accordingly, the Commission requires that FortisBC increase its customer rates by 2.1 percent effective with its next monthly billing to recover over the remainder of 2007 the additional revenue requirement of \$4.135 million shown on page 12 of the FortisBC Submission. Any unrecovered balance of this additional revenue requirement of \$4.135 million is to be recorded in a non-rate base deferral account bearing interest at the short term interest rate to be recovered in customer rates over 2008.