BRITISH COLUMBIA UTILITIES COMMISSION

ORDER NUMBER G-199-08

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

and

An Application by FortisBC Inc.
for Approval of a Subcontractor Agreement
between FortisBC Inc. and Fortis Pacific Holdings Inc.
for the Supply of Resources to the Brilliant Expansion Power Corporation

BEFORE: L.F. Kelsey, Commissioner
P.E. Vivian, Commissioner
D.A. Cote, Commissioner

December 18, 2008

O R D E R

WHEREAS:

A. On August 26, 2008, FortisBC Inc. ("FortisBC") applied to the British Columbia Utilities Commission (the "Commission") pursuant to the applicable provisions of the Utilities Commission Act (the "Act") and in particular section 60 for an order approving the Subcontractor Agreement dated May 31, 2008 between Fortis Pacific Holdings Inc. ("FPHI") and FortisBC for the supply of resources to the Brilliant Expansion Power Corporation ("BEPC"); and

B. On October 3, 2008 and November 24, 2008, FortisBC responded to Commission information requests; and

C. On July 16, 2008, FortisBC filed its Internal Audit Report as a confidential filing regarding Code of Conduct ("COC") and Transfer Pricing Policy ("TPP"). In the report, FortisBC stated that it will update the COC and TPP documents, as suggested, and will file the documents with the Commission no later than March 31, 2009; and

D. The Commission has considered the Application and the FortisBC responses to Commission information requests and the Commission finds that it has not been persuaded that the Application should be approved. The Reasons for Decision are attached as Appendix A to this Order.

NOW THEREFORE pursuant to section 64(1)b of the Act, the Commission orders as follows:

1. The Commission grants interim approval of the Subcontractor Agreement between FPHI and FortisBC for the supply of resources to the BEPC and the Commission will establish the permanent rates and terms under Subcontractor Agreement after it completes its review of the updated COC and TPP that FortisBC plans to file.

2. FortisBC will refund or charge to FPHI, as the case may be, any differences between the interim and permanent rates including interest under the Subcontractor Agreement.

3. The Commission directs FortisBC to submit evidence regarding a competitive market price or a Fair Market Value price (including interest) for the services offered to FPHI in this Subcontractor Agreement as part of its updated COC and TPP filing.

4. The Commission directs FortisBC to review the cost based price loadings, including the General and Administrative Overhead loadings, in its COC and TPP filing, in response to the Commission's concerns as set out in the attached Reasons for Decision.

DATED at the City of Vancouver, in the Province of British Columbia, this 20th day of January 2009.

BY ORDER

Original signed by:

P.E. Vivian
Commissioner

Attachment

An Application by FortisBC Inc.
for Approval of a Subcontractor Agreement
between FortisBC Inc. and Fortis Pacific Holdings Inc.
for the Supply of Resources to the Brilliant Expansion Power Corporation

REASONS FOR DECISION

1.0 THE UTILITIES COMMISSION ACT

On August 26, 2008, FortisBC Inc. ("FortisBC") filed an Application requesting approval of a Subcontractor Agreement between Fortis Pacific Holdings Inc. ("FPHI") and FortisBC. The purpose of this Agreement is to define the terms of the supply of services to the Brilliant Expansion Power Corporation ("BEPC") by FortisBC at the direction of FPHI.

FortisBC applied for British Columbia Utilities Commission ("Commission") approval pursuant to the applicable provisions of the Utilities Commission Act (the "Act") and in particular section 60.

In FortisBC's response to Commission IR 1-A1.1, FortisBC states that the followings sections of the Act are applicable to the Subcontractor Agreement:

> General supervision of public utilities section 23 (2): "the commission may make regulations requiring a public utility to conduct its operations in a way that does not unnecessarily interfere with, or cause unnecessary damage or inconvenience to, the public."
>
> Regulation of agreements section 31: "the commission may make rules governing conditions to be contained in agreements entered into by public utilities for their regulated services or for a class of regulated service."
>
> Setting of rates section 60 (1)(b)(ii): "encourages public utilities to increase efficiency, reduce costs and enhance performance", and (1)(b.1) "the commission may use any mechanism, formula or other method of setting the rate that it considers advisable…"

2.0 TRANSFER PRICING POLICY

In April 1997 the Commission issued its Transfer Pricing Policy, of Retail Markets Downstream of the Utility Meter Guidelines ("RMDUM Guidelines"). Section 5.2 of the RMDUM Guidelines states:

> "…the Commission will be reluctant to approve any transfer pricing policy which deviates significantly from that which the Commission believes provides the most protection to ratepayers. In all cases, the burden will lie with the utility to prove that deviations are appropriate.
>
> Accordingly, the Commission concludes that a utility's transfer pricing policy should ensure the following:
>
> i) The operating costs of non-regulated activities are not reflected in the utility's cost of service.
>
> ii) The costs of developing new business ventures are charged to and recovered from the NRB.
>
> iii) The accounting costs are transparent and will normally fully recover for all services, including overhead, space, employee benefits, inconvenience, and a profit margin where appropriate. If the service provided by the utility to the related-NRB could also be obtained from an independent supplier, the price paid by the related-NRB to the utility should be no less than the competitive market price and will never be below the incremental cost.
>
> iv) The financial costs of each business are borne by the business. In the exceptional case where the utility provides guarantees, it must be given financial compensation.
>
> v) Utilities will be required to file periodic reports which demonstrate that they are adhering to the transfer pricing policy. The form and timing of the report will be determined by the Commission.
>
> The Commission will require utilities to bring forward for approval proposed transfer pricing policies at the time they bring forward any application to use utility assets or services in the provision of unregulated goods and services in the downstream retail market".

In Letter L-4-98 dated February 17, 1998, the Commission found that the Transfer Pricing Policy ("TPP") of West Kootenay Power Ltd. ("WKP", now FortisBC), should be amended to reflect the fact that the costs of developing new business ventures will be charged to and recovered from the non-regulated business ("NRB"); that the financial costs of each business will be borne by the business; and that if the service provided by the utility to the related-NRB could also be obtained from an independent supplier, the price paid by the related NRB to the utility should be no less than the competitive market price and will never be below the incremental cost.

In 1998 WKP developed a document titled 'Revised Code of Conduct and Transfer Pricing Policy' ("COC & TPP") based on the RMDUM Guidelines. It was submitted to the Commission and subsequently received its approval. This policy remains in effect today and is the basis for this report.

3.0 FORTISBC'S INTERNAL AUDIT REPORT

On July 16, 2008, FortisBC filed its Internal Audit Report regarding the COC & TPP. The report has been prepared in accordance with the Commission's RMDUM Guidelines with respect to utility participation in retail markets downstream of the utility meter. FortisBC management's response to the Internal Audit Report states that "the Regulatory department will update the COC & TPP documents, as suggested, and will file the documents with the Commission no later than March 31, 2009. Once approved by the Commission, these documents will be posted on the Company's Intranet site for access by employees and contractors". Also, FortisBC recommended that Transfer Pricing calculations be based on percentages rather than fixed amounts, which can become obsolete. After having reviewed the Internal Audit Report the Commission, by Letter L-38-08 dated August 28, 2008, requested additional information. On October 3, 2008 FortisBC filed its Related Party Transactions Reports for the years 2006 and 2007, the loading rates that were used in 2006 and 2007, as well as the Shared Services Agreements with FortisAlberta and Princeton Light and Power Company, Limited.

4.0 CONSISTENCY OF SUBCONTRACTOR AGREEMENT WITH TPP

Section 5.2(iii) of the RMDUM Guidelines states "…If the service provided by the utility to the related-NRB could also be obtained from an independent supplier, the price paid by the related-NRB to the utility should be no less than the competitive market price and will never be below the incremental cost". Also, Commission Letter L-4-98 states "…if the service provided by the utility to the related-NRB could also be obtained from an independent supplier, the price paid by the related NRB to the utility should be no less than the competitive market price and will never be below the incremental price". FortisBC states "The TPP does not prescribe Fair Market Value in terms of labour rates" and does not consider the transfer of staff to be the same as the transfer of assets (BCUC IR 2-A5.1).

FortisBC states that the loadings and provided margins are the same as those provided in response to Letter L-38-08 (BCUC IR 1-A3.1). FortisBC contracts to both regulated and non-regulated businesses (BCUC IR 1-A2.5) and that the same rates apply for services provided to regulated customers and to non-regulated customers (BCUC IR 2-A4.1.1). All services provided to regulated and non-regulated generation entities are subject to the same rate for Generation Absorption Costing (BCUC IR 2-A4.5.1). At the time the TPP was approved, 10 percent was considered to provide a reasonable benefit, over and above the recovery of costs, to FortisBC's customers for the use of the Company's resources for non-regulated activity. FortisBC has not carried out a market study with respect to the services being provided for BEPC under the terms of the Subcontractor Agreement (BCUC IR 2-A4.5.1). Also, as stated in the Audit Report, FortisBC intends to update the TPP to reflect current rates by March 31, 2009 (BCUC IR 2-A2.1). FortisBC stated that it does not know the value of the work requested (BCUC IR 1-A4.2).

COMMISSION DETERMINATION

As FortisBC did not establish a benchmark competitive market price for this service, and intends to update the TPP by March 2009, the Commission Panel has not been persuaded that the price to be paid by FPHI to FortisBC is at least equal to the competitive market price for these services.

The Commission Panel also notes that FortisBC does not distinguish between regulated and non-regulated businesses and uses a cost recovery method in both cases for the calculation of its service rates. **The Commission Panel directs FortisBC to address the issue of a competitive market price in its update of the TPP.**

5.0 COST EFFECTS OF USING FULL-TIME EMPLOYEES

FPHI has no direct employees. Currently, FortisBC has 17.25 of its Full-Time Employees ("FTEs") committed for 2008 to Arrow Lakes Power Company and the City of Kelowna (BCUC IR 1-A2.1, A2.3, A2.5, A2.6). The estimated number of FTEs to service BEPC is 7.75 in 2008. When permanent employees are assigned, FortisBC utilizes temporary workers and contract forces to backstop any permanent employees assigned to that capital or third party work (BCUC IR 1-A2.6). The number of resources required varies depending on the operations and maintenance requirements throughout the year (BCUC IR 1-A1.4.1). FortisBC does not retain surplus resources (BCUC IR 1-A2.6). FortisBC states there is minimal risk exposure to the Company that could arise as a result of the termination of the Subcontractor Agreement. The main source of potential risk would be related to redundancy of FortisBC employees (BCUC IR 1-A6.1).

As FortisBC intends to utilize temporary workers and contract forces to replace the FTEs required to service the Subcontractor Agreement, the Commission is concerned that ratepayers may not benefit significantly from the Subcontractor Agreement, as the temporary workers and contract forces employed will actually maintain the staff levels at or above the current levels but not necessarily have the same productivity levels. As the requirements of the Subcontractor Agreement vary, FortisBC may incur costs as a result of having to accommodate the return of some of its employees on short notice. The Commission views the Subcontractor Agreement as an “as and when required” resource agreement that provides FPHI with flexibility but may put FortisBC at risk of greater costs.

Forecast expenditures in the FortisBC 2009-2010 Capital Expenditure Plan for all major and minor generation projects are relatively constant, slightly increasing in the years 2009 ($21,935,000) and 2010 ($22,557,000). The question is whether experienced FTEs would outperform temporary or contract labour in the successful completion of these projects as well as the ongoing maintenance resulting from the turnover of these projects to operations and maintenance.

COMMISSION DETERMINATION

The Commission Panel has not been persuaded that the productivity issues and the potential risks of redundancy caused by returning FortisBC staff upon completion of their assignments have been adequately addressed. The Commission Panel has not been persuaded that the assignment of FTEs to FPHI will not cause unnecessary inconvenience to the public as their expertise may be required by FortisBC to complete and maintain the ongoing generation projects. The Commission Panel has not been persuaded that the General and Administrative Overhead loadings are adequate when considering the variable staffing levels required by this agreement and the fact that the overall staffing level is likely to remain the same or increase.

When FortisBC files the updated COC and TPP, **the Commission Panel directs FortisBC to address the impact on costs and productivity of replacing experienced permanent staff with temporary or contract staff and to show that the proposed General and Administrative Overhead loadings are adequate when considering this concern as well as other costs associated with contracting services to FPHI.**

SUMMARY OF COMMISSION DETERMINATIONS

The Commission Panel has carefully considered the Application and weighed the evidence submitted, and has considered the effect of the RMDUM Guidelines on the transfer pricing for the Subcontract Agreement and the impact of transferring FTEs to FPHI under the Subcontract Agreement.

For the reasons given in these Reasons for Decision, **the Commission Panel grants interim approval of the Subcontractor Agreement between FPHI and FortisBC for the supply of resources to the BEPC and will establish the permanent rates and terms under the Subcontractor Agreement after it completes its review of the updated COC and TPP, and subject to the following directions:**

(i) FortisBC will submit evidence regarding a competitive market price or a Fair Market Value price for the services offered to FPHI in this Subcontractor Agreement as part of its updated COC and TPP filing;

(ii) FortisBC will provide a detailed analysis of the cost based price loadings, including the General and Administrative Overhead loadings, in its COC and TPP filing; and

(iii) FortisBC will refund or charge to FPHI, as the case may be, any differences between the interim and permanent rates (including interest) under the Subcontractor Agreement.