

SIXTH FLOOR, 900 HOWE STREET, BOX 250  
VANCOUVER, B.C. V6Z 2N3 CANADA  
web site: <http://www.bcuc.com>



**BRITISH COLUMBIA  
UTILITIES COMMISSION**

**ORDER  
NUMBER G-73-12**

TELEPHONE: (604) 660-4700  
BC TOLL FREE: 1-800-663-1385  
FACSIMILE: (604) 660-1102

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

and

FortisBC Inc.  
The Kettle Valley Distribution Source Project  
Commission Order C-5-06 for  
A Stage 2 Prudency Expenditure Inquiry  
Under Sections 59 and 60 of the Utilities Commission Act

**BEFORE:** D.M. Morton, Panel Chair/Commissioner  
R.D. Revel, Commissioner

June 4, 2012

**O R D E R**

**WHEREAS:**

- A. On October 11, 2005, FortisBC Inc. (FortisBC) applied (Application) to the British Columbia Utilities Commission (Commission) for a Certificate of Public Convenience and Necessity (CPCN) for the Kettle Valley Distribution Source Project (Project);
- B. On August 9, 2006, the Commission issued Order C-5-06, granting a CPCN to FortisBC for the Project as described in Option 2 of the Application with an estimated cost of \$21.48 million;
- C. On May 6, 2011, FortisBC, pursuant to Commission Order C 5-06, submitted its Final Quarterly Progress Report No. 13 (the Report) to December 31, 2010, for the Project and reported \$28.67 million as the final cost of the Project;
- D. On December 19, 2011, the Commission issued Order G-215-11 establishing a Stage 1 written comment process to determine whether there are reasonable grounds to question the prudence of the decisions of FortisBC that led to the expenditures and whether the Commission should establish a Stage 2 proceeding to review the prudence of the expenditures prior to allowing them into rates. The Commission also invited comment on the review process in the event the Commission determines that a Stage 2 proceeding is needed;
- E. On March 22, 2012, the Commission issued Order G-36-12 that established a Stage 2 Written Hearing to review the prudence of the expenditures on the Project previously approved by Order C-5-06;
- F. In Order G-36-12, the Commission stated:
  - a. Parties in the hearing may make submissions on the regulatory tests that are appropriate to apply in this hearing to determine if a utility expenditure should be allowed into rate base, on the role of progress reports with respect to a review of the prudence of Project expenditures, and the import of the project progress

**BRITISH COLUMBIA  
UTILITIES COMMISSION**

**ORDER  
NUMBER G-73-12**

2

reports on determination of the prudence of an expenditure on the Project; and

- b. Parties in the hearing may make submissions on how past revenue requirements Negotiated Settlement Process (NSP) Settlements affect the review of the prudence of Project expenditures.
- G. Between April 13 and April 20, 2012, FortisBC, Ms. B. Slack, British Columbia Old Age Pensioners' Organization *et al.* (BCOAPO), the Industrial Customer Group (ICG) and British Columbia Hydro and Power Authority (BC Hydro) responded to Order G-36-12;
- H. On April 27, 2012 FortisBC filed its reply to the submissions of ICG, BCOAPO, Ms. B. Slack and BC Hydro;
- I. The Commission has considered the submissions of FortisBC and the Interveners and concluded that a Stage 2 written hearing is necessary to determine if any expenditure related to the Project will be disallowed for recovery in rates.

**NOW THEREFORE** the Commission orders FortisBC to:

- 1. Remove the year-end 2011 net book value amount of the total Project costs from the FortisBC 2012 rate base until a final determination on this prudence review is made.
- 2. Place the amount from Directive No. 1 above in a separate non rate base deferral account attracting AFUDC [Allowance for Funds Used During Construction] at the historically approved rate of 6.7 percent. This deferral account should also capture the related depreciation, Capital Cost Allowances (CCA) deductions, and any other revenue requirement effects as a result of this Project.
- 3. File a report with the Commission within 10 business days from the date of this Order as part of the evidentiary record in this proceeding. This report should include a detailed breakdown by year of the assets in service, their related depreciation, the CCA deductions and the return on investment earned for the Project up to year-end 2011. This report should also include any trailing costs observed to date related to the Project.
- 4. Provide a copy of the above report to all registered Interveners in the FortisBC 2012-2013 Revenue Requirements and ISP proceeding.

**DATED** at the City of Vancouver, in the Province of British Columbia, this *Fourth* day of June 2012.

BY ORDER

*Original signed by:*

D. Morton  
Commissioner

Attachments

FortisBC Inc.  
The Kettle Valley Distribution Source Project  
Commission Order C-5-06 for  
A Stage 2 Prudency Expenditure Inquiry  
Under Sections 59 and 60 of the Utilities Commission Act

**REASONS FOR DECISION**

---

**1.0 BACKGROUND**

On March 22, 2012, the British Columbia Utilities Commission (Commission) issued Order G-36-12, which established a Written Hearing process for the Stage 2 Inquiry into the prudency of expenditures related to construction costs for the Kettle Valley Distribution Source Project (Project). Directive 3 of Order G-36-12 requested submissions on:

- the regulatory tests that are appropriate to apply in this hearing to determine if a utility expenditure should be allowed into rate base;
- the role of progress reports with respect to a review of the prudency of Project expenditures; and
- the import of the project progress reports on the determination of the prudency of an expenditure on the Project.

In addition, directive 4 of Order G-36-12, sought comments on how past revenue requirements and Negotiated Settlement Process (NSP) settlements affect the review of the prudency of Project expenditures.

On March 29, 2012, Norman Gabana requested intervener status in the Stage 2 Prudency Review of the Project.

On March 30, 2012, Buryl Slack requested intervener status in the Stage 2 Prudency Review of the Project.

On April 2, 2012, the British Columbia Old Age Pensioners Organization, the British Columbia Coalition of People with Disabilities, the Council of Senior Citizens Organizations of British Columbia and the Tenant Resource and Advisory Centre (collectively, BCOAPO) requested intervener status in the Stage 2 Prudency Review of the Project.

On April 2, 2012, the City of Trail provided a letter of comment to the Commission Secretary expressing appreciation for commencing a prudency review of the Project but did not request intervener status or provide submissions on directives 3 and 4.

On April 4, 2012, the Industrial Customer Group (ICG) requested intervener status in the Stage 2 Prudency Review of the Project.

On April 4, 2012, British Columbia Hydro and Power Authority (BC Hydro) requested intervener status in the Stage 2 Prudency Review of the Project.

On April 13, 2012, FortisBC Inc. (FortisBC) submitted its comments in response to directives 3 and 4.

On April 13, 2012, Buryl Slack submitted comments in response to Order G-36-12 but confined her comments to that portion of directive 3 requesting submissions on the appropriate regulatory test to apply in this proceeding.

On April 20, 2012, BCOAPO submitted comments in response to directives 3 and 4.

On April 20, 2012, ICG submitted comments in response to directives 3 and 4.

On April 20, 2012, BC Hydro submitted comments in response to Order G-36-12 but confined its comments to that portion of directive 3 concerning the role and import of project progress reports in determining the prudence of expenditures.

On April 27, 2012, FortisBC submitted a reply to the submissions of the Interveners.

## **2.0 STAGE 2 REGULATORY PROCESS**

The two-stage inquiry process for a capital expenditure is described in Section 4.0 of the Reasons for Decision to the Order G-36-12 and derives from *Enbridge Gas Distribution Inc. v. Ontario Energy Board* (2006) O.J. No. 13555 (C.A.) (Enbridge).<sup>1</sup>

In the Reasons for Decision to Order G-36-12, the Commission concluded that the 33.5 percent overrun of the approved CPCN amount of \$21.48 million and the questions the interveners have identified with regard to specific expenditures on the Project was sufficient to overcome the presumption of prudence, which is the first stage of the two stage inquiry process contemplated by Enbridge. The Regulatory Timetable for the Stage 2 Written Hearing is attached as Appendix B to Order G-36-12.

## **3.0 ISSUES**

The Commission has primarily four issues to decide at this time. The first issue is to determine the appropriate regulatory tests to apply in this hearing to determine if a utility expenditure should be allowed into rate base. The second issue is to determine the role of progress reports with respect to a review of the prudence of Project expenditures. The third issue is to determine the import of project progress reports on determination of the prudence of an expenditure on the Project. The fourth issue is to determine how past revenue requirement NSP settlements affect the prudence of Project expenditures.

## **4.0 FORTISBC'S SUBMISSIONS**

FortisBC provided detailed submissions concerning the regulatory tests to be used in a prudence review to determine if a utility expenditure should be allowed into rate base (Exhibit B-4, pp. 8-14).

FortisBC states that because there has been no suggestion that the Project is not "used or useful" its submissions were primarily focussed on the prudent investment test. As for the used and useful test, FortisBC submits the "used and useful" principle is qualified by the following:

"...if the decision to incur (or that led to the incurring of) some portion of the capital expenditures related to a capital project was imprudently made, the regulator may determine not to allow those resulting expenditures into rate base" (Exhibit B-4, p. 8).

FortisBC relies on Enbridge and the earlier Superior Court decision and submits that a prudent decision is a "reasonable" decision and that the utility should not be held to a standard of correctness or perfection.<sup>2</sup> Instead, only those costs that rise to the level of having been "dishonestly incurred, or which are negligent or wasteful losses" are costs that are subject to not being allowed into rate base (Exhibit B-4, p. 8).<sup>3</sup>

Citing *Enbridge*, FortisBC submits

"...the reasonableness of the decision must be evaluated "under the circumstances that were known to, or ought to have been known to, [the utility] at the time it made the decision."<sup>4</sup> The evidence required to evaluate whether or not a decision was prudent "must be concerned with the time the decision was made and must be based on facts

---

<sup>1</sup> *Enbridge Gas Distribution Inc. v. Ontario Energy Board* (2006) O.J. No. 1355 (C.A.) at para. 11

<sup>2</sup> *Enbridge Gas Distributions Inc. v. Ontario Energy Board*, 2006, CanLII 10734 (Ont. C.A.) at para. 11

<sup>3</sup> *Enbridge Gas Distribution Inc. v. Ontario Energy Board* (2005), 75 O.R. (3d) 72, 2005 CanLII 4941 at para. 9

<sup>4</sup> *Enbridge* at para. 11

about the elements that could or did enter into the decision at the time.”<sup>5</sup> In determining whether or not the decision was prudent, the regulator is not permitted to use “[h]indsight, that is knowledge of facts relevant to the prudence of the business decision gained after the decision was made.”<sup>6</sup>

The fact that, in the result, an expenditure is greater than forecast or that might have resulted from taking an alternative approach does not, in itself, demonstrate imprudence.<sup>7</sup> In this regard, “consideration of the outcome of the decision” is to be used only to overcome the presumption that the expenditure was prudent (and, hence, to determine whether a stage 2 inquiry should be undertaken; in this proceeding, that stage has passed, so hindsight is no longer relevant).”<sup>8</sup> (Exhibit B-4, p. 9)

FortisBC submits that if the reasonableness of a decision was assessed at the time the decision was made, the result of any prudency inquiry should not change because no new information could be considered at a later inquiry.

FortisBC further submits that the prudency of expenditures on the Project were reviewed by the Commission in three types of proceedings, the CPCN application, the 2007-08 Capital Expenditure Plan application and the consideration of additions to plant in service in successive revenue requirement applications. FortisBC reviews each of the proceedings to support its submission that the Project has undergone numerous prudency reviews at different stages of development.

On directive 4, which asks how past revenue requirement NSP settlements affect the review of the prudency of Project Expenditures, FortisBC submits that not only were settlements reached as a result of the NSP in each of 2006-2011 for revenue requirements but the Commission approved each of the settlements by a Commission Order. FortisBC relies on the Negotiated Settlement Process: Policy, Procedures and Guidelines (February 2012) (NSP Policy), to state that the Commission does not rubber stamp NSP settlements but evaluates each NSP settlement to determine whether or not the settlement itself satisfies the public interest and does not contravene the Commission’s statutory obligations.

FortisBC makes submissions on the role and import of project progress reports in determining the prudency of expenditures. FortisBC states “the progress reports allow the Commission to assess whether the utility has omitted to consider (a) certain facts which might be pertinent to its expenditure decisions and (b) more particularly, certain further avenues to mitigate the costs of a given project.”

Because the progress reports are provided to the Commission during the course of the Project, FortisBC submits the progress reports provide the Commission with the opportunity to make recommendations to the utility to modify its course of action. As such, FortisBC submits the progress reports provide contemporaneous evidence of the factors the utility considered at the time it made its decisions. Further, FortisBC submits that any response or non-response by the Commission to any particular progress report may serve an evidentiary purpose in the current proceeding.

FortisBC submits past Commission Orders have approved Negotiated Settlement Agreements (NSA) in the public interest and that parties to NSPs relied on these Commission approvals. Given the prohibition against retro-active rate making, FortisBC argues that if any reduction to rate base is to be made as a result of this proceeding, it could only be made on a going forward basis rather than for the years which have already passed (Exhibit B-4, p. 13).

## 5.0 INTERVENER SUBMISSIONS

BCOAPO provided submissions in response to the appropriate regulatory tests to be used in this proceeding to determine if a utility expenditure should be allowed into rate base and in response to the submissions of FortisBC. BCOAPO submits the central issue of a Stage 2 prudency review is to determine whether expenses were prudently incurred.

---

<sup>5</sup> Enbridge at para. 10

<sup>6</sup> Enbridge at para. 12

<sup>7</sup> Enbridge at para. 13

<sup>8</sup> Enbridge at para. 10

BCOAPO also provided submissions on the role and import of progress reports in a prudency review and in response to the submissions of FortisBC regarding the same. BCOAPO submits the Commission was not in a position to stop the Project upon receipt of any progress report (Exhibit C1-3, p. 2). Citing Order C-3-10, a BC Hydro CPCN decision for the Vancouver City Central Transmission Project (VCCT) (Exhibit A2-17, pp. 2-3), the BCOAPO submits the purpose of a progress report is for information purposes only.

BCOAPO submits that during the course of a project, progress reports are to be treated by the Commission as information only, particularly because progress reports arising out of a CPCN application are not, by a matter of course, distributed to all stakeholders or interveners. As such, the progress reports should not prevent a post-completion prudency review.

BCOAPO notes the Commission's concerns regarding FortisBC's financial reporting and cost overruns on the Project raised in response to progress report # 4 (Exhibits A2-19 and A2-20).

BCOAPO responds to the submissions of FortisBC regarding the effect of past proceedings, including NSPs, on the review of Project expenditures. BCOAPO submits that it participated in NSPs on the understanding that:

“...should the regulatory test be met, projects that have been approved as being in the public interest can still become the subject of expenditure reviews. Otherwise this would result in NSPs granting pre-approval to cost overruns that have significantly exceeded approved costs, with no opportunity to review the reasons for such overruns” (Exhibit C1-3, p. 4).

Finally, BCOAPO submits that projects which have been approved as being in the public interest can still become the subject of expenditure reviews; otherwise, NSPs would result in granting pre-approval to cost overruns (Exhibit C1-3, p. 4).

ICG provided submissions in response to both directives 3 and 4 to the submissions of FortisBC. ICG submits that in this proceeding, the Commission must determine whether or not the costs actually incurred by FortisBC to complete the Project have been imprudently incurred (Exhibit C2-3, p. 1).

ICG distinguishes between the review of project costs in a CPCN application and the review of project costs in a prudency review. ICG submits the review of project costs in a CPCN application is to determine whether or not a project is cost-effective. It further submits, however, that the Commission may decide after a CPCN is issued that it is imprudent to continue with a project. ICG submits “a CPCN does not amount to a finding that if the project is executed at the costs in the CPCN application that it will have been executed prudently” (Exhibit C2-3, p. 2).

ICG submits the concern should be whether or not lax project management practices by FortisBC resulted in avoidable delays and/or cost overruns. As such, any costs resulting from the avoidable delays and/or cost overruns should be disallowed from recovery through the rate base. ICG submits that FortisBC must not only convince the Commission that the Project is a prudent project to proceed at the CPCN stage but it must also, in a Stage 2 hearing, demonstrate that it managed the Project effectively throughout its execution and that it took reasonable steps to avoid delays and/or cost overruns (Exhibit C2-3, p. 2).

ICG submits the filing of progress reports does not amount to acceptance or approval by the Commission of any revised estimates, project management decisions or other activities related to the Project. ICG submits the first and appropriate time for the Commission to consider the prudency of the decisions by FortisBC that led to the expenditures on the Project is in a Stage 2 proceeding (Exhibit C2-3, p. 3).

ICG submits a prudency review is not a reconsideration of an earlier Commission decision; therefore the Commission must evaluate whether imprudently incurred costs should be disallowed (Exhibit C2-3, p. 4).

In response to the submissions of FortisBC and BC Hydro regarding the role of progress reports, ICG submits that utilities should not be able to point to progress reports as relevant evidence to a Stage 2 prudency review (Exhibit C2-3, p. 4).

ICG submits that NSP settlements are not a bar to the Commission disallowing any costs it concludes were imprudently incurred (Exhibit C2-3, p. 4).

BC Hydro submitted limited comments relating to the role of progress reports as requested by the Commission in directive 3. BC Hydro submits that:

“...while a response or non-response to project progress reports is not determinative of prudence, BC Hydro submits that project progress reports and the BCUC’s responses or non-responses to such reports can serve an evidentiary role in subsequent prudence reviews, with the particular BCUC panel determining the weight to be afforded to the reports themselves and any responses” (Exhibit C4-2).

Buryl Slack submitted comments on the regulatory tests that are appropriate as follows:

“1. did costs equate with those of other utilities at the time of order/purchase (prices skyrocketed);

2. could the job have been delayed without causing further costs or inconvenience to the project/customers” (Exhibit C5-2).

## **6.0 FORTISBC’S REPLY TO INTERVENERS**

In reply to the submissions of the Interveners, FortisBC submits that a Stage 2 prudence review should not involve a fresh application of the used and useful test or the prudent investment test. FortisBC submits that the question on a Stage 2 prudence review is whether the criteria for reconsidering the earlier determinations of the used and useful test and prudent investment test have been met. In other words, “were those earlier determinations in some manner defective within the parameters of the reconsideration criteria” (Exhibit B-5, p. 1).

FortisBC disputes ICG’s submission that the first and appropriate time for the Commission to consider the prudence of FortisBC’s decisions that led to expenditures on the Project is in a Stage 2 proceeding. Instead, FortisBC submits that Project expenditures have previously been subject to Commission consideration and determination (Exhibit B-5, p. 2).

FortisBC disagrees with BCOAPO’s submission that FortisBC’s submissions would amount to “the Project [being] exempt from an expenditure review.” FortisBC relies on its original submission and states that because the Project has already been subject to repeated expenditure reviews throughout its regulatory history, including during the revenue requirements proceedings, the reconsideration test should be applied to the Stage 2 proceeding in the present case (Exhibit B-5, p. 2).

FortisBC disputes BCOAPO’s submission that if FortisBC’s submissions are accepted, cost overruns on a project would be excluded from review by ratepayers. Instead, FortisBC submits there are several opportunities for ratepayers to review and scrutinize project costs because revenue requirements proceedings allow a ratepayer to review, direct information requests, participate in NSPs or hearings and provide submissions on project costs or overruns before any project costs are allowed into rate base (Exhibit B-5, p. 4).

FortisBC disagrees with BCOAPO’s interpretation of FortisBC’s original submission on the effect of past proceedings on the review of project expenditures. FortisBC submits that the forecast additions agreed to as part of the revenue requirements NSPs were close to the actual costs of the Project (Exhibit B-5, p. 5).

FortisBC disputes ICG’s submission on the use and role of progress reports and disputes both ICG’s and BCOAPO’s submission that the Commission is understaffed to review progress reports. FortisBC submits that it repeatedly drew the Commission’s attention to Project cost overruns within the progress reports and, on occasion, the Commission requested further information. FortisBC submits that if the Commission lacked resources to review or assess the progress reports or any further information, the Commission should have stated that such material need not be provided because it would not be reviewed (Exhibit B-5, p. 6).

In response to Ms Slack's submissions, FortisBC states that although the questions raised by Ms. Slack may be relevant in a fresh application of the prudent investment test that is not the case in the present Stage 2 proceeding (Exhibit B-5, p. 6).

FortisBC agrees with the submissions of BC Hydro that progress reports and any responses or non-responses to the reports may serve an evidentiary role in the Stage 2 proceeding (Exhibit B-5, p. 7).

## 7.0 COMMISSION DIRECTIVES

### Appropriate Regulatory Tests:

**The Commission Panel finds that the appropriate regulatory test to use in this Stage 2 proceeding to determine if a utility expenditure should be allowed into rate base is the prudent investment test as described in Section 4.0 of the Reasons for Decision to Order G-36-12. FortisBC must show that its business decision was reasonable under the circumstances that were known to, or ought to have been known to, FortisBC at the time it made the decision.** The Commission Panel notes that hindsight, that is the knowledge of facts relevant to the prudence of the business decision gained after the decision was made, cannot be used in determining prudence in this Stage 2 proceeding to determine whether the decision was prudent. In addition, the Commission Panel notes that prudence must be determined in a retrospective factual inquiry, in that the evidence must be concerned with the time the decision was made and must be based on facts about the elements that could or did enter into the decision at the time.

### Role and Import of Progress Reports:

The Commission Panel agrees with both FortisBC's and BC Hydro's submissions regarding the role and import of progress reports on the determination of the prudence of an expenditure on the Project. The Commission Panel acknowledges further requests for information were made by the Commission from FortisBC in response to the filing of progress reports throughout the Project. **The Commission Panel finds that both the progress reports and any response or non-response by the Commission, including the responses of FortisBC to requests made by the Commission for further information to the progress reports, can be entered into evidence in the current Stage 2 proceeding.** The Commission Panel will determine the weight to be afforded to the reports and to any responses the Commission may or may not have made to Fortis BC with respect to those reports.

### Past Decisions and Negotiated Settlement Processes:

The Commission Panel agrees with FortisBC's submission regarding its approval of NSAs under the NSP Policy in that the Commission "does not grant such approval unless it is satisfied that the approval is consistent with its statutory obligations and that the agreement is in the public interest" (Exhibit B4, p. 12). Further, the Commission Panel acknowledges that FortisBC has transferred portions of the Project expenditures into plant-in-service between 2007 and 2011. However, the Commission Panel notes that implicit approval of those past decisions and NSAs were based on the presumption that decisions of the utility were made prudently. This presumption underlies the approach taken to all reviews and approvals made by the Commission. In the Commission Panel's view, a review of the prudence of an expenditure should not be limited because the Commission had presumed that the decisions were made prudently.

Given that the presumption of prudence has been overcome with the current Stage 2 review process as ordered in G-36-12, the Commission Panel must now ensure that ongoing rates being charged to customers are not "unjust or unreasonable" within the definition of those terms provided by section 59(5) of the *Utilities Commission Act*.

The Commission Panel also agrees with FortisBC on the prohibition against retro-active ratemaking. **Therefore, the Commission Panel directs FortisBC to:**

- **remove from its 2012 rate base the year-end 2011 net book value amount of the total Project costs until a final determination on this prudence review is made;**



- place this amount in a separate non rate base deferral account attracting AFUDC at the historically approved rate of 6.7 percent This deferral account should also capture the related depreciation, CCA deductions, and any other revenue requirement effects as a result of this project;
- file a report which includes a detailed breakdown by year of the assets in service, their related depreciation, the CCA deductions and the return on investment earned for the Project up to year-end 2011;
- include in the report any trailing costs observed to date related to the Project (year to date 2012);
- file the report with the Commission within 10 business days from the date of the Order accompanying these Reasons as part of the evidentiary record in this proceeding; and
- provide a copy of the report to all registered interveners in the FortisBC 2012-2013 Revenue Requirements and ISP proceeding.

FortisBC Inc.  
The Kettle Valley Distribution Source Project  
Commission Order C-5-06 for  
A Stage 2 Prudency Expenditure Inquiry  
Under Sections 59 and 60 of the Utilities Commission Act

**REGULATORY TIMETABLE**

<b>ACTION</b>	<b>DATE (2012)</b>
Commission Information Request No. 1 to FortisBC	Friday, June 22
FortisBC Response to Commission Information Request No. 1	Friday, July 6
Intervenors' Information Request No. 1 to FortisBC	Friday, July 13
FortisBC Response to Intervenors' Information Request No. 1	Friday, July 20
Commission Information Request No. 2 to FortisBC	Friday, August 3
FortisBC Response to Commission Information Request No. 2	Friday, August 17
Intervenors' Information Request No. 2 to FortisBC	Friday, August 24
FortisBC Response to Intervenors' Information Request No. 2	Friday, August 31
Oral Phase of Arguments	TBA
FortisBC Final Argument	TBA
Intervener Replies	TBA
FortisBC Final Reply	TBA