



Sarah Walsh
Director, Regulatory Affairs

Gas Regulatory Affairs Correspondence
Email: gas.regulatory.affairs@fortisbc.com

Electric Regulatory Affairs Correspondence
Email: electricity.regulatory.affairs@fortisbc.com

FortisBC
16705 Fraser Highway
Surrey, B.C. V4N 0E8
Tel: (778) 578-3861
Cell: (604) 230-7874
Fax: (604) 576-7074
www.fortisbc.com

November 5, 2024

Industrial Customer Group
c/o Robert Hobbs
2206 Happy Valley Road
PO BOX 1552
Rossland, BC
V0G 1Y0

Attention: Robert Hobbs

Dear Robert Hobbs:

Re: FortisBC Energy Inc. (FEI) and FortisBC Inc. (FBC) (collectively FortisBC)
Application for Approval of a Rate Setting Framework for 2025 through 2027
(Application)
Response to the Industrial Customer Group (ICG) Information Request (IR) No. 2

On April 8, 2024, FortisBC filed the Application referenced above. In accordance with the amended regulatory timetable established in BCUC Order G-255-24 for the review of the Application, FortisBC respectfully submits the attached response to ICG IR No. 2.

If further information is required, please contact the undersigned.

Sincerely,

on behalf of FORTISBC

Original signed:

Sarah Walsh

Attachments

cc (email only): Commission Secretary
Registered Interveners

Reference: Exhibit B-4, BCUC IR 1, 1.1.1

Therefore, both the historical and forecast O&M are available for examination, similar to the detail that would be available in a cost-of-service rebasing application. The result of the proposed 2024 Base O&M for FEI and FBC and the resulting 2025 O&M funding envelope would therefore generally be the same as a new O&M forecast for 2025 developed on a cost-of-service basis.

1.1 Please provide zero-based budgets by O&M department for 2024 and 2025?

Response:

FortisBC does not consider this question to be a reasonable request and respectfully declines to provide the information.

FortisBC is proposing a formulaic index-based approach for the majority of its O&M and this formula is proposed to be in place for three years. For the proposed Base O&M for the Rate Framework, FortisBC has reasonably started with 2023 Actuals (i.e., the most recent year of actuals) and has provided evidence to support the adjustments to arrive at the Base O&M based on FortisBC's expectations of its funding needs for the upcoming three years. This question is not seeking information related to these proposals, but is essentially requesting FortisBC to develop its O&M expenditures in a non-traditional method that is not applicable or necessary for the purpose of this Application. For example, taking a one-year view (i.e., 2025) of FEI's and FBC's O&M funding needs would be inappropriate when establishing a funding envelope that is intended to provide annual O&M funding for three years.

In any case, FortisBC does not have "zero-based budgets by O&M department" and would not have time to prepare such budgets within the time allotted to respond to IRs. FortisBC understands that a "zero-based budgeting" approach requires the construction of a budget without regard to previous actuals, requiring a fresh identification of department level activities, requirements and costs for the budget period. However, FortisBC utilizes a traditional budgeting approach which involves starting with the previous year's budget or actuals and adjusting based on changes in requirements. This commonly used approach is efficient, reasonable and would be the same whether FortisBC was proposing a multi-year rate framework or cost of service approach. This traditional approach is reasonable for the Companies as they are providing utility services to customers as required by the *Utilities Commission Act*, and the Companies must meet a level of service quality and reliability, among other requirements. Therefore, the Companies would not start a budgeting process at "zero", as there would always be a base level of resourcing required to operate the utilities safely and reliably and in accordance with the various standards and regulations imposed on gas and electric utilities. In contrast, a zero-based approach is more complex, inefficient and time consuming than a traditional approach. Further, it is unlikely to materially change the result given the mature and ongoing nature of FortisBC's utility operations.

1.2 Please comment on whether a new O&M forecast for 2025 developed on a cost-of-service basis would be based on a forecast of O&M expenditures and productivity improvements would be included in the O&M indexing formula for test years beyond 2025?

Response:

If FEI's and FBC's 2025 O&M forecasts were developed on a cost-of-service basis, they would be based on:

- the most recent year of actuals (i.e., 2023), consistent with the starting point for the Companies' proposed Base O&M;
- the same adjustments for exogenous factors and flow-through items as described in Sections C2.2.2 and C2.3.2 of the Application;
- the same adjustments for the required 2024 O&M funding (as described in Sections C2.2.3 and C2.3.3); and
- forecasts for net incremental funding required for 2025 resulting from changes in FEI's and FBC's operating environments and/or changes in policies or regulation.

Regarding the inclusion of productivity improvements for test years beyond 2025, generally if the O&M is forecast each year on a cost-of-service basis, any savings from past productivity improvements would be incorporated into the forecast. However, the forecast would not normally include any prediction of future productivity savings. Instead, if any productivity improvements materialize, they would be reflected in the actual O&M. In contrast, under the formulaic approach for Base O&M, a productivity improvement factor (i.e., X-Factor) is built into the formula for calculating the O&M throughout the proposed term of the Rate Framework. Therefore, customer rates, which are based on the formula O&M, would inherently include the savings resulting from the X-Factor.

Reference: Exhibit B-4, BCUC IR 1, 8.2

In contrast, in FEI's and FBC's unique cases, the effects of economies of scale are currently counted first in the X-factor and then again in the discount factor to the growth factor.

2.1 Please explain whether the X-factor is intended to capture the effects of both economies of scale and productivity improvements?

Response:

The following response was provided by Dr. Kaufmann:

Confirmed that the X-factor is intended to capture the effects of both economies of scale and productivity improvements. There are two components of the X factor: (1) the productivity factor; and (2) the stretch factor. The productivity factor is intended to capture the effects of economies of scale and productivity improvements that have been realized within the utility industry. The stretch factor is designed to reflect the incremental productivity improvements the utility can reasonably be expected to achieve over the term of its upcoming incentive regulation plan.

2.2 If not, please comment on whether the effects of economies of scale can be measured in order to adjust the X-factor?

Response:

Please refer to the response to ICG IR2 2.1.

2.3 Please explain whether economies of scale should benefit customers with no benefit to shareholders?

Response:

The following response was provided by Dr. Kaufmann:

Cost savings achieved through economies of scale and other means should be shared with both customers and shareholders.

FortisBC further adds the following response:

FortisBC Energy Inc. (FEI) and FortisBC Inc. (FBC) (collectively FortisBC or the Companies) Application for Approval of a Rate Setting Framework for 2025 through 2027 (Application)	Submission Date: November 5, 2024
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- 1 The economies of scale reflected in the proposed X-Factor values result in otherwise lower
- 2 formula driven amounts, irrespective of the utility's ability to achieve the X-Factor, which provides
- 3 a direct benefit to customers.

- 4 Further, in the proposed Rate Framework, FEI and FBC share 50 percent of any savings achieved
- 5 during the term of the Rate Framework through the proposed earnings sharing mechanism. In
- 6 addition, the rebasing of the costs at the start of the next revenue requirement would return any
- 7 remaining savings to customers.

- 8

3 Reference: Exhibit B-4, BCUC IR 1, 41.3

“Increasing net salvage collections to the historical indications instead of moderate increases over time would cause significant rate impacts in the near term, and when considering affordability, it would not be reasonable to do so.”

3.1 Please comment on whether delaying increases to net salvage collections increases cumulative returns to FBC?

Response:

In theory, FBC’s rate base is higher and, by extension, FBC’s cumulative return is higher in the near-term as a result of delaying the increase to net salvage collections; however, FBC’s cumulative return is not part of the consideration for delaying the increase to net salvage collection.

As explained by Concentric in the response to BCUC IR1 41.3, FBC only started to pre-collect net salvage costs in 2016 and there have been large costs of removal in recent years (as noted for those accounts discussed in the response to BCUC IR1 41.3). Consequently, FBC’s current net salvage collection is behind the salvage requirement based on historical indications. However, that historical time period is limited and is only one factor in setting net salvage rates. To clarify, if FBC was to increase the net salvage collection immediately to match historical indications, there would be significant rate impacts to its customers. FBC considers that a gradual and moderate increase in net salvage collection over time is more reasonable and acceptable to customers compared to a significant and immediate impact from raising salvage rates too quickly.

3.2 Please comment on the use of a deferral account instead of net salvage collections to delay rate impacts?

Response:

As noted by Concentric in the response to BCUC IR1 41.3, future increases in net salvage rates would depend on whether the current trend of removal costs continues, specific to each individual asset account. Therefore, future increases in some accounts could be offset by future decreases in other accounts when future studies are completed.

If FBC were to increase net salvage collection immediately to match historical indications and use separate deferral accounts to manage rate impacts, this would still likely result in significant rate impacts to customers in the near term. This is because the separate deferral account will still need to be amortized and recovered from customers within a reasonably short timeframe in order to prevent potential intergenerational inequities related to future customers paying for a deferral balance essentially built up by the salvage provision of current assets. FBC considers the gradual increase of net salvage collection through periodic review within depreciation studies (which might

be offset by decreases in other accounts as noted above) to be more reasonable and appropriate for customers instead of an immediate increase in customer rates, either through larger increases to net salvage rates or through a separate deferral account with amortization over several years.

3.3 Please calculate the rate impact of a 5% change in net salvage estimate?

Response:

A 5 percent change in the net salvage estimate is arbitrary and without any basis and would have different impacts depending on which asset classes the change was applied to. Based on the Depreciation Study completed for FBC filed as Appendix D2-2 to the Application, Concentric has recommended net salvage rates based on the salvage requirement of each individual account with consideration to historical trends.

However, in order to be responsive, FBC notes that a 5 percent change (increase) in the recommended total net salvage estimate of \$17.2 million (as shown in Table D2-5 of the Application) would increase the net salvage estimate to \$18.1 million. Referring to the same table, this would increase the change between total salvage based on the existing salvage rates and total salvage based on the recommended salvage rates from \$1.2 million to \$2.1 million, resulting in an increased rate impact of 0.2 percent, from 0.26 percent to 0.46 percent, when compared to 2024 Approved rates.

4 Reference: Exhibit B-4, BCUC IR 1, 42.2

“While there is a net increase in corporate service costs allocated to FEI and FBC as a result of the ACGS disposition, it is inclusive of a reduction in FI costs allocated to FHI as a result of the change in allocation percentages with ACGS no longer included.”

4.1 Please explain “it is inclusive of a reduction in FI costs allocated to FHI”?

Response:

The response to BCUC IR1 42.2 can be more clearly restated as: “it is net of a reduction in FI costs allocated to FHI”.

The increase in corporate service costs referred to as part of the response to BCUC IR1 42.2 is a net increase, meaning it is a combination of:

- an increase in the allocation formula used to charge down to FEI and FBC, as a result of the percentages changing due to no longer including ACGS; and
- a decrease in the total costs charged down from FI to FHI, as a result of no longer including ACGS in the allocation group.

The reduction in FI costs allocated to FHI was estimated at 0.9 percent, as provided in Section 6 of the KPMG Corporate Services Cost Allocation Report (Appendix D4-1 to the Application), as follows:

If there were no change to the value of assets and controllable costs for all FI subsidiaries, the sale of ACGS would result in FHI receiving a smaller corporate shared service allocation from FI. In practice, however, there may be other changes to FI and its subsidiaries’ operations, including through other acquisitions and divestitures. The proportion of costs allocated by FI to FHI was recalculated by FI for 2023 excluding ACGS’s assets and controllable operating costs. This resulted in the FHI’s share of the management fee falling from 21.8% to 20.9%.

This estimated decrease in allocation of FI’s management fee by 0.9 percent translates to an approximate \$0.3 million reduction in FI costs allocated to FHI. This is provided in the KPMG Corporate Services Cost Allocation Report by comparing the budgeted FI management fee including ACGS of \$7,558,000 in Table 12 to the estimated FI management fee after removal of ACGS of \$7,245,972 in Table 14. It is also represented in Table 15 of the KPMG Corporate Services Cost Allocation Report as the sum of the reduction in FHI’s corporate costs allocated to ACGS compared to the increase in FHI’s corporate costs allocated to FEI and FBC.

1 4.2 Is the net increase in corporate service costs allocated to FEI and FBC lower
2 because of a reduction in FI costs allocated to FHI?
3

4 **Response:**

5 Please refer to the response to ICG IR2 4.1.
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7

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9 4.3 If so, please provide the amount of and explain the reduction in FI costs allocated
10 to FHI?
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12 **Response:**

13 Please refer to the response to ICG IR2 4.1.
14

Reference: Exhibit B-10, ICG IR 1, 10.1

“FBC respectfully declines to provide the prioritization requested in the question. The 2023 and 2024 capital expenditures referenced in Table C3-36 were previously reviewed and approved as part of FBC’s Annual Review for 2023 Rates and are not the subject of approvals requested in this Application.”

5.1 Please change and comment on a Revised Table C3-36 so that the 2025 Forecast does not exceed \$9.029 million, so that the 2026 Forecast does not exceed \$9.931 million, and so that the 2027 Forecast does not exceed \$10.093 million. Please calculate the rate impacts of the changes?

Response:

FBC respectfully declines to provide the requested table. FBC is not able to reprioritize the forecast expenditures in Table C3-36 for the purposes of excluding programs and projects in order to get expenditures down to the levels requested in the question. The forecast costs for 2025 through 2027 included in Table C3-36 are for projects and programs required to continue providing safe, reliable, and cost-effective service to its customers. FBC manages its capital investment plan to maintain a safe and reliable system, optimize resources and spending, and provide value to its customers.

5.2 Please prioritize the discrete projects included in Table C3-37?

Response:

The discrete projects in Table C3-37 have already been prioritized based on the timing of when the project is required to be in service.

5.3 Please identify any financial constraints or rate impact concerns relevant to Table C3-37?

Response:

As discussed in the response to ICG IR2 5.1, the forecast Station Upgrade/Replacement Projects contained in the Application are required to ensure FBC maintains a safe and reliable system. FBC acknowledges that the increased level of planned projects during the proposed Rate Framework term will impact customer rates; however, for the reasons provided in the Application and in IR responses, the projects are necessary based on various factors, including condition issues (as identified through condition assessments), aging infrastructure, and/or capacity issues.

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1 FBC has optimized the required projects and expenditures to mitigate rate impacts to the extent
2 possible and notes that significantly delaying projects into the future as proposed in ICG IR2 5.1
3 could result in higher overall costs (and rate impacts) in addition to potentially jeopardizing FBC's
4 ability to provide safe and reliable service for customers. Please also refer to the response to
5 BCUC IR1 24.1 for the annual rate impact of the total forecast Sustainment capital expenditures
6 during the Rate Framework term (FBC notes that this is the impact from the total annual
7 Sustainment capital expenditures, not just the expenditures contained in Table C3-37).

8

6 Reference: Exhibit B-10, ICG IR 1, 1.2

“BC Hydro’s lower monthly bill amount reflects its tiered rate structure (675 GWh is charged at the lower rate) as well as its much larger customer base and its lower generation costs due to its heritage hydro generation resources.”

6.1 Please confirm that FortisBC rates are 45% higher than BC Hydro rates for a customer consuming 700 kwh per month?

Response:

An FBC residential customer consuming 700 kWh per month pays approximately 44 percent more than a BC Hydro customer. However, FBC notes that this differential decreases at higher consumption levels. For instance, for residential customers with average consumption of 1,000 kWh per month, the difference is approximately 30 percent.

FBC also notes that the rate differentials are not uniform among all rate schedules. FBC’s rates for industrial customers are reasonably aligned with those of BC Hydro. For instance, an average industrial customer with demand of 1,500 kVa and consuming 575,000 kWh per month pays 2 percent less under FBC’s rates than BC Hydro’s (not including RS 1901 and 1904).

6.2 Given the reasons (“a much larger customer base and its lower generation costs due to its heritage generation resources”) for much higher rates, does FortisBC expect its rates to continue to be significantly higher than BC Hydro rates?

Response:

FBC does not agree with the characterization of “much higher” and “significantly higher” as stated in the question. The differential between what a FBC customer pays versus a similar BC Hydro customer will depend on their rate class, rate design (including whether they are a time-of-use customer), and their consumption levels, as discussed in the response to ICG IR2 6.1. In some cases, a customer will pay less under FBC’s rates than under BC Hydro’s rates.

FBC is not able to provide insight into the future differences between its rates and BC Hydro’s rates. However, in the specific case of a residential customer with consumption of 675 kWh, a potential approval of BC Hydro’s proposal in its ongoing 2024 Rate Design proceeding to gradually move towards a flat rate structure (similar to FBC’s residential rates), all else equal, would gradually reduce the differential to a lower amount.

6.3 Please comment on whether load growth in both the BC Hydro and FBC service areas can be expected to lead to an even larger difference in rates?

Response:

The impact of load growth on FBC rates will depend on a number of factors, including the number, type and size of each customer and where they choose to connect in the service territories. Although FBC cannot definitively comment on the impact of load growth on BC Hydro's rates, FBC expects the same factors would apply and would also be impacted by government policy. Please also refer to the response to ICG IR2 6.2.

6.4 Does FortisBC believe that such a large difference in rates within BC is fair to its customers?

Response:

It is not reasonable or appropriate to assess the fairness of FBC's rates by comparing FBC's rates to BC Hydro's. Among other factors, FBC is a much smaller electric utility compared to BC Hydro, which means that changes in FBC's revenue requirement (positive or negative) will have a greater impact on rates than changes of a similar scale to BC Hydro's revenue requirement. Thus, comparing FBC's rates to BC Hydro's provides no meaningful information about the reasonableness of FBC's costs and rates. This is illustrated by Dr. Kaufmann's O&M cost benchmarking study which shows that, when compared to the much larger sample group of the US electric industry, FBC is actually a superior cost performer. Dr. Kaufmann concludes on page 25 of his report in Appendix C1-1 of the Application:

Overall, FBC's benchmarking studies provide strong evidence that it is registering superior cost performance in all the non-generation activities covered by its ratemaking frameworks. It should also be remembered that FBC's own "internal" O&M PFP growth averaged 3.68% over the 2014-2022 period. This rate of O&M PFP growth greatly exceeds the O&M PFP trend typical of small utilities (-0.42% per annum), as well as the O&M PFP trend of the electric utility industry. FBC has therefore outperformed the industry's O&M PFP performance since the implementation of its incentive plans in 2014. This exceptional performance has almost certainly generated cost savings that have since been rebased into rates and thereby benefited customers.

As shown in the response to BCUC IR2 45.4, FBC ranks 20th among the US sample of 81 electricity distributors with respect to average O&M unit costs, which is consistent with first quartile and superior cost performance.

Furthermore, FBC's rates are set by the BCUC pursuant to sections 59 to 61 of the *Utilities Commission Act*, which sets out that the BCUC must have due regard to the setting of a rate that is not unjust, unreasonable or unduly discriminatory. Pursuant to section 59(5) of the *Utilities Commission Act*, a rate is "unjust" or "unreasonable" if the rate is "insufficient to yield a fair and

1 reasonable compensation for the service provided by the utility, or a fair and reasonable return
2 on the appraised value of its property”. Thus, in accordance with the Fair Return Standard, FBC
3 rates must be set to provide it with a reasonable opportunity to recover its prudently incurred costs
4 and its allowed return on investment. In short, FBC’s rates must be set with reference to its own
5 costs to serve its customers, not BC Hydro’s.

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9 6.5 Has FortisBC discussed its much higher rates and the large difference in rates
10 within BC with the provincial government?
11

12 **Response:**

13 FBC discusses a range of issues affecting its customers with the Province, including factors that
14 impact its rates. Pursuant to the *Utilities Commission Act*, FortisBC must apply to the BCUC for
15 approval of rates.
16