Dennis Swanson
Director, Regulatory Affairs

FortisBC Inc.
Suite 100 - 1975 Springfield Road
Kelowna, BC V1Y 7V7
Ph: (250) 717-0890
Fax: 1-866-335-6295
electricity.regulatory.affairs@fortisbc.com
www.fortisbc.com

February 12, 2013

<u>Via Email</u>
Original via Mail

Ms. Erica Hamilton
Commission Secretary
BC Utilities Commission
Sixth Floor, 900 Howe Street, Box 250
Vancouver, BC V6Z 2N3

Dear Ms. Hamilton:

Re: FortisBC Inc. (FortisBC) Application for a Certificate of Public Convenience and Necessity for the Purchase of the Utility Assets of the City of Kelowna – Responses to Industrial Customers Group Information Request No. 2

Please find attached FortisBC's responses to Information Requests No. 2 from the Industrial Customers Group (ICG).

If further information is required, please contact the undersigned at (250) 717- 0890.

Sincerely,

Dennis Swanson
Director, Regulatory Affairs

1. Re: Customers to be Acquired Exhibit B-1, Application p.1 line 13 and p. 22,

Figure 2

FBC states that:

"Approximately 15,000 residential, commercial, industrial and institutional customers in central Kelowna, who currently receive service under the City's Bylaw 7639 will become customers of FortisBC and will be billed under FortisBC's Electric Tariff No. 2"

1.0 Please provide details by rate class of the number of customers who will become customers of FortisBC?

Response:

Please find below the information requested in ICG IR 2.1.0, 2.1.1, and 2.1.2.

Note that all data is consistent with the assumptions used in the modelling that supports the Application with the exception of column 4 which was provided by the City of Kelowna. City of Kelowna revenues at City of Kelowna rates are not available for 2013-2017 and the City only records sales on a gross basis.

	1	2	3	4	5	6	7	8	9	10
	Number of Meters (Customers)	2012 Sales (kWh)	2012 Sales (kVA)	2012 Revenues (City) ($000's)	2012 Revenues (FortisBC) ($000's)	April - December 2013 Revenues (FortisBC) ($000's)	2014 Revenues (FortisBC) ($000's)	2015 Revenues (FortisBC) ($000's)	2016 Revenues (FortisBC) ($000's)	2017 Revenues (FortisBC) ($000's)
Customer Class										
Residential	13,056	147,616,124	-	16,484	16,546	12,002	18,578	20,756	22,224	22,717
General Service	1,675	123,463,377	170,234	12,859	11,216	8,483	11,683	13,051	13,974	14,284
Industrial	10	53,207,500	154,285	3,719	3,727	2,829	4,090	4,570	4,893	5,002
Irrigation	3	10,381	-	0.767	1.174	0.816	1.288	1.440	1.541	1.575
Total	14,744	324,297,382	324,519	33,064	31,491	23,315	34,352	38,378	41,093	42,005

1.1 Please provide details by rate class of net and gross sales for the years 2012-2017 for the customers who will become customers of FortisBC?

Response:

Please refer to the response to ICG IR 2.1.0. The Company has assumed no load growth over the years in question.

1.2 Please provide details by rate class of revenues, in accordance with City of Kelowna and FortisBC rates, for the years 2012-2017?

Response:

Please refer to the response to ICG IR 2.1.0.

1.3 Please quantify the line losses FBC expects within the system to be acquired and explain how the losses have been treated in its analysis?

Response:

A detailed system loss analysis has not yet been carried out by the Company. However, the differential revenue impact assessment was carried out as follows:

- Power Purchase: No impact, since the electric network remains unchanged
- CoK Wholesale Revenue: Assessed through FortisBC Revenue Records
- CoK Retail Revenue: Assessed through retail information received from CoK

Therefore, any impact of system losses is incorporated into the analysis.

1.4 Will any customers being acquired become Irrigation customers of FortisBC?

Response:

FortisBC expects that there will be three customer accounts that will be irrigation customers.

1.5 Please confirm that none of the City's departments has been receiving service from the City at no charge?

Response:

Confirmed.

2. Re: Cost of Service studies

The application is silent on rate design matters and cost of service analyses.

2.0 Please identify the most recent cost of service study performed by FBC in accordance with Commission Order G-156-09? Please provide the summary results with revenue to cost (R/C) ratios by rate class and for each wholesale customer, and provide the COSA model?

Response:

Commission Order G-156-09 is specific to BC Hydro regarding its Large General Service rate design and is not applicable to FortisBC. The Company assumes that the reference should by to Order G-156-10 which relates to its 2009 Cost Of Service Analysis and Rate Design Application (2009 COSA and RDA).

The final revenue-to-cost ratios for FortisBC's customer classes at the time of that decision are found in the following table. Please note that due to rate class rebalancing since the time of that decision, the customer classes are now much closer to unity.

Residential	93.3%
Small General Service	107.6%
General Service	128.2%
Large GS Primary 30	112.8%
Large GS Transmission 31	103.1%
Lighting	80.4%
Irrigation	88.8%
Wholesale Primary	93.9%
Nelson Wholesale	95.1%

The 2009 COSA model is attached as Electronic Attachment ICG IR2 2.0.

2.1 Please comment on whether or not the City has performed a cost of service study in the past three years? If so, please provide the study? If not, please provide all rate class specific data provided by the City to FortisBC in the past three years?

Response:

The City of Kelowna has not performed a Cost of Service study in the past three years. The rate class specific data received from the City is attached as Appendix ICG 2.1. On occasion, the City may have provided additional summary data to FortisBC upon request, however there is no record of receipt of this information and none was used in the current analysis. FortisBC anticipates and has suggested in other regulatory proceedings that it intends to perform a new cost of service study after it has an adequate amount of customer data (1 year) from its proposed Advanced Metering Infrastructure (AMI) system. If both the AMI CPCN and the Acquisition of the City of Kelowna Distribution Assets CPCN are approved, the current City of Kelowna customers would be included in that study.

2.2 Please comment on whether or not industrial and commercial customers of FortisBC will be required to cover a portion of the cost of service of customers who will become customers of FortisBC that are in rate classes with R/C ratios below unity?

Response:

Based on the 2009 COSA, by the end of 2013 the only customer classes forecast to have a R/C ratio below unity are Irrigation and Lighting. The combined revenue deficiency of these classes is less than $800,000, a portion of which is recovered solely from the Large Commercial class. FortisBC does not have information specific to customers of the City of Kelowna and will not have information reflecting their inclusion in the FortisBC customer base until the next COSA is performed, however the Company believes that the addition of the City of Kelowna customers to FortisBC customer classes will not materially impact the revenue to cost ratios.

3. Re: Increased efficiency Application p.6 ll.13 et seq

FBC asserts that:

"As evidenced in Table 2 – Per Unit Operation & Maintenance (O&M) Costs, and Table 3 – Per Unit Revenue Requirement Analysis, the transaction will decrease the average O&M per customer and average Revenue Requirements per customer by approximately 9 percent as a result of this efficiency".

The application suggests that O&M expense per customer will be reduced by $43 per customer in 2013.

3.0 Please confirm that the numbers in the "O&M without COK" column actually include many of the costs of O&M that provided service to the one customer (City of Kelowna) prior to 2013, and that the analyses on Tables 1 and 2 merely increase the size of the denominator and thus appear to reduce the quotient.

<u>Response:</u>

The increase in the number of customers does increase the size of the denominator which serves to lower the O&M cost per customer. The Company's intent was to indicate that per unit O&M cost per customer (for all FortisBC customers) will reduce as a result of the acquisition of the COK electrical systems and its electricity customers.

For further clarification, the table below indicates the following:

- The average cost per customer without CoK in 2013 is estimated at $480;
- While the O&M cost to serve the COK customers alone in 2013 is $91;
- This lower cost of service from one local area will benefit all FortisBC customers and for all future years.

Per Unit Customer Analysis	2013	2014	2015	2016	2017	Remarks
Gross O&M Cost without COK WH	$56,277,000	$59,618,188	$60,734,584	$60,740,175	$62,436,469	Assuming marginal O&M Cost for COK WH
Average Customers without COK WH	117,230	119,512	121,831	124,112	126,368	
Gross O&M Cost per Customer without COK WH	**$480**	**$499**	**$499**	**$489**	**$494**	
O&M Cost for COK	$1,344,500	$1,355,600	$1,245,635	$1,158,111	$1,192,061	
COK Customers	14,744	14,744	14,744	14,744	14,744	
Gross O&M Cost per Customer for COK	**$91**	**$92**	**$84**	**$79**	**$81**	

4. Re: Customer benefit of transaction Application p.20 ll.19-24

FBC states that:

"Customer Benefit of Transaction – For 2013, this represents the benefit to customers associated with the transaction. As 2013 rates are already approved, this $1.98 million benefit will be recorded in a deferral account for the benefit of customers. Disposition will be sought in FortisBC's 2014 Revenue Requirements Application. For 2014, the analysis assumes that this benefit will be flowed back to customers to mitigate the 2014 customer rate increase".

4.0 Please confirm that the "customer benefit of transaction" of $1.98 million is primarily caused by the following assumptions:

- that it will not commence amortization or depreciation on the acquired assets until 2014;
- that it will start capitalizing 20% of O&M expense; and
- that no property taxes will be paid to the City of Kelowna until 2014.

Response:

The customer benefits are caused by the transaction. The numerical value of the particular $1.98 million benefit is derived as shown in the table below. Please note that the $1.98 million does not represent the total customer rate benefit of the transaction. The $1.98 million only represents the 2013 customer rate benefit of the transaction which is being proposed to flow back to customers in 2014 due to the fact that the 2013 rates are already set. As Figure 2, page 22 of the Application (Exhibit B-1) indicates, the 2015-2017 rates indicate that the cumulative rate increases are still lower than what they would have been absent the acquisition. It is anticipated that the 0.9 percent cumulative impact will remain as a permanent benefit to customers. This means that customer rates will permanently be approximately 1 percent lower than what they would have been absent the acquisition.

The $1.98 million flow through in 2014 arises due to the fact that FortisBC will over collect this amount in 2013 as the customer rates are already set for 2013 pursuant to the 2012-2013 Revenue Requirement Order G-110-12. This amount will flow back to the customers in 2014 to mitigate rate increases. The three items listed in the question above refer to the Company's Commission approved rate setting methodologies and the prevailing property tax rules which all impact the Company's rate setting calculation and therefore contribute to the resulting impact to customer rates.

Please also refer to the Application, Exhibit B-1, Page 22, Fig. 2 for further clarity.

Revenue Parameters for COK	**2013**
Net Operating Cost	1,076
Taxes	493
Financing Cost	3,249
	4,818
Revenue @ 2013 Approved Rate of 4.2%:	6,798
So, additional Revenue Collected in 2013:	**1,980**

In addition, please refer to the response to BCPSO IR 2.3.3 which discusses some of the other benefits of the transaction.

4.1 Please explain why FBC would not charge depreciation on the assets it proposes to acquire until January 1, 2014.

Response:

FortisBC will charge depreciation on the acquired assets no different than the depreciation methodology applied to FortisBC's other plant in service assets. For many years, FortisBC's depreciation expense has been calculated based on the investment in plant in service at the beginning of the year and therefore this policy will continue to apply for this particular asset acquisition. Most recently, this depreciation methodology has been approved under Commission Order G-110-12 concerning the Company's 2012 – 2013 Revenue Requirements. In addition it would not be cost effective or practical to employ different depreciation methodologies for different asset additions.

4.2 Please explain why FBC proposes to capitalize 20% of additional O&M expense, when the response to BCUC 1.14.9 makes it clear that the bulk of the O&M costs represent such items as costs of meter reading, bad debts, billing, postage and customer care.

Response:

FortisBC will capitalize 20 percent of these additional O&M expenses as this is the approved capitalized overhead policy applied to FortisBC's existing gross O&M expenses which already include meter reading, bad debt, billing, postage and customer care, among other items. The capitalization of the 20 per cent of these additional O&M expenses would be consistent with Commission Order G-110-12 concerning the Company's 2012-2013 Revenue Requirements which approved a 20 percent capitalized overhead rate against gross O&M expenses. In addition, it would not be cost effective or practical to incorporate different capitalized overhead policies for different geographic areas or different capital projects.

4.3 Please explain why FBC'S estimates of other income (Figure 2 at l.15) remain unchanged under the acquisition and the status quo scenarios. Has FBC not considered that there will be items such as pole rentals that will accrue to it as the new owner should the transaction proceed?

Response:

At the time of forecasting the acquisition and status quo scenarios, other income remained unchanged as FortisBC had not elected to take assignment of any of the potential income producing agreements as noted in the response to BCPSO IR 2.6.1.

However, recent negotiations indicate that the impact of these third party negotiations will have minor revenue differential increases and hence minor but positive impacts on customer rates.

Please also refer to the responses to BCUC IRs 2.9.1 and 2.9.2.

4.4 Please re-run Figure 2 on the assumptions that FBC does not capitalize customer care expense; property taxes accrue from the date of the agreement; and FBC charges depreciation on the assets it acquires from the date of the transaction.

Response:

Please see the requested financial model below. Please note that this model is not reflective of reality because it does not take into account the Commission approved treatment of costs for revenue requirement purposes and also overrides standard property tax conventions. The financial model in the table below is representative of the requested assumptions and results in a cumulative customer rate decrease of approximately 1%. The following assumptions have been made while running this scenario:

1. CoK Operating & Maintenance (O&M) Expense does not have any capitalized component (O&M will increase) for the period 2013-17. Note that this assumption is inconsistent with how FortisBC has been approved to recognize capitalized overhead pursuant to Commission Order G-110-12 as discussed in the response to ICG IR 2.4.2;
2. CoK Capital has also been adjusted (reduced) for Capitalized Overhead accordingly for the period 2013-17;
3. Property Tax has been introduced in the year 2013 at 97 percent of the 2014 value;
4. Depreciation for CoK assets initiates as of April 1, 2013. Note that this assumption is inconsistent with how FortisBC has been approved to recognize depreciation pursuant to Commission Order G-110-12 as discussed in the response to ICG IR 2.4.1; and
5. 2013 Customer Rate remains static at 4.2 percent approved level through an adjusted ”Customer Benefit of Transaction”.

However, please note that FortisBC believes that property taxes would not be payable in 2013 based on the following:

- The sale takes place after the legislated state and condition date of October 31, 2012. The distribution grid will become taxable property to FortisBC in 2014; and
- The City of Kelowna distribution grid is currently not taxable because improvements owned by the City of Kelowna are exempt from property taxes.

Please also refer to the response to ICG IR 2.5.1 regarding property tax assumptions.

Figure 2 - Comparative Revenue Requirement (Adjusted per ICG IR-2 Q4.4)

		Revenue Requirements Overview (With COK)					Revenue Requirements Overview (Without COK)					Difference (COK Effect Only)				
		Forecast 2013	Forecast 2014	Forecast 2015	Forecast 2016	Forecast 2017	Forecast 2013	Forecast 2014	Forecast 2015	Forecast 2016	Forecast 2017	Forecast 2013	Forecast 2014	Forecast 2015	Forecast 2016	Forecast 2017
1	Sales Volume (GWh)	3,233	3,266	3,289	3,293	3,298	3,233	3,266	3,289	3,293	3,298	-	-	-	-	-
2	Rate Base	1,216,011	1,320,041	1,364,834	1,402,670	1,428,152	1,172,902	1,257,471	1,297,004	1,329,558	1,352,063	43,109	62,569	67,831	73,111	76,089
5	Return on Rate Base	7.47%	7.44%	7.46%	7.52%	7.50%	7.47%	7.49%	7.49%	7.56%	7.54%	0.00%	-0.05%	-0.03%	-0.04%	-0.04%
6																
7	**REVENUE DEFICIENCY**															
8																
9	**POWER SUPPLY**															
10	Power Purchases	91,942	97,725	125,945	144,508	151,111	91,942	97,725	125,945	144,508	151,111	-	-	-	-	-
11	Water Fees	9,871	10,068	10,270	10,475	10,684	9,871	10,068	10,270	10,475	10,684	-	-	-	-	-
12		101,813	107,793	136,215	154,983	161,795	101,813	107,793	136,215	154,983	161,795	-	-	-	-	-
13	**OPERATING**															
14	O&M Expense	57,621	60,974	61,980	61,898	63,628	56,277	59,618	60,735	60,740	62,436	1,344	1,356	1,245	1,158	1,191
15	Capitalized Overhead	(11,255)	(11,924)	(12,147)	(12,148)	(12,487)	(11,255)	(11,924)	(12,147)	(12,148)	(12,487)	-	-	-	-	-
16	Wheeling	5,233	4,801	4,896	4,993	5,092	5,233	4,801	4,896	4,993	5,092	-	-	-	-	-
17	Other Income	(7,165)	(7,223)	(7,275)	(7,433)	(7,642)	(7,165)	(7,223)	(7,275)	(7,433)	(7,642)	-	-	-	-	-
18		44,434	46,629	47,453	47,309	48,590	43,090	45,273	46,208	46,152	47,399	1,344	1,356	1,245	1,158	1,191
19	**TAXES**															
20	Property Taxes	15,578	16,051	16,494	17,088	17,621	15,085	15,543	15,976	16,447	16,932	493	508	518	641	689
21	Income Taxes	7,394	8,281	10,739	12,326	13,020	7,022	8,302	10,726	12,253	12,856	373	(21)	13	73	163
22		22,972	24,332	27,233	29,414	30,641	22,107	23,845	26,702	28,700	29,788	866	487	531	714	853
23	**FINANCING**															
24	Cost of Debt	42,634	45,985	47,815	49,977	50,548	41,125	44,378	45,847	47,861	48,350	1,510	1,606	1,968	2,116	2,198
25	Cost of Equity	48,154	52,274	54,047	55,546	56,555	46,447	49,796	51,361	52,650	53,542	1,707	2,478	2,686	2,895	3,013
26	Depreciation and Amortization	52,127	62,516	63,168	67,306	67,531	51,091	60,684	61,549	65,494	65,536	1,035	1,832	1,619	1,812	1,995
27		142,915	160,774	165,030	172,829	174,634	138,663	154,858	158,757	166,005	167,427	4,252	5,916	6,273	6,824	7,206
28																
29	Flow Through Adjustments	(1,941)	(3,200)	-	-	-	(1,941)	(3,200)	-	-	-	-	-	-	-	-
30	Customer Benefit of Transaction	338	(338)	-	-	-	-	-	-	-	-	338	(338)	-	-	-
31		(1,603)	(3,538)	-	-	-	(1,941)	(3,200)	-	-	-	338	(338)	-	-	-
32																
33	**TOTAL REVENUE REQUIREMENT**	310,532	335,991	375,931	404,535	415,661	303,732	328,569	367,882	395,840	406,410	6,800	7,421	8,049	8,695	9,251
34																
35	**LESS: REVENUE AT APPROVED RATES**	298,005	316,515	338,875	377,872	406,658	291,481	307,006	331,479	369,839	397,985	6,525	9,509	7,396	8,032	8,673
36	**REVENUE DEFICIENCY for Rate Setting**	12,526	19,476	37,056	26,663	9,003	12,251	21,564	36,402	26,001	8,425	275	(2,087)	653	662	578
37																
38	**RATE INCREASE**	**4.2%**	**6.2%**	**10.9%**	**7.1%**	**2.2%**	**4.2%**	**7.0%**	**11.0%**	**7.0%**	**2.1%**	**0.0%**	**-0.8%**	**-0.1%**	**0.1%**	**0.1%**
39	**Cumulative Rate Increase**	**4.2%**	**10.7%**	**22.7%**	**31.4%**	**34.3%**	4.2%	11.5%	23.8%	32.4%	35.2%	**0.0%**	**-0.8%**	**-1.0%**	**-1.0%**	**-0.9%**

5. Re: Property Taxes

5.0 The City's Annual Report lists FortisBC as the fourth largest corporate tax-payer. For the years 2011 and 2012, please provide details of the property taxes paid by FBC to the City of Kelowna and the properties/operations the payments were in respect of.

Response:

FortisBC paid approximately $2.3 million for each of 2011 and 2012 to the City of Kelowna as Property Tax. The detail is provided in the Tables below:

Property Tax Breakdown City of Kelowna – 2011:

Folio		Tax Payment 2011
214-020250	Glenmore Substation	$ 57,251.60
214-067330	Recreation Ave Substation	33,087.05
214-075958	Saucier Substation	39,879.54
217-02095-164	8850 Grigg Road	42,153.24
217-02095-173	RW - UCL Bed of Vernon Creek	1.59
217-03161-047	Sexsmith Substation	39,373.83
217-03664-500	Ellison Substation	76,887.56
217-04032-180	Benvoulin Substation	100,852.52
217-04423-202	Hollywood Substation	35,152.05
217-06832-005	RW-UCL Sec 6, Twn 27 ODYLD Except Plar	306.27
217-06869-001	Black Mountain Sub	112,600.35
217-06922-020	Lee Terminal	119,538.95
217-07249-000	Bell Substation	47,024.11
217-10589-070	Fortis Office / Warehouse	123,042.19
217-10806-005	Okanagan-Mission Substation	49,281.56
217-24165-000	TL City of Kelowna (TL 45, 46, 48, 50, 51, 72	136,806.48
217-24165-010	DL 9330 - City of Kelowna	404,922.75
217-24165-101	Hiram Walker Plant Substation	416.94
217-24165-103	Duck Lake Substation	66,894.18
217-24165-210	TL City of Kelowna (TL 50, 55, 48)	25,904.21
217-24165-220	TL City of Kelowna (TL 50, 55)	77.48
	Totals	$ 1,511,454.45
	Grants-in-Lieu	735,209.01
	Grand Totals	$ 2,246,663.46

Property Tax Breakdown City of Kelowna – 2012:

Folio		Tax Payment 2012
214-020250	Glenmore Substation	$ 59,430.69
214-067330	Recreation Ave Substation	35,714.48
214-075958	Saucier Substation	39,316.16
217-02095-164	Duck Lake Sub	109,972.86
217-02095-173	RW - UCL Bed of Vernon Creek	1.66
217-03161-047	Sexsmith Substation	43,116.76
217-03664-500	Ellison Substation	83,923.53
217-04032-180	Benvoulin Substation	105,204.86
217-04423-202	Hollywood Substation	34,585.06
217-06832-005	RW-UCL Sec 6, Twn 27 ODYLD Except Plan	321.58
217-06869-001	Black Mountain Sub	113,352.11
217-06922-020	Lee Terminal	118,226.77
217-07249-000	Bell Substation	46,147.46
217-10589-070	Fortis Office / Warehouse	128,599.09
217-10806-005	Okanagan-Mission Substation	48,269.83
217-24165-000	TL City of Kelowna (TL 45, 46, 48, 50, 51, 72	141,070.87
217-24165-010	DL 9330 - City of Kelowna	418,053.50
217-24165-210	TL City of Kelowna (TL 50, 55, 48)	26,963.55
217-24165-220	TL City of Kelowna (TL 50, 55)	81.31
	Totals	1,552,352.13
	Grants-in-Lieu	770,868.75
	Grand Totals	2,323,220.88

5.1 Please confirm that in Appendix BCUC IR1 11.2, the City's letter of engagement to Deloitte, it states that property taxes of $761,000, $ 791,000, $841,000 and $871,000 will be payable by FBC in the years 2013-6, whereas page 22 of the application at line 18 includes the numbers $0, $508,000, $518,000 and $638,000 for those years. If confirmed, please explain the differences?

Response:

FortisBC confirms its Property Tax estimation to the City of Kelowna, as indicated in the Application (Exhibit B-1) in Figure 2 and page 22 at line 18, as $0, $508,000, $518,000 and $638,000 for the years 2013 to 2016 respectively.

Additionally, FortisBC believes that Property taxes would not be payable in 2013 based on the following:

- The sale takes place after the legislated state and condition date of October 31, 2012. The distribution grid will become taxable property to FortisBC in 2014; and
- The City of Kelowna distribution grid is currently not taxable because improvements owned by the City of Kelowna are exempt from property taxes.

The City's letter of engagement to Deloitte was not based on estimates and assumptions made by FortisBC, therefore the Company is not in a position to reconcile the differences.

5.2 Would FBC have expected the City, in preparing its economic evaluation of the transaction, to have included the impact of receiving property taxes on land that was exempt prior to the transaction?

Response:

Yes.

5.3 Please confirm that the net present value of a payment stream of the magnitude included in the City's letter to Deloitte would yield a net present value in the order of $10 million, discounted at 3% over 20 years.

Response:

The City's letter to Deloitte, which provided estimates of property taxes, was not based on estimates provided by FortisBC, therefore the Company is not in a position to comment on the same.

Please also refer to the response to ICG IR 2.5.1.

5.4 Please comment on the fairness of FBC requiring all its customers to contribute to what might be considered a benefit to only those customers resident within the City's boundaries.

Response:

FortisBC submits that benefits associated with the project will be received by all FortisBC customers. If the question is referring to the fact that FortisBC's property plant and equipment is subject to various forms of taxes, then the Company submits that paying those taxes are necessary in order for FortisBC to provide service to its customers.

5.5 Has FBC considered recovering this amount by way of a Rider on its Kelowna customers' bills?

Response:

No. FortisBC submits that it pays property taxes on its assets in all of its jurisdictions and does not recover these costs from those customers in each of those areas by way of a rate rider.

6. Re: The City of Kelowna's electrical system operating results

6.0 Please confirm that the following table summarizes the City of Kelowna's electrical system operating results:

City of Kelowna Electric System Operating Results			$million		
Year	2011	2010	2009	2008	2007
Revenues	32.0	27.7	26.7	24.3	23.5
Costs	24.2	21.4	20.7	21.1	25.2
Amortization	1.1	1.1	1.0		
Surplus	6.7	5.2	5.0	3.2	-1.7

(Source: City website)

Response:

Confirmed. However, the surplus amount shown is before any contribution to the General Fund or capital expenditures from current year revenues. The 2008 information above was restated to match the PSAB 3150 reporting requirements. The 2007 information was adjusted by removing the capital expenditures from the costs to be consistent with the statement format of the other years.

6.1 Please also confirm that the electric system carries no debt and does not pay property taxes?

Response:

While FortisBC understands that the City holds the utility assets directly with its other assets, the Company is not certain if the City has allocated a portion of its outstanding debt specifically to the utility assets, or if its debt is unallocated and funds all Utility assets.

FortisBC understands that the City does not pay property tax but it does provide an annual return back to the citizens of Kelowna, which though not related to a tax liability, may be considered as a payment-in-lieu of property taxes.

7. Re: Accumulated Depreciation

7.0 Please confirm that the City adopted depreciation accounting for its fixed assets in or around 2009?

Response:

Confirmed. Effective January 1, 2009, the City adopted PS 3150, Tangible Capital Assets of the Public Sector Accounting Handbook of the CICA which required the recognition and depreciation of tangible capital assets, including a retroactive adjustment for 2008 comparatives. It should be noted that the City's depreciation practices differ from the depreciation methodology implemented by a rate-regulated utility such as FortisBC, as discussed in the response to ICG IR 2.7.2.

7.1 How did the City calculate its accumulated amortization as at December 31, 2008?

Response:

The retroactive adjustment of accumulated amortization, as required under PS 3150, Tangible Capital Assets of the Public Sector Accounting Handbook of the Canadian Institute of Chartered Accountants, was accomplished by conducting a review of original cost, completeness of the assets and an estimation of remaining useful life effective December 31, 2007. The retroactive amortization adjustment and the establishment of the City's net book value of the assets, as determined under public sector accounting, was included as part of the City's annual consolidated financial statements which are audited. Note that this did not lead to an adjustment for all factors that a rate regulated utility would face. It should be noted that the City's depreciation practices differ from the depreciation methodology implemented by a rate-regulated utility such as FortisBC, as discussed in the response to ICG IR 2.7.2.

7.2 Please provide, in a table, a comparison of amortization rates used by the City with those in use for comparable assets by FBC?

Response:

A comparison of depreciation rates has been provided below based on the following:

- CoK depreciation rates are derived from the City's electrical asset sub ledger as shown in Exhibit B-7, Electronic Attachment 1, Tab Asset Inventory DEPR Asset Value; and
- FortisBC's depreciation rates are effective for 2012 and 2013 and were approved under Commission Order G-110-12 concerning the Company's 2012-2013 Revenue Requirements.

COK Asset Type	COK Average Depr. Rate 2008-2011	Comparable FortisBC Asset Accounts & Approved Depreciation Rates	
		Asset Account	Depr. Rate
Substation	2.0%	A/c 362	2.2%
Electrical Meters	3.2%	A/c 370	6.7%
Distribution Components	3.0%	A/c 362,364,365	2.3% Average
Main Switcher Replacements	1.5%	A/c 362	2.2%
Copper Replacements	1.3%	A/c 365	2.6%
Electrical Undergrounding	1.5%	A/c 366	2.6%
Feeder Back-Up Mains	1.7%	A/c 364,363	2.4% Average
Feeder Condition Upgrades	1.7%	A/c 364,364	2.4% Average
Capacity Driven O/H Upgrades	1.6%	A/c 364,365	2.4% Average

When comparing the depreciation rates between the City and FortisBC, it is necessary to consider that each is subject to different depreciation methodologies.

The City tracks its assets by individual asset and depreciates those assets on a straight-line basis over the expected useful life of the individual asset. For example, the 2.0% used to depreciate substations is actually the straight-line rate applied to a 50 year expected useful life. FortisBC understands that these depreciation rates are applied once the asset is put into service.

FortisBC, on the other hand, uses group depreciation practices consistent with the BC Uniform System of Accounts and as approved under Commission Order G-110-12 concerning the Company's 2012-2013 Revenue Requirements. FBC's group depreciation rates are based on the estimated remaining life of an asset class and those rates are revised based on the results of depreciation studies performed on a periodic basis. This will always lead to a variance from the expected useful life. Based on FBC's most recent depreciation study included in the 2012-2013 Revenue Requirements, the Survivor Curve for account 362-Substations has an expected useful life of 55 years, which would represent a 1.8% straight-line rate. This rate is actually lower than the substation depreciation rate used by the City. However, as determined in the study, a 2.2% depreciation rate was applied to the original cost of account 362-Substations. The depreciation rate was increased to accommodate historical under depreciation, higher costs of removal and higher losses on retirement. It should also be noted that the Company's depreciation rates would be updated on the next depreciation study to reflect the acquisition of the City's electrical assets.

As such, these are drivers that need to be considered when comparing depreciation rates between an entity that maintains its depreciation on an individual asset level, such as the City, as compared to a rate-regulated utility, such as FBC, which applies a group depreciation methodology which is consistent the BC Uniform System of Accounts and as approved by the BCUC.

8. Re: NBV of City assets Ref IR 7.5

Included in the response to IR 7.5 are a number of internal emails concerning the NBV of the assets to be acquired. One, dated January 26, 2012 speaks of the City's estimate at the end of 2011 being $34.5 million, while another dated February 28, 2012 speaks of the NBV being $32.818 million.

8.0 Please explain how FBC satisfied itself as to the accuracy of the number it used in its response to BCUC 1.11.3 of $29.218 million?

Response:

FortisBC agreed the City's December 31, 2011 Net Book Value of $29.218 million, which is derived under public sector accounting policies, with the City's internal capital asset sub ledger. This number has been included in the City's 2011 annual consolidated financial statements and as such has been subject to an external audit in accordance with public sector accounting policies. The $29.218 million has been used as a starting point to provide the City's forecast asset Net Book Value, using public sector accounting policies, at the end of the first quarter of 2013. This leads to a base value of $38.8 million as at March 31, 2013, prior to the application of rate regulated accounting principles.

8.1 Please also confirm that the number is not readily available in the annual report of the City, but is rather combined with a number of other City departments' assets?

Response:

The $29.218 million net book value of the City's electric assets as at December 31, 2011, which was derived using public sector accounting policies, is not readily available in the City's annual report as it was combined with other City departments' property, plant and equipment. Despite the lack of explicit disclosure around this number in the City's Annual Report, it has still been subject to an external audit in accordance with public sector accounting policies as part of the City's 2011 annual consolidated financial statements.

9. Re: Capital Additions 2012 to close Ref BCUC IR 1.11.3

FBC states that the following assets have been added by the City:

2012 estimated additions - $5,308,000

Q1 2013 estimated additions $1,419,000

Construction work in progress 1t December 31, 2011 $3,700,000

9.0 Please explain why the Commission should grant a CPCN in respect of $10,427,000 of capital expenditures for which neither the City nor FBC can provide any detail?

Response:

The estimated 2012 and 2013 additions are based on the financial information included in the attached City of Kelowna electrical system development plan and determined as follows:

- The determination of 2012 estimated additions of $5.308 million were based on the listing of projects that amounted to the $5.349 million capital expenditures for 2012 less the street lighting new installations of $0.041 million; and
- The determination of the Q1 2013 estimated additions of $1.419 million were based on the listing of projects that amounted to the $5.719 million less the street lighting new installation of $0.042 million. The remaining balance was then pro-rated for three months to arrive at $1.419 million.

The Construction Work In Progress balance of $3.7 million as at December 31, 2011 is supported by the COK's internal subledger which is also attached.

	2012	Q1-2013	Total
	($000s)		
Capital Budget Total (expenditures in year)*	5,349	5,719	
less: street light new installations	(41)	(42)	
subtotal	5,308	5,677	
pro-rata for the period	100%	25%	
Capital expenditures in the period	5,308	1,419	
add 2011 Construction Work In Progress**	3,700	-	
Estimated capital asset additions	9,008	1,419	**10,427**

*see attached City of Kelowna Electric System Development Plan

**see attached City of Kelowna December 31, 2011 CWIP subledger

City of Kelowna Electrical System Dev

Capital Growth

	Section	2011	2012	2013	2014	2015	2016
New Connects							
New Customers	*	20,000	20,000	21,000	21,000	22,000	22,(
Forced System Upgrades	*	500,000	510,000	520,000	531,000	541,000	552,(
City Infrastructure Driven Work							
Total City Infrastructure Driven Work	*	250,000	255,000	260,000	265,000	271,000	276,0
Street Lighting							
New Installations	*	40,000	41,000	42,000	42,000	43,000	44,0
Captal Growth Subtotal		810,000	826,000	843,000	859,000	877,000	894,0

Capital - Sustaining and Reliability

	Section	2011	2012	2013	2014	2015	2016
Capacity Driven Upgrades							
Capacity Driven Feeder Projects†	8.1	1,304,000	883,000	210,000	57,000		317,0
Reliability Driven Upgrades							
Reliability Driven Feeder Projects	8.2	258,000				260,000	
Fault Indicator Installation†	7.5		102,000	104,000	106,000	108,000	110,0
Condition Driven Feeder Upgrades							
Overhead Distribution Condition Assessment	7.7				144,000		
Overhead Distribution Rehabilitation	7.7				84,000	756,000	
Secondary Repairs	*	62,000	63,000	65,000	66,000	67,000	68,0
Underground Distribution Condition Assessment	7.2	38,000		40,000		42,000	
Underground Distribution Rehabilitation	7.2		453,000		471,000		490,00
Underground Cable Replacement†	7.3	200,000	765,000	780,000	796,000	812,000	828,00
Underground Subdivision Regeneration†	7.6		398,000	406,000	414,000	422,000	431,00
Overloaded Transformers and Copper Replacement†	7.6	250,000	510,000	520,000	531,000	541,000	552,00
Lightning Arrestor Replacement	7.8	5,000					
Miscellaneous Feeder / Urgent Repairs	*	91,000	93,000	95,000	97,000	99,000	100,00
Condition Driven Equipment Upgrades							
Switch Replacement†	7.4		526,000	537,000	548,000	559,000	570,00
PCB Record and Test†	7.9		102,000	104,000	106,000	108,000	110,00
PCB Rehabilitation†	7.9			110,000	112,000	115,000	117,00
Station Upgrades							
Emergency Station Repairs	6.1	10,000	10,000	10,000	11,000	11,000	11,00
Saucier Breaker House	6.1					1,922,000	1,960,00
Spall Breaker House	6.2			1,098,000	1,120,000		
General Projects							
System Development Plan	5					125,000	
Feeder Optimization	7.1	95,000					105,00
Assessment of Street Light Options†	7.10		92,000				
Connect Billing Data to ArcFM†	7.12		26,000	152,000	84,000		
ArcFM Feeder System Audit	7.13			135,000			
Smart Metering	7.14		500,000	510,000			
Capital - Sustaining and Reliability Subtotal		2,313,000	4,523,000	4,876,000	4,727,000	5,947,000	5,769,000

	2011	2012	2013	2014	2015	2016
Capital Budget Total	3,123,000	5,349,000	5,719,000	5,586,000	6,824,000	6,663,000

Street Lighting

	Section	2011	2012	2013	2014	2015	2016
Street Lighting							
Condition Assessment	7.11	240,000	49,000	50,000	51,000	52,000	53,000
Pole Replacement	7.11		125,000	50,000	51,000	52,000	53,000
Luminaire, bulb, photocell Maintenance	7.11	180,000	184,000	187,000	191,000	195,000	199,000
Street Lighting Budget Total		420,000	358,000	287,000	293,000	299,000	305,000

City of Kelowna
Tangible Capital Assets
Electrical Fund
2011 Work in Progress

Electrical Infrastructure

2380	Customer Driven Line Extension	1,735.98	
238004	Customer Driven Line Extension 2010 WIP	138,131.95	
238004	Customer Driven Line Extension	104,041.96	
238006	Customer Forced System Upgrades 2010 WIP	176,606.44	
238006	Customer Forced System Upgrades	84,846.11	
238010	Customer Driven Upgrades Transformers	115,450.04	
	Total project 2380		620,812.48
2380E	Customer Driven Line Extension - 08 WIP	337,754.58	
	Customer Driven Line Extension - 09 WIP	86,296.09	
	Customer Driven Line Extension - 10 WIP	8,967.97	
			433,018.64
	Infrastructure - Electrical (TCA220)		
2671	PCB Testing		139,433.29
	Feeder Condition Upgrades		
2469	Feeder Condition Upgrades - 10 WIP	9,646.93	
2469	Feeder Condition Upgrades	10,645.11	
246901	79TB014 - 1490 Gordon Dr feeder condition upgrades 2010 WIP	58,496.52	
2476	City Infrastructural Work - 10 WIP	12.57	
2476	City Infrastructural Work	35,602.96	
247601	Lane North of Lawrence 2010 WIP	23,012.14	
247606	Abbott St Rec Corridor 2010 WIP	200,094.07	
247606	Abbott St Rec Corridor	(39609.98)	
			297,900.32
2949	Reliability Driven Feeder Upgrades	187,869.22	
294901	Reliabilitiy Driven Feeder Upgrades - OH Knox Mtn	22,854.44	
294902	Parkingson Rec Cable Replc - Reliability Driven Feeder	63,618.36	
2951	Feeder Capacity Upgrades	162,836.57	
			437,178.59
	Main Switcher Replacement		
	Feeder Tie-Ins		
	Copper Replacement Program (TCA390)		
2956	Fault Indicator Installation		16,013.21
	Electrical Undergrounding (TCA390)		
247604	City Infrastructure Ellis UG feeder 2010 WIP	108,080.34	
247604	City Infrastructure Ellis UG feeder	7,690.35	
247605	City Infrastructure Parkinson Rec Corridor Sutherland 2010 WIP	315.92	
247605	City Infrastructure Parkinson Rec Corridor Sutherland	42,642.01	
247608	City Infrastructure Ethel St Cawston to BCTTP -KPR	42,055.67	
247609	City Infrastructure - Bernard Revitalization	9,422.85	
2797	U/G Subd Cable Replacements	92,962.34	
279701	Coopland - upgrade U/G Subd Cable replacement 2010 WIP	277.37	
279705	St. Andrews U/G cable replacement 2010 WIP	207,509.35	
279705	St. Andrews U/G cable replacement	20,137.05	
279706	Montrose - U/G Subd cable replacement 2010 WIP	13,787.49	
279707	Monterey - U/G Subd cable replacement 2010 WIP	120,284.22	
279709	U/G Subd cable replacements - Van St 2010 WIP	4,981.71	
279709	U/G Subd cable replacements - Van St	129,751.73	
279710	U/G Subd Cable replacements - Secondary upgrade 2010 WIP	10,338.53	
279710	U/G Subd Cable replacements - Secondary upgrade	10,747.57	
279711	U/G Subd Cable replacements	168,056.58	
295101	Install 750MCM to extend Saucier Subt Feeder #7	333,371.83	
295102	Tap Recreation # 2 Feeder at switch 79MS020	245,073.06	
295103	RE Feed pull box 79JN033 with 350 MCM Feeder	122,049.74	
295104	Replace 79N330 to 79MS021 Feeder capacity upgrade	20,566.60	
			1,710,102.31
			3,654,458.84
		PREV WIP	3,364,693.69
		CF WIP CAP	(1,860,099.50)
		2011 additions	2,149,864.65
			3,654,458.84

9.1 Will the City provide an indemnity to the effect that should the expenditures not be made; the purchase price will be adjusted?

Response:

No. There is no such indemnity available.

10. Re: Land at Richter St Ref BCUC 1.11.3

10.0 Please confirm that land at 1000-8 Richter St, Kelowna forms part of the transaction, and that its value has been set at $700,000?

Response:

As stated in Schedule 1.1(iii) of the Asset Purchase Agreement the following two parcels of land are included in the sale:

- Richter/Recreation Power Pole St. located at 1000 Richter Street; PID 006-057-861, Lot 1 District Lot 139 Osoyoos Division Yale District Plan 24283; and
- Richter/Recreation Substation located at 1008 Richter Street; PID 006-057-870, Lot 2 District Lot 139 Osoyoos Division Yale District Plan 24283.

The 2012 assessed value of the above properties is approximately $0.7 million as per the CoK Letter of September 10, 2012 to Deloitte & Touche LLP (Refer to Appendix BCUC IR1 11.2), Page 2 Cl. 8 & Page 3, Cl. 15.

10.1 If so, has FBC commissioned an appraisal of the land on Richter St?

Response:

No.

10.2 Has FBC considered Property Transfer Tax on the land on Richter St as well as any other parcels of land it may be acquiring?

Response:

Yes, FortisBC has considered property transfer tax on the real property being transferred to FortisBC. As stated in the response to ICG IR 2.10.0, the real property which will be transferred to FortisBC as part of the proposed acquisition is listed in Schedule 1.1(iii) of the Asset Purchase Agreement.

10.3 Presently, what utility service is being provided at the Richter St properties?

Response:

The Richter Street property owned by the City houses the Saucier Substation which is a wholesale meter point to the City. FortisBC owns the main power transformer and associated high voltage breakers, wholesale meters and substation equipment while the City owns the distribution breakers.

11. Re: Cost of Capital

11.0 Please provide a comparison of FBC's incremental cost of capital (60:40 long term debt and equity) and income taxes, with the cost of borrowing by the City of Kelowna?

Response:

FortisBC's 2013 forecast, interim (due to the ongoing Generic Cost of Capital proceeding) after-tax Weighted Average Cost of Capital, based on the underlying assumptions included in the 2012-2013 Revenue Requirements which was approved under Commission Order G-110-12, is approximately 6.6%. While the City holds a variety of debt instruments at different interest rates, FortisBC understands that the City does not have available a single weighted average cost of debt, nor does it have debt directly allocated to its electrical utility fund.

11.1 Please calculate the present value of the difference in revenue requirements of FBC making the $70 million in additional infrastructure investment which the City states that it will require over the next 20 years, with the incremental cost of City ownership.

Response:

The City of Kelowna had estimated infrastructure investment of $70 million over the next 20 years. On a simplistic basis, this yields an average rate of $3.5 million per year. This rate has been used to revise the additional capital expenditure volume in the FortisBC base case model (Refer to Exhibit B-1, Page 22, Fig. 2) during 2013-17.

The revised capital expenditure as above, results in a variance in revenue requirements from the base case. The Net Present Value (NPV) of this variance stream during 2013-17 at an assumed discount rate of 8% would be -$2.3 million (negative).

The analysis is shown in the tables below:

COK Capital & Revenue (per IR)	2013	2014	2015	2016	2017	Cumulative	Average
Additional Sustaining & Growth Capital (per IR)	3,231	3,229	3,251	3,268	3,262	**16,241**	**3,248**
Capitalized Overhead (per IR)	269	271	249	232	238	**1,259**	**252**
Total	**3,500**	**3,500**	**3,500**	**3,500**	**3,500**	**17,500**	**3,500**
Revenue Requirement (per IR)	6798.00	4561.09	7242.10	7601.44	7961.49	**34,164**	**6,833**

COK Capital & Revenue (Base Case)	2013	2014	2015	2016	2017	Cumulative	Average
Additional Sustaining & Growth Capital (Base Case)	5,965	6,473	7,032	6,809	2,482	**28,761**	5,752
Capitalized Overhead (Base Case)	269	271	249	232	238	**1,259**	252
Total	**6,234**	**6,744**	**7,281**	**7,041**	**2,720**	**30,020**	**6,004**
Revenue Requirement (Base Case)	6,798	4,904	7,869	8,559	9,136	**37,266**	**7,453**

Variance in Revenue Requirements & NPV	2013	2014	2015	2016	2017	Cumulative	Average
Variance in Revenue Requirements	-	(343)	(627)	(958)	(1,175)	**(3,103)**	**(621)**
NPV (2013-2017 @ 8% Discount Rate)	**(2,295)**						

12. Re: Tangible Benefits of the Transaction

12.0 Please provide and quantify the tangible benefits of the transaction. These include, but are presumably not limited to:

- a reduction in the margin earned by Fortis through its non-regulated affiliate Fortis Pacific Holdings Inc.;
- economies of scale in the area of customer billing; and
- other.

Response:

While there are tangible benefits that arise from this transaction to be discussed later in this response, the suggested items in this information request noted above are not indicated benefits of the transaction.

During the preparation of the FortisBC revenue requirements for 2012-13, it was decided that it was unlikely that Fortis Pacific Holdings would enter into a new agreement to provide the management services; therefore no associated revenues were included beyond 2012. As such, there are no reductions to revenue requirements that will arise due to this acquisition, related a decrease in non-regulated affiliate margin.

In addition, the benefits that are expected to arise out of the area of customer billing are not quantitatively significant in the short-term. However the aggregate of smaller processes, such as one process for customer communication, are eventually expected to create benefits over the longer-term.

Many of the tangible benefits that all FortisBC ratepayers will receive assuming the $55 million purchase price is included in rate base are discussed in the CPCN Application as follows:

Firstly, all FortisBC ratepayers will receive benefit from the approximately 1 per cent cumulative reduction in customer rate increases from 2013 through to 2017 as shown in Figure 2 on page 22 of the CPCN application.

Secondly, the tangible benefits of the transaction can be stated as including:

- as an operating and maintenance expense per customer reduction ranging from $43 to $45 from 2013 to 2017 as shown in Table 1 “Per Unit O&M Costs” on page 7 of the CPCN application, and
- as a revenue requirement per customer reduction ranging from $238 to $277 from 2013 to 2017 as shown in Table 2 “Per Unit Revenue Requirements Analysis” on page 7 of the CPCN application

As shown on page 7 of the CPCN application there are absolute increases in costs of service and revenue requirements as a result of this transaction, however those increases are more than offset by the addition of the approximately 15,000 customers. The incremental and existing costs of service and revenue requirements will be shared by more customers thereby reducing cost and revenue requirement per customer unit. While FortisBC is always looking for opportunities to prudently reduce costs, tangible benefits to be passed along to all of FortisBC’s ratepayers can also be obtained through the addition of customers in absence of reducing the absolute cost side of the equation.

In addition, the Company submits that there are many tangible benefits that will accrue to customers as a result of this transaction. Some of these benefits are easily quantified in terms of dollar or rate impacts, while other may not easily be dollar quantifiable, but still represent tangible benefits to customers. As discussed in response to BCPSO #2-3.3, the benefits that should be considered include, but are not limited to:

- rates for both sets of customers that are lower than if the transaction did not take place;

- existing FortisBC customers will receive the benefit of rate mitigation of approximately 1 percent over the 5 years following the conclusion of the transaction;
- current City commercial and industrial customers will benefit by both the immediate reduction in rates, and by the ongoing rate mitigation that the transaction provides;
- all customers benefit from the increased efficiency related to the continuity of service territory that this transaction affords;
- existing City of Kelowna customers will benefit from BCUC regulation;
- as part of FortisBC, existing City of Kelowna customers will have rate parity with other FortisBC customers and will likely enjoy more rate stability going forward;
- existing City of Kelowna customers will benefit from future energy conservation initiatives proposed by FortisBC;
- existing City of Kelowna customers will benefit from a uniform application of provincial policy; and
- existing City of Kelowna customers will benefit from the ongoing expert utility management of FortisBC that will ensure safe, secure and reliable utility service.

The above sampling of tangible benefits will be passed on to all of FortisBC's ratepayers. Since this transaction is not a transfer of rate base assets between regulated utilities and there are tangible benefits that accrue to all ratepayers, the Company believes that the inclusion of the $55 million purchase price in rate base will establish just and reasonable rates,

12.1 Please contrast and quantify the tangible benefits with the tangible downsides of the transaction, including:

- the increased cost of capital of FBC over the City;
- the fact that FBC is liable for income taxes while the City is exempt;
- the fact that FBC pays property taxes while the City does not; and
- the premium being proposed over book value payable by FBC.

Response:

First, the Company submits that the question contains errors in its assumptions including the characterizations of “downsides”. For example, the question assumes that any increase in cost to operate the City’s assets is a downside of the transaction. This is not an accurate assumption due to the fact that the City has not set rates on a regulated basis. The increases in costs to operate the assets do not result in an increase in customer rates. In fact customer rates will decrease even with the items listed above. Therefore, the items identified in the question cannot be considered a downside of the transaction.

Please refer to the response to ICG IR 2.12.0 which has already considered all the above factors with the exception of the premium comment. The concept of premium is defined in the response to BCUC IR 2.8.1 as any amount in excess of rate base. The tangible benefits which will be passed along to customers are based on the inclusion of the entire purchase amount of $55 million in rate base and therefore the concept of premium is not applicable.

13. Re: Income Taxes

13.0 Please confirm that FBC’s proposal effectively requires that all its customers take the risk of the entire purchase price being eligible for capital cost allowance treatment, in that, if a portion of the proceeds are disallowed as capital additions and are treated as Eligible Capital Expenditures, the negative impact will be allocated to all FBC’s customers?

Response:

FBC believes that it is unlikely that a CRA review, at a subsequent tax audit date, would reclass a portion the acquired assets included in rate base from a Capital Cost Allowance pool to an Eligible Capital Expenditure pool due to the following:

- FortisBC has forecast the tax basis based on its knowledge and experience of maintaining the assets for the last twelve years; and
- *Federal Court of Appeal (FCA) TransAlta Corporation v The Queen (Docket: A-350-10), January 20, 2012*, supports the principle that the capital asset approved for inclusion in a regulated rate base can be appropriately allocated to capital cost allowance tax pools, rather than eligible capital expenditures.

In the event of an adverse tax assessment related to any of the Company's tax positions, FortisBC would apply for settlement in a future test period.

13.1 Please confirm that on a stand-alone basis the value of the tax shield provided by capital expenditures diminishes each year due to the fact that depreciation is based on a straight line methodology and capital cost allowances are calculated using the declining balance methodology?

Response:

Consistent with when the Company's other capital assets are placed into service, all FortisBC customers will receive this tax shield benefit from acquiring the City of Kelowna electrical assets. This benefit has been considered in the cumulative decrease in customer rates as shown in Figure 2, on page 22 of the Application (Exhibit B-1). This tax benefit results from capital cost allowance deductions, as determined in accordance with the Income Tax Act, in excess of the add back of depreciation, the calculation and methodology which has been approved under Commission Order G-110-12 concerning the Company's 2012-2013 Revenue Requirements.

This tax treatment results in an initial lower effective tax rate which reverses over the life of the assets. Pursuant to Commission Order G-37-84 and consistent with many other North American rate-regulated utilities, this tax benefit occurs because deferred income taxes are not recognized in the determination of customer rates.