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British Columbia Utilities Commission
Suite 410, 900 Howe Street
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attention: Commission Secretary

filed online

Dear Mesdames/Sirs:

FortisBC Energy Inc. - Annual Review for 2019 Delivery Rates

This is the Final Written Argument of MoveUP in this proceeding.

General Observations

1. FEI has demonstrated in this Annual Review that it is able to check virtually all of the boxes currently presented by the 2014-19 PBR. It proposes to hold rates steady through the next year. It has managed to squeeze out a small trickle of available funds for earnings sharing, albeit on a trivial scale. It has managed to clear the Service Quality Indicator hurdles, meeting or exceeding the prescribed targets.

2. The only significant negative has been the utility's inability to maintain capital spending within bounds, a pattern that has been consistent through the latter years of the PBR cycle. FortisBC has indicated that it will seek to address the difficulties presented by the capital formula when it files its proposal for a second consecutive PBR cycle in 2019.

3. But now that we are in the final stretch of the PBR, the Commission and interveners are in an increasingly good position to step back and begin to seriously assess whether the PBR experiment has been a true success, and more to the point whether it should be extended through another iteration, or alternatively the utility should "come up for air" with at least one cycle of traditional Cost of Service-based Revenue Requirements rate-setting.

4. MoveUP submits that it is difficult to detect *any* material benefit for ratepayers, or the public interest generally, flowing from the PBR – that is, specific and concrete gains that would not have been just as available under a more traditional regulatory cycle. The utility is unable to identify *any* specific benefits of that nature, and neither are we.

5. The Commission and participants need to ask themselves, in the cold light of day, what has really been accomplished through the PBR regime, other than a regulatory framework that is in some ways more light-handed, and in others more constraining – to the point of seriously distorting day-to-day decision-making, especially about capital investment but also about utility operations. The driver becomes adherence to formulaic PBR targets rather than optimal decision-making in the long run.

6. PBR may mean less work for the utility in relation to reporting, accountability and compliance, but if we go beyond general platitudes it is difficult to see delivered results that resemble the promises held out back in 2014.

7. In the result, coming out of this Annual Review we submit that while FortisBC Energy has justified all of the remedies sought in its Application, the Commission should be orienting itself toward a clear-eyed examination of the cycle that is now approaching its end and a certain skepticism toward a proposed new PBR term. It must be up to the utility to justify departing from "normal" regulation.

O&M

8. FEI has delivered a reduced global O&M and another year of flat rates for customers. No-one has ever explained how this result is the product of the PBR regime, or that it would have been unavailable through a more rigorous and transparent regulatory process. FEI does not attempt to do so, but rather has continued to assert an earnest belief that the dynamics of PBR have helped transform the company into a more motivated utility, with fewer reasons not to make prudent investments for the benefit of ratepayers:

> **MoveUP IR 2.2:**
>
> **REFERENCE: Exhibit B-2 page 4 section 1.4. Overview of O&M Savings**
>
> *Net ratepayer gains from PBR*
>
> 2.2 Please identify the savings and efficiencies that have been achieved for ratepayers since the inception of the PBR Plan that have been a direct result of the PBR – i.e., that would not have been achieved in the absence of the incentive mechanisms and other features of the PBR plan.

<u>Response:</u>

FEI believes that the savings and efficiencies achieved to date have been driven in full or in part by the incentive mechanisms and other features of the PBR Plan, including the six-year test period. However, FEI cannot know what it would have done in the hypothetical situation in which FEI was under forecast cost of service ratemaking over the same time period. As such, FEI cannot identify the portion of savings and efficiencies achieved to date that would not have been achieved in the absence of the incentive mechanisms and other features of the PBR Plan.

While it is impossible to answer the hypothetical question posed, one of the features of the PBR Plan is that it extended the period before rebasing. This allowed FEI to invest in measures and obtain a payback of investment in circumstances where rebasing after a typical test period of one or two years would otherwise preclude the utility from recovering that investment. . . .

Further, the current PBR Plan has generated benefits to both customers and the Company. The two most common cited benefits of a PBR plan are its effectiveness in incenting a utility to capture efficiencies and to promote regulatory efficiency. . .

Prospects Looking Forward: "Low-Hanging Fruit"

9. The rationale for a further PBR term becomes much weaker in light of the decayed availability of realizable efficiencies. This is particularly the case given Fortis' own acknowledgment, in response to a series of MoveUP IRs, that (as we put it) the "low-hanging" efficiency opportunities were harvested early in the 2014-19 PBR, and that significant further gains are getting thinner on the ground, and that there is little basis to expect that this trend would not continue into a second consecutive PBR cycle.

MoveUP IR 2.9:

As a general proposition, has FEI sought to implement the most substantial and realizable efficiencies and savings for ratepayers in the early phase of the PBR term, that were reasonably achievable at that time? If not, please explain why not.

<u>Response:</u>

Confirmed.

Since the start of the current PBR Plan, FEI has sought to undertake initiatives that are achievable and provide attractive financial and/or customer service returns to the benefit of customers and the Company. Additionally, under the current PBR Plan, the Company is incented to implement initiatives earlier on in the PBR term, as the efficiencies and savings can be evaluated over a longer time frame.

MoveUP IR 2.10:

To what extent has this strategy (of first harvesting low-hanging fruit) produced an erosion of incremental annual ratepayer benefit from the PBR plan?

Response:

Generally, the strategy of "first harvesting low hanging fruit" produces the greatest overall O&M savings for ratepayers under PBR, as the benefits of initiatives begin to be realized sooner rather than later. Nonetheless, as time passes under the PBR Plan, it is natural to see the level of incremental annual formula O&M savings decline, as there are fewer financially attractive and achievable opportunities to undertake, new cost pressures emerge, and the cost challenge of the Productivity Improvement Factor in the PBR formula accumulates year over year. Despite the natural decline in incremental annual formula O&M savings over the term of the PBR, there have been no rate increases in the last three years of the PBR Plan. As such, overall, FEI does not see that there has been an erosion in the overall incremental annual ratepayer benefit from the PBR Plan.

MoveUP IR 2.12:

If there is a renewal or continuation of the PBR plan after its 1 current expiry, what continue (i.e., to expect that the renewal or continuation would re-create more substantial realizable efficiencies than were available through the latter years of the present PBR plan?)

Response:

FEI cannot speculate on what efficiency initiatives may be undertaken in the upcoming PBR plan.

FEI agrees that finding new productivity opportunities will continue to be difficult.

Earnings Sharing Mechanism

10. One of the core features of the FortisBC PBRs has been the earning sharing mechanism, which was held out as a major instrument to better align the interests of the utility and its ratepayers. It is not clear why the Regulatory Compact and its statutory

realization in the *Utilities Commission Act* fail to strike the appropriate balance of obligations and entitlements, or why anything more is needed in order for us to expect utility management to exert itself in the interests of ratepayers, ensuring that its services remain reliable, affordable and safe.

11. But be that as it may, FEI originally described the impact of its proposed ESM as follows, in its 2014-2019 Application[1]:

> **EARNINGS SHARING MECHANISM**
>
> FBC is proposing to include an ESM as a component of the PBR Plan. The rationale for ESMs generally, and FBC's proposal to adopt an ESM design based on the 2007 PBR Plan, are addressed below.
>
> **6.4.1 Rationale for ESM**
>
> **Sharing mechanisms are regulatory tools in a PBR that are designed to enhance the alignment between customer and company interests and share the risks and benefits of the PBR plan**. They are also put in place to militate against unintended results of a new PBR plan such as excessive utility gains or losses. An earnings sharing mechanism is typically a backward looking sharing mechanism in which a rate adjustment is provided if the actual earnings fall below or exceed a certain threshold (in some cases, the threshold equals the allowed ROE).
>
> In general, two schools of thought exist in the regulatory economics literature regarding the use of an ESM. At one end of the spectrum is the assertion that ESM is contrary to the principles of incentive regulation as it decreases the incentive power of the PBR plan and imposes additional regulatory burdens and costs. The experts in the second group counter these claims by indicating that an ESM can allow for a utility's rates to better track realized costs which, along with other regulatory safeguards, mitigates the concern about excessive profits or losses, and that it is a fair approach for sharing the benefits of a PBR plan. In other words, an ESM amends some of the links between rates and costs that are decoupled under a PBR plan and helps to improve the allocative efficiency of the plan. The schools of thought also assert that ordinarily regulatory burden and costs related to ESM are minimal.
>
> B&V is supportive of an ESM in the context of FBC's proposed PBR Plan. The B&V PBR Report articulates B&V's rationale for supporting the ESM:

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[1] FortisBC Energy Inc. (FEI) *Application for Approval of a Multi-Year Performance Based Ratemaking Plan for 2014 through 2018* Exhibit B-1, Application, pages 70-71, quoted in part in the Commission's September 15, 2014 Decision at page 123

"The concept of earnings sharing is based on assuring that an acceptable level of benefits are shared with consumers during the regulatory control period and that the utility is protected from unreasonably low returns in the event of unforeseen plan outcomes. The earnings sharing mechanism benefits both parties and does so without an overtly heavy hand of regulation." (p.37)

[Bold added]

12. In practice, the funds distributed between ratepayers and shareholders through the earnings sharing mechanism have been on a trivial scale: in 2018, residential ratepayers will be enriched to the projected extent of 49 cents per customer[2]. The utility's cut for the current year is projected at less than a penny per share[3].

13. When asked to agree that "the monetary value of he shareholder credit "does not provide a material incentive to the company to modify its operations and management decision-making in order to achieve it", the utility acknowledged that "the dollar value of the 2019 earnings sharing calculation is not material in the context of the entire revenue requirement"[4], a bold exercise in understatement. FEI testified in its Annual Review Workshop that the ESM actually blunts the incentive for the utility to strive for efficiency gains for the benefit of ratepayers:

> MR. QUAIL: And that, for example, having the earnings sharing provides a financial incentive to the utility to perform even harder to try to achieve efficiencies for ratepayers.
>
> MS. ROY: I would actually disagree with that. Most PBR setups do not have an earnings sharing at all, which means the utility retains 100 percent of any savings. So I would say the earnings sharing reduces the incentive for the utility to find those things.[5]

14. Despite this impact of the EMS mechanism – damping the incentive to strive for ratepayer benefit – FEI continues to assert, without offering an explanation, the mantra that it better aligns the interests of the utility and its ratepayers:

> MS. ROY: The purpose of the earnings sharing is to align the interests of the company and customers, so that we're both working towards a similar goal.

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[2] MoveUP IR 2.1
[3] MoveUP IR 2.6
[4] MoveUP IR 2.8
[5] Transcript p. 27

Conclusions

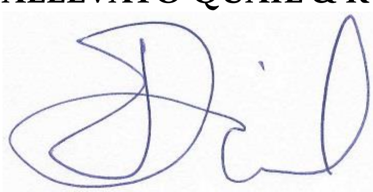
15. As we stated at the outset, MoveUP agrees that the orders sought by FEI in this Annual Review should be granted. The larger question is *what next?* – particularly with imminent filing of the first stage of the FortisBC utilities' application for a further PBR cycle. While the companies appear to take it for granted that another PBR round is their destiny, it is apparent that MoveUP can expect company in questioning the appropriateness of that mode of regulatory treatment in the coming period.

16. We look forward to a thorough examination of these and the many other issues that will land on the Commission's agenda this coming winter.

All of which is respectfully submitted.

Yours truly,

ALLEVATO QUAIL & ROY



per **Jim Quail**
Barrister & Solicitor