British Columbia Utilities Commission

FortisBC Energy Inc. and FortisBC Inc.

Multi-Year Rate Plan Application for 2020 to 2024

Project No. 1598996

Final Submissions

of

Industrial Customer Group

of

FortisBC Inc.

February 10, 2020

Table of Contents

A. Introduction

1) The Industrial Customer Group (ICG) makes submissions on behalf of the FortisBC Inc. (electric) industrial customers.
2) In this Final Argument, the ICG considers alternatives to the Proposed MRP and first recommends cost of service regulation (COS), and as a distance alternative, recommends extending the term of the Current PBR.
3) The ICG then considers certain components of the Proposed MRP: O&M Base, Capital Base, and the X-Factor. The ICG also considers the SQIs related to reliability performance.
4) The ICG then considers the Targeted Incentives and recommends the Targeted Incentives for FBC not be approved because the Commission does not have jurisdiction to approve the proposed Targeted Incentives, with the exception of the PSI.
5) Finally, the ICG argues that the Clean Energy Innovation Fund should not be approved because the Fund does not follow COS principles. In the alternative, the ICG argues that the policy objectives related to Climate Change and GHG reductions that directly apply to FEI, do not directly apply FBC, and for that reason the FBC Targeted Incentives should not be approved.

B. Alternative Rate-Setting Approaches to the Proposed MRP

6) FBC has proposed one rate-setting approach – the 2020-2024 MRP (Proposed MRP). The Proposed MRP is neither a PBR approach nor a COS approach to rate-setting. It is a hybrid approach to rate-setting with significant reliance on flow-through mechanisms and deferral accounts. Although interveners have sought evidence relevant to other rate-setting approaches, principally COS, there is very limited evidence relevant to an alternative rate-setting approach to that designed and advanced by FBC. This is despite the following Commission Panel invitation:

> All parties are welcome to pursue any information necessary to assist the Panel in making determinations regarding a potential re-basing of certain costs and an appropriate approach to rate-setting.[1]

[1] Exhibit A-6, Order G-156-19, p. 7

7) Under traditional cost of service, utilities are allowed to recover prudently incurred costs plus a return determined by the Fair Return Standard. Under PBR, utilities are allowed to recover prudently incurred costs plus a return, plus an incentive. Customers pay the additional incentives of PBR and benefit only if there are efficiency gains that would not be achieved under traditional cost of service. Under certain circumstances, the likelihood that a utility can achieve efficiency gains that would not be achieved under traditional cost of service is so low that the additional cost to customers of the incentives is not appropriate.

8) PBR is simply not appropriate for all utilities. In fairness to customers, there must be strong evidence that the benefits will exceed the cost of the incentives. A utilities proposal to share the excess earnings does not change this fundamental question: PBR is only fair to customers when efficiency gains that would not be achieved under COS offset the cost of the incentive. In this Application, FBC does not advance any efficiency initiatives, so there is no evidence that efficiency gains will offset the cost of the incentives.[2]

9) Whenever actual results are lower than an Index-Based formula amount FBC refers to that difference as savings. For example, FBC claims O&M savings of $0.5 million in 2019.[3] In each year of the Current PBR plan, the O&M formula resulted in actual O&M costs being lower than the O&M formula.[4] This difference could just as accurately be described as "excess returns" due to an O&M formula or an X-Factor (PIF) that is unfair to customers. Instead, whenever the actual results are lower than the O&M formula amount FBC claims O&M savings, and never considers the possibility that excess revenues have been collected from customers that warrant an adjustment to the O&M formula such as an increase to the X- Factor. Given FBC has realized higher returns than allowed under the Fair Return Standard every year since 2003, but for one, the evidence points far more

[2] Exhibit
[3] Exhibit B-1, p. B-32-33, Table B2-3
[4] Ibid.

clearly to a long series of Index-Based formulas that are not fair to customers.[5] It is for that reason the ICG is unwilling to support yet another attempt by FBC to establish an Index-Based formula approach to determine overall revenue requirements during the Proposed MRP period.

10) Given the limited evidence regarding any alternatives other than that proposed by FBC and the significant experience of all parties, including the Commission and Commission staff, with COS, the record does not support consideration of any rate-setting alternatives other than an extension of the Current PBR, the Proposed MPR, and COS. Under these circumstances, the ICG recommends the Commission select COS as the appropriate approach to rate-setting with a test period of one to two years. During the final test year, the Commission can further consider an appropriate approach to rate-setting. At the same time, the Commission should direct FBC to file evidence for the Commission to approve FBC's cost of capital.

11) There is a noteworthy asymmetry between allowed and actual ROEs that is apparent in the occurrence of annual overearnings in every year, but for one, since 2003.[6] The Proposed MRP together with the Targeted Incentives will almost certainly increase this asymmetry of returns.

12) The Proposed MRP with its dramatic increase to Base Capital, a zero X-Factor, and the PSI, is, as intended by FBC, more favourable to the utility than is the Current PBR and very likely more favourable than any other PBR plan since 2003. Just as the Current PBR resulted in excess earning every year during its term, the Proposed MRP will result in even higher excess earnings. The asymmetry of actual vs approved returns of both the Current PBR and the Proposed PBR can be addressed under COS regulation because the objective of COS regulation are returns determined by the Fair Return Standard. However, if the Commission does not agree, and prefers a PBR mechanism, then the ICG recommends the Current PBR over the Proposed MRP. Although the returns under the Current PBR have not been symmetrical, at least the returns, are closer to that prescribed by the Fair Return

[5] Exhibit B-10, BCUC 1.6.3.1 – the difference between O&M actual and O&M Base is evidence that the X-Factor was set too low.

[6] Exhibit B-17, ICG 2.12.1

Standard than can be reasonably expected under the Proposed MRP.

C. Components of the Proposed MRP

13) FBC is proposing an Index-Based formula approach based on total O&M per customer to determine overall O&M funding for the Proposed MRP period. FBC is seeking approval for a Base O&M of $57.67 million.[7]

14) A detailed examination of the cost to serve customers is long overdue. Despite efforts to examine the cost to serve customers in this proceeding, FBC has refused to file adequate evidence that could be examined to determine the cost to serve customers. This is contrary to the following evidence of FBC's expert in the proceeding to review the Current PBR.

> PBR only requires a starting point for prices or revenues (depending on the form of the cap). In some circumstances this starting point may not reflect current costs because of the elapsed time between the cost of service application and the current base year. In that case a revenue requirements application would be an important element of filing a plan. Where the last cost of service review is fairly recent and still produces just and reasonable rates (with or without discrete adjustments such as added rate base) there would be no reason to require a complete cost of service proceeding and it would be inefficient to do so.[8]

15) FBC believes that the opinion of Black and Veatch (B&V) is limited to circumstances where a cost of service has recently been approved by the Commission. FBC further believes that when a COS application has not been approved recently, as in the current circumstances, then such evidence is not necessary. Instead of using an approved COS, FBC concludes that the starting point referred to in the B&V opinion can be the 2018 actual Base O&M, with certain adjustments.

16) FBC starts with the 2018 actual Base O&M because in FBC's opinion it reflects efficiencies and productivity gains during the Current PBR Plan. The ICG submits that the appropriate starting point should have been a Commission approved cost of service for 2020.

17) Just as the starting point for the Current PBR was the 2013 Approved O&M, the

[7] Exhibit B-10, BCUC 1.34.1, Table C2-14, and updated by Exhibit B-25, BCOAPO 3.178.1
[8] Exhibit B-8, ICG 1.1.1

starting point for the Proposed MRP should be the 2020 Approved O&M. As noted by B&V, current costs may not reflect historic costs. In order for the Commission to conclude that the 2018 Actual Base O&M is fair to customers, the ICG submits that the Commission must conclude that the 2018 Actual Base O&M reflects the expected/current cost of service during 2020.

18) In the event the Commission disagrees, then before approving the 2018 Actual Base O&M, the ICG submits that the Commission needs to conclude that the 2018 Actual Base O&M reflected the cost of service in 2018. It should not be assumed just because FBC incurred those costs, that all incurred costs were reasonable and prudent. One alternative would be to not accept the actual base year as identified by FBC.

19) Before approving the Proposed PBR, the ICG submits that the Commission first needs to examine the 2020 cost of service. One of the advantages of extending the Current PBR is that it at least started with a Commission approved cost of service. The link between revenues and costs has not been examined since 2013; for that reason, if the Current PBR is to be extended, it should be extended for only a year or two.

20) In the event the Commission agrees with FBC that actual costs should be used as the starting point for Base O&M, without an examination of the link between revenues and costs, then the ICG submits that the Base O&M should be calculated from the lowest-cost year during the Current PBR Plan (including 2019).

D. Adjustments to 2018 actual Base O&M

21) The ICG further submits that the starting point should be rates where the utilities are expected to achieve their approved return on equity and no more. Under COS, returns would be limited to the Fair Return Standard. This is why the rebasing and determination of the starting point for rates are so important to ratepayers. The 2018 actual O&M proposed as the starting point by FBC occurred in a year of excess returns. In the event the Commission agrees that the 2018 actual O&M should be the starting point, then in addition to the adjustments to the 2018 actual O&M proposed by FBC there should be an adjustment equivalent to the amount of the excess returns. In the event the Commission approves the Base Capital

proposed by FBC, then the full adjustment should be made to the 2018 actual O&M set forth in the Revised Table C2-14, 2019 Base O&M.[9]

E. Shared Service Costs

22) In this Application, FortisBC is proposing a change in allocation of Shared Service Costs, not including Corporate Shared Services which will continue to be based on the Massachusetts Formula. During the Current PBR, the approved allocation to FBC of Shared Service Costs, not including Corporate, was based on Time Sheets (Time Sheet Approach). During the Proposed MRP, the proposed allocation to FBC is based on the Cost Driver Approach. The ICG believes that allocations to FBC should continue to be based on Time Sheets, which would reflect the relative size of FEI and FBC. Although the differences between the two approaches have been relatively small, the size of the difference should not determine the allocation.[10] Cost allocation should match cost causation as closely as possible. Time Sheets will match cost causation more closely than the proposed Cost Driver Approach, and for that reason should be the preferred method for allocating costs to FBC. The Cost Driver Approach could be used to allocate costs to FEI, and only the residual costs be the subject of Time Sheet allocation to FBC.

23) The alternative would be to directly assign costs to FEI and FBC based on Time Sheets. And then only the residual costs would be allocated based on the Cost Driver Approach. The ICG does not advocate this approach, but in no case should all Shared Service Costs be allocated based on the Cost Driver Approach.

F. X-Factor

24) FBC proposes an X-factor of zero percent, and is asking the Commission to approve an X-factor of zero percent. However, FBC has not conducted a Total Factor Productivity (TFP) study and is instead proposing a judgement-based approach for X-factor determination.[11] The ICG does not oppose a judgement-based approach for X-factor determination, but in the absence of cost of service evidence

[9] Exhibit B-10, BCUC 1.34.1, Table C2-14
[10] Exhibit B-12, BCUC 2.253.3
[11] Exhibit B-12, BCUC 2.161.1 and again at Exhibit B-12, 2.161.2

establishing the link between revenues and costs there is no starting point or any other basis for a judgement-based approach for X-factor determination. Under these circumstances, a TFP study was necessary, and for that reason, the Application for the Proposed MRP is deficient because it did not include a TFP study.

25) The objective of PBR Plans is to incent the utility to achieve efficiency gains. In the absence of an X-Factor, the utility can receive excess returns with no efficiency gains by simply tracking inflation. Moreover, in the absence of efficiency gains, there is no reason for customers to prefer PBR over COS. It would be fairer to customers to limit returns to the Fair Return Standard under COS than to give the utility an opportunity to realize excess returns under PBR with no efficiency gains. The objective of PBR is to incent utilities to maximize their returns by improving efficiency, rather than by increasing their COS, as may be the case under traditional COS regulation. But with no reasonable plans to achieve efficiency gains, there is no reason for customers to support PBR. Moreover, in the absence of the identification of any efficiency initiatives in this proceeding, there is no reason for the Commission to approve the Proposed MRP.

26) FBC submits that the X-Factor is not the reason to support PBR, rather it is the decoupling of revenues from costs that results in incentives to utilities. That may be true (and it is the reason why an approved cost of service is necessary), but in the absence of achievable productivity gains, as claimed by FBC, then the alternative of COS and the strict application of the Fair Return Standard would be fairer to customers. Moreover, not only is FBC proposing an X-Factor of zero, FBC is not proposing a stretch factor. Under these circumstances, COS will be fairer to customers than the Proposed PBR.

27) The onus is always on the utility to provide adequate evidence for the Commission to approve the elements of the Application. For the Current PBR the Commission approved an X-Factor of 1.03% for FBC.[12] The Proposed MRP requires approval of an X-factor. However, FBC's position is that it is not recommending an X-Factor. An X-Factor of zero percent requires the same examination and evidence as

[12] Exhibit B-10, BCUC 1.13.1

any other X-Factor, and of course, the burden of proof lies with FBC to provide adequate evidence to support their X-Factor. In BCUC IR responses, FBC was given an opportunity to file evidence to support its proposal for an X-Factor of zero percent, and instead advanced its position that such evidence was not needed to assess the reasonableness of the X-Factor.[13] This was despite the Commission reminding FBC of its decision in the FEI PBR Application that stated as follows:

> The reasonableness of FEI's proposed X-Factor can be assessed by comparing the impact of the proposed X-Factor on forecast rate changes under a formula relative to forecasted rate changes under the cost of service model. As FEI explains in Section B7 of the Application, the rates arising from PBR formulas (the combination of proposed 0.5 per cent X-Factor and the proposed composite inflator) will lead to average delivery revenues that are 2.0 per cent lower than the average rates under cost the cost of service model which indicates that the proposed X-Factor is an ambitious estimate of expected productivity gains and represents a challenge to the Company.[14]

28) FBC has filed evidence that suggests the rates would be the same under the Proposed MRP and COS. Comparing that evidence and the Commission conclusion drawn from the 2.0 per cent difference noted above, the X-Factor should be at least 2.0 per cent. There certainly is no evidence that supports an X-Factor of zero percent.

29) And again as noted in the Commission IR, the O&M excess earnings were achieved for each of FEI and FBC in each year of the Current PBR Plan beyond the productivity improvement factor (PIF) savings. This would support an X-Factor at least equivalent to the average annual O&M excess earnings achieved during the Current PBR Plan. In the absence of adequate evidence to support the X-Factor of zero percent and the evidence that suggests it should be much higher, the Proposed MRP should not be approved. In the absence of evidence to support an X-Factor of zero percent and in the absence of cost of service evidence to establish the link between revenues and costs, the Commission should not now determine an X-Factor

[13] Exhibit B-12, BCUC 2.161.3
[14] Exhibit B-12, BCUC 2.161.1

in this proceeding.

30) Again, in response to a BCUC IR, FBC said the X-Factor determination can be based on experts' computed TFP growth values, their proposed X-Factor values, and regulators' final approved X-Factor values.[15] FBC did not file a TFP study. The ICG respectfully submits that FBC cannot now incorporate by reference such evidence from other jurisdictions. This would require the Commission to conclude that TFP analysis of a utility in another jurisdiction is applicable to FBC with no adjustment for the utility's circumstances or for changes that can be expected with the passage of time. This series of IRs illustrates that FBC has not filed adequate evidence to support its X-Factor of zero per cent.[16] Given these deficiencies, the Commission should not now mend together an Application that is otherwise deficient. In fairness to customers, the Commission should deny the Application rather than rely on inadequate cost of service evidence or rely on TFP analysis of other utilities in other jurisdictions. Given the regulatory record of this proceeding regarding the X-Factor, the ICG submits that the Commission should conclude that there is inadequate evidence to approve an X-Factor.

G. Capital Expenditures

31) FBC proposes to replace the capital formula, which is part of the Current PBR, with forecast capital expenditures for the term of the Proposed MRP. The average 2017- 2019P is $91 million, and the 2020 forecast capital expenditures is $120 million for a 30% increase in capital expenditure arising from the change from the formula to forecasts.[17] In these circumstances, it is no surprise that FBC proposes to replace the capital formula.

32) The forecast capital expenditures decline from the forecast in 2020 of $120 million to $92 million in 2024. Capital expenditure forecasts often decline during a five year period because capital projects have not yet been fully considered in the latter years of forecast period. This is especially true when the largest increase in capital

[15] Exhibit B-12, BCUC 2.163.5.2 and Exhibit B-10, BCUC 1.17.5, the Concentric evidence does not provide evidence relevant to X-Factor determinations; it is not a TFP study.
[16] Exhibit B-12, BCUC 2.163 series
[17] Exhibit B-10, BCUC 1.51.1, Table 1 and Table 2

expenditures from the 2017-2019 average relates to Sustainment Capital. The proposed increase in Sustainment Capital is not justified by the SAIDI and SAIFI reliability indices. Although the 2018 SAIDI performance was worse than previous years, FBC attributes this to earlier reporting of outages as a result of the implementation of the Outage Management System and the influence of wildfires.[18] Indeed, the 2018 SAIFI performance was similar to previous years and below the current benchmark.[19] The proposed increases in Sustainment Capital should be rejected until such time that either the reliability indices justify an increase, or root cause analysis of outages shows a direct correlation to equipment condition.

33) In an effort to address the declining forecast, FBC proposes to review the forecast during the final two years of the proposed MRP. This will almost certainly result in capital expenditures that materially exceed the capital formula for the full term of the MRP.

34) FortisBC submits that replacing the capital formula with a forecast will limit the risk of large variances.[20] Under PBR, the risk of large variances should be borne by the shareholder. FortisBC should not have both the benefit of incentives for capital expenditure and no formula. FortisBC justifies their inability to derive a formula satisfactory to the shareholder on the lumpy nature of capital expenditures.

35) For the years 2014 to 2016, FBC was able to manage its capital expenditures with limited variances from the capital formula amounts. And then for the years 2017-2019, FBC was able to manage capital expenditures so that year-over-year variances were similar. For the period 2017-2019 the largest annual variance from the average capital expenditures of $91 million is $3.3 million (2018) or 3.6%.[21] This variance does not support FBC's contention that capital expenditures are "lumpy" and therefore cannot be subject to a formula.[22]

36) The evidence does support FBC's contention that it has been unable to achieve the targets established by the capital formulas because FBC spent more than was

[18] Exhibit B-1-1, Appendix C5-2, Table A:C5-2-13, page 13
[19] Exhibit B-1-1, Appendix C5-2, Table A:C5-2-14, page 14
[20] FortisBC Final Argument, p. 159, para. 364
[21] Exhibit B-10, BCUC 1.51.1, Table 2
[22] FortisBC Final Argument, p. 158, para. 362

approved.[23] But such excess spending occurred at the same time as excess earnings for every year during the Current PBR. Under these circumstances, the Commission should not relieve FBC of capital expenditure targets merely because FBC has been ineffective at achieving those targets. Earnings in excess of the Fair Return Standard in each year of the Current PBR have been unfair to customers, especially when the utility has failed to properly manage their capital program.

37) Replacing the capital formula so as to increase revenue requirements while at the same time making limited changes to the O&M formula to preserve revenue requirements is a selective revision of the Current PBR designed by FBC and that can only benefit FBC. Both the capital formula and the O&M formula should be preserved, or preferably, both should be replaced with COS regulation.

38) In the event that the Commission approves the use of capital expenditures forecasts for the Proposed MRP, then there should be no ongoing incentive for capital expenditures. The annual forecast of capital expenditures should be included in the following year's rate base forecast, and then rate base should be trued up to actual capital expenditures for following years. FBC should not be permitted to apply a COS approach to determine the targets (forecasts of capital expenditures), and then achieve ongoing PBR incentives for the subsequent years of the Proposed MRP term. That is, if the Commission agrees with FortisBC that capital formulas should be replaced with COS forecasts, then PBR type incentives should also be replaced with COS incentives. Simply, cost of service forecasts should not be accompanied with PBR incentives.

39) As noted above, FBC is seeking approval for an increase to capital expenditures over actual capital expenditures of approximately 30%. Further, FBC is seeking approval for an increase to capital expenditures over the Current PBR formula of approximately 46%.[24] Moreover, FBC claims that it is not possible to develop unit costs and establish a formula for capital expenditures. If so, then the Proposed MRP should not be approved, and at least for the next few years, FBC should be

[23] Exhibit B-1-1, Appendix B8-3, Table A:B-8-3-1, the cumulative variance was $49.6 million

[24] Exhibit B-10.1.51.1, Table 2 and B-1-1, Table A:B8-3-1 (2019P of $94.1 million, less 2019P of $11.6 million equals 2019 Capital Formula amount of $82,495: ($120-$82)/$82=46%)

regulated under COS regulation. Especially under the circumstances of the 30% and 46% increases, the five year capital plan should not be approved.

H. SQI

40) FBC has proposed Service Quality Indicators (SQI) at Table C7-5 of Section C7.3 of the Application. FBC will report each year's results at the Annual Review to allow a comparison of the SQI performance against the benchmark targets and thresholds.

41) The reliability indicators - SAIDI and SAIFI - remain unchanged. However, FBC proposes that the benchmark for SAIDI and SAIFI be based on the 2017 to 2019 average actual results for the entire MRP period. FBC claims that this three-year average balances the need to smooth some of the variability in the data while ensuring that the benchmark accurately reflects current operating conditions. SQIs make it seem like utilities are held accountable for performance during the term of PBR Plans. However, SQIs related to reliability, as confirmed by FBC, on an annual basis are often insufficiently sensitive to performance changes to detect such changes.

42) FBC's proposal to increase capital spending by approximately 30% in the first year of the Proposed MRP, and then use the 2017 to 2019 average actual result for reliability indicators for the entire MRP period does not reflect the substantial capital investments in infrastructure during the Proposed MRP term. The Commission should direct FBC to calculate the benchmark based on a three-year historical rolling average for both SAIDI and SAIFI. The ICG supports FBC's proposal to use the current year only as the basis for the actual results for both SAIDI and SAIFI.

I. Deferral Accounts

43) FBC has designed the Current PBR and the Proposed MRP with heavy use of deferral accounts. Under the Current PBR 87% of expenses flow through deferral accounts and in the Proposed MRP 61% of expenses flow through deferral

accounts.[25] At the same time that FBC has increased returns on equity by designing favourable incentive mechanisms, as evidenced by returns during the Current PBR, FBC has reduced its return risk by the use of deferral accounts, as evidenced by the percent of expenses flowing through deferral accounts.

44) This heavy use of deferral accounts has evolved over time. In Order G-110-12, Decision, p. 119, the Commission said:

> "FortisBC is seeking approval to defer what it expects to be costs in the amount of … for its 2014 Revenue Requirements Application in 2013 … The Commission Panel is of the view that these *regulatory expenses are operating costs and should be capable of being absorbed into rates without deferral*." (emphasis added)[26]

Similarly, in the 2015 Annual Review Decision (Order G-202-15, dated December 14, 2015, p.10), the Commission said:

> ICG proposed making a change to the handling of external costs for regulatory proceedings representing a significant departure from current practice. While not appropriate to consider their proposal at this time, the Panel is in support of a more *fulsome review* of deferral account alternatives as appropriate at either the end of this PBR term or at the time of rebasing. This could provide the parties the opportunity to comment on whether certain deferral accounts are necessary, or could be eliminated, or combined and other alternatives to handling items currently deferred. (emphasis added)

Contrary to the Commission conclusion above, FBC does not accept that regulatory expenses are operating costs and should be capable of being absorbed into rates without deferral. Instead, FBC treats regulatory expenses as flow-through costs. Regulatory costs are difficult to forecast, but they are not beyond the control of the company. There are probably no costs that are completely beyond the control of the company, including regulatory expenses, debt costs, property taxes, and pension expenses. In response to the Order G-110-12 Decision, FBC states:

> Factors not within the control of the utility include the regulatory process determined by the BCUC and the degree of involvement of interveners.[27]

Every utility activity includes factors that are not within the control of the utility.

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[25] Exhibit B-8, ICG 1.9.1
[26] Exhibit B-8, ICG 1.12.1
[27] Ibid.

Moreover, whether or not there are factors that are or are not within the control of the utility should not determine who assumes the cost risks of such activities.

45) The regulatory compact and the Fair Return Standard requires the utility be given a reasonable opportunity to earn a fair return. The Fair Return Standard does not require the ratepayer to assume the risk of costs beyond the control of the Company. The contrary is true, the Fair Return Standard assumes that the Company will assume the risk of costs beyond its control. That is why business risk assessments are necessary to determine a fair return. There simply is no foundation in the regulatory compact or in the Fair Return Standard for the FBC position that customers should assume the risk of costs beyond the control of the company. Although a PBR plan should provide the company with a reasonable opportunity to recover its prudently incurred costs including a fair rate of return, it does not follow that under a PBR plan customers should assume the risk of costs beyond the control of the utility.

46) The ICG submits that the "fulsome review" of deferral accounts anticipated in this proceeding should begin with consideration of whether the risk of costs beyond the control of the utility should be borne by ratepayers. As part of that "fulsome review", the Commission Panel should consider the Commission finding in Order G-110-12 that "regulatory expenses are operating costs and should be capable of being absorbed into rates without deferral."

47) Under cost of service regulation, rates for a given period are designed to recover the costs for that period. Some deferral accounts under PBR mechanisms are designed to adjust future revenues for incentives under PBR mechanisms. However, the widespread use of deferral accounts under PBR mechanisms goes well beyond what is necessary to adjust future rates for the sharing of efficiency gains. Utilities in B.C., at the same time as establishing PBR mechanisms have sought approval for deferral accounts costs on the basis that the utility should not bear the risk of uncontrollable costs. For example, FBC justifies the deferral account treatment of regulatory proceeding costs because such costs are "dependent on factors not within the utility's control."[28] This is despite the Commission's view that "these

[28] Exhibit B-8, ICG 1.12.1

regulatory costs are operating costs and should be capable of being absorbed into rates without deferral."

48) The Regulatory Accounting Filing Checklist (Checklist) requests comments from regulated entities on "whether, or to what extent, the item is outside of management's control". The Checklist does not establish that cost variances beyond the utility's control should be borne by ratepayers, nor does it identify the type of costs that are "outside of management's control". The Checklist is just that - a checklist to assist regulated entities in the preparation of an application. It does not fetter in any way a Commission Panel's authority to make decision relevant to an Application.

49) The Commission has accepted that the risk of cost variances that are beyond the utility's control should be borne by ratepayers. As noted above, this risk transfer did not need to accompany the introduction of PBR mechanisms. That is why the Commission concluded that a "fulsome review" of deferral accounts was appropriate at this time.

50) In the Application,[29] FortisBC identifies the "Treatment of Variances in Revenue Requirement Items from Forecast". Items that are forecast outside of the O&M Base and Base Capital formulas are recorded in deferral accounts. Cost recovery of such items related to pension costs, interest rates, income tax rates, property tax rates did not need to include risk transfers to customers. Revenue variance deferral accounts also did not need to accompany the introduction of PBR mechanisms. However, it was assumed that if variances from forecast revenues were beyond the control of the utility, then such variances should be recorded in deferral accounts.

51) The ICG respectfully submits that the Commission should establish criteria for the use of deferral accounts, which is something the Checklist did not do. Further, the ICG recommends the use of deferral account be limited to future recovery/refund of cost variances that:

1) arise from PBR mechanisms such as the O&M Base formula and the Base Capital formula;

2) arise from Targeted Incentives; or

[29] Exhibit B-1-1, p. C-118

3) are highly volatile and unpredictable.

52) To be clear, ICG does not recommend approval of PBR mechanisms or Targeted Incentives in this proceeding. The criteria relevant to PBR mechanisms and Targeted Incentives are being recommended for adoption in this proceeding, and to be applied in future proceedings. Following this criteria, customers would no longer bear the risk of most variances currently being recorded in deferral accounts related to Revenue and Power Supply, BCUC fees, Pension and OPEB, property tax, interest expense, income tax, and any other O&M costs or capital expenditures that are not subject to PBR mechanisms.

53) In this Application, FBC is seeking approval for the Flow-through deferral account that is part of the Current PBR to capture the annual variances between the approved and actual amounts for those costs and revenues which are included in rates on a forecast basis, are proposed for flow-through treatment as identified in Section C4, and which do not have a separately approved deferral account. FBC then states that the specific items included in the Flow-through account for the term of the Proposed MRPs are set out in Section C4, Table C4-1. However, Table C4-1, includes variances for many costs beyond those arising from the PBR mechanism such as the O&M Base formula and the Base Capital forecast. In the event the Commission approves new criteria for the use of deferral accounts, then the ICG submits FBC should be directed to revise Table C4-1 to be consistent with the new criteria.

54) The ICG has proposed a return to cost of service regulation at least for the next test period. If and when "cost of service" rate-setting is approved, then deferral accounts can be considered under the new criteria.

J. Targeted Incentives

55) In this Application, FBC is asking for compensation beyond what is required by the Fair Return Standard, and beyond PBR incentives. In order to advance their proposal, it was necessary to distinguish activities for which it is compensated by the ROE and activities for which is it not compensated by the ROE. The ICG submits that such a distinction does not exist today and was not contemplated when the current ROE was approved. For that reason and because the distinction between

what is and what is not compensated by the Fair Return Standard has not been established by FBC, FBC's request to be compensated beyond the Fair Return Standard should be denied.

56) FBC position must fail on the following premise advanced in response to BCUC IR 1.96.1:

> *The Targeted Incentives listed in Table C8-1 of the Application are not being compensated by the approved rate of return.* The approved rate of return is based on the Fair Return Standard, the legal test applied to ensure that investors receive the opportunity cost on the investment represented by the rate of return investors could expect to earn elsewhere without bearing more risk. (emphasis added)[30]

57) Before approving the Targeted Incentives, the ICG submits that the Commission must agree with FBC that: "The Targeted Incentives listed in Table C8-1 are not being compensated by the approved rate of return."

58) FBC also claims that compensation under the Fair Return Standard is conceptually different from compensation proposed under the Targeted Incentives.[31] FBC then attempts to distinguish compensation under the Fair Return Standard from compensation under Targeted Incentives.

59) First, FBC argues that the Fair Return Standard is not based on carrying out a business plan.[32] This suggests that the Commission should accept the proposition that the Fair Return Standard does not compensate the utility for business activities. However, it always has in the past, and will continue to do so. In fact, intrinsic to business risk assessment is an assessment of management ability to manage those risks. So it cannot be said that no business activities are compensated under the Fair Return Standard.

60) Second, FBC advances the following proposition:

> … the Targeted Incentives have been designed to create outcomes above what is normally expected in the regular course of business.[33]

Assuming the test to be applied to identify Targeted Incentives are for activities beyond the

[30] Exhibit B-10, BCUC 1.96.1, see also Exhibit B-8, ICG 1.25.3
[31] Ibid.
[32] Ibid.
[33] Ibid.

"regular course of business", then it will be necessary for the Commission to be able to apply the "regular course of business" test with predictable results. It is sometimes applied by the Courts in commercial proceedings, but it is a completely different matter for the Commission to adopt such a test to distinguish activities compensated under the Fair Return Standard from those not compensated under the Fair Return Standard. So how is the Commission to determine what activities require compensation beyond the Fair Return Standard? FBC's proposed "regular course of business" test does not provide a helpful answer. And the answer cannot be based on identifying activities that benefit customers.

61) In Final Argument, FBC distinguishes Targeted Incentives from traditional PBR incentives.[34] The distinction is based on FBC's view that PBR Incentives seek to minimize inputs into the utility and Targeted Incentives seek to maximize the outputs of the utility. Then counsel for FBC argue that the *Utilities Commission Act*, subsection 60(1), provides the Commission with jurisdiction to approve Targeted Incentives. The ICG agrees that pursuant to subsection 60(1), the Commission has jurisdiction to approve PBR incentives because such incentives seek, as characterized by FBC, to "minimize inputs" and are limited to "cost-cutting". PBR incentives are designed, as required by subsection 60(1) to "encourage public utilities to increase efficiency, reduce costs and enhance performance." However, Targeted Incentives are not designed to "increase efficiency, reduce costs and enhance performance". Both FBC's claims cannot be correct – the Target Incentives cannot be beyond the "regular course of business" of a utility, and also be within the jurisdiction granted to the Commission by subsection 60(1).

62) FBC submits that the Targeted Incentives are in the public interest. It does not follow that the Commission has jurisdiction to approve the Targeted Incentives.

63) In the event that the Commission concludes that it does have jurisdiction to approve Targeted Incentives, then the ICG submits that such approval should be limited to approval of Targeted Incentives for FEI. As per the FortisBC Final Argument,[35] FBC is not seeking approval for a target related to EV Charging. Until such target

[34] FBC Final Argument, p. 243, para. 554
[35] Ibid., p. 244, paras. 556 and 557

is established, the ICG submits that FBC's proposal to establish a Targeted Incentive for EV Charging should not be considered. It then follows that FBC Targeted Incentives are limited to "Customer Engagement" and the PSI.

64) In summary, the Targeted Incentives are not within the Commission jurisdiction, are not designed to reduce costs, and are being proposed by FBC for the first time in this proceeding, and with no regulatory precedent in any other Canadian jurisdiction.[36]

K. Target Incentives re Customer Engagement

65) It has always been necessary for utilities to engage with their customers. Whatever form customer engagement may take, including the use of new technologies, the cost of such activities are recoverable, but without the cost-plus (plus the Targeted Incentive) proposed by FBC. This Targeted Incentive must fail on FBC's own test because it clearly falls within the "regular course of business". Targeted Incentives for PSI

66) Incentives related to power supply should not be considered as Targeted Incentives. The PSI proposal should be excluded from the Targeted Incentives and be considered on its merits as part of PBR incentives, or MRP. In a following section of this Argument, the ICG will address the PSI.

L. Establish Criteria For Targeted Incentives

67) In the event that the Commission concludes that Targeted Incentives provide an appropriate incentive for utilities, the ICG respectfully submits that the Commission should define the circumstances under which Targeted Incentives are appropriate. The ICG submits that the reasons for Targeted Incentives for FBC are far less compelling than for FEI.

68) FBC is proposing that the Targeted Incentives be a subset of performance measures reported to the Commission, and be in addition to the incentives provided by the Proposed MRP. Unlike the Proposed MRP targets, this subset of performance measures (Targeted Incentives) attracts an incentive, but not a penalty. The

[36] Exhibit B-10, BCUC

Targeted Incentives could be, as proposed by FortisBC, in addition to other incentives or under COS be stand-alone incentives. In this proceeding (assuming the Commission concludes that it has jurisdiction to approve Targeted Incentives), the Commission could deny approval of the Proposed MRP, and at the same time approve the Targeted Incentives for a future COS. This option has the benefit of: 1) limiting returns to the Fair Return Standard under COS regulation; and 2) adding incentives to target specific areas of concern. In the event that the Commission concludes that incentive regulation is appropriate, then ICG recommends this form of incentive regulation (where Targeted Incentives are used to address specific areas of concern) to that of the Commission approving both the Proposed MRP and the Targeted Incentives.

69) The ICG believes those specific areas of concern should relate to either reliability or to new services and should reflect the unique drivers of change for electric and gas utilities. For example, unlike the gas sector, there is very limited policy change relevant to electric utilities. The new targets to be established by the provincial government for EVs may be where Targeted Incentives address a concern. For example, if there is a concern that FBC will not build charging stations in the absence of incentives, then a Targeted Incentive may be appropriate. The ICG believes that FBC will meet those targets without an incentive additional to that provided by the Fair Return Standard. In that case, customers should not pay for additional incentives related to targets that the utility would meet in the absence of the additional incentive. So if the Commission agrees that FBC will build charging stations as necessary to meet provincial targets or demand, then customers should not be asked to pay for such incentives. The utility should be limited to the incentives provided by the Fair Return Standard.

M. Power Supply Incentive (PSI)

70) FBC proposes a Power Supply Incentive (PSI) to incent management of power supply costs "above what is reasonably expected in the normal stewardship of

FBC's business."[37] FBC does not justify the PSI based on innovation or even new business practices. FBC justifies the PSI based on enhanced performance in the area of power supply. FBC now wants an incentive to participate in power markets to buy or sell power resources. Under the Current PBR, FBC participated in power markets and it was considered "normal stewardship of FBC's business." No incentives were required.

71) In the Proposed MRP, FBC proposes incentives for participating in power markets. FBC's success in power markets will be determined by factors beyond its control, namely, power market prices. Moreover, purchasing and selling power should not be considered an effort beyond the "normal stewardship of FBC's business." [38]

72) FBC has been participating in power markets for decades. There is no reason to now pay FBC an incentive to do what it always has done. This was confirmed by FBC when it said that regardless of whether PPE are a flow through or an "at risk" item, FBC actively manages the power purchase expense budget with the objective of minimizing power purchase expense.[39]

73) It is true that over the past twenty years, the BCUC has at times approved incentive mechanisms for FBC's efforts to mitigate power purchase expenses (PPE). However, under the Current PBR no such incentives were required, and there is no evidence to suggest that FBC should now earn an incentive to do what it did without an incentive under the Current PBR.

Under the Current PBR, the evidence is that the range of annual incentives would have added from zero to 30 basis points (bps) to FBC's ROE.[40] There is no reason to now increase FBC earnings to encourage them to participate in power markets. Participating in power markets should be part of the "normal stewardship of FBC's business." Just as was the case under the Current PBR, the benefit of low market prices should continue to accrue to customers under the Proposed MRP.

74) The PSI would have increased FBC earnings by 30 bps in 2018.[41] If the PSI is

[37] Exhibit B-1-1, Appendix C7, p. 1
[38] Ibid.
[39] Exhibit B-8, ICG 1.7.2, see also Exhibit B-25 BCOAPO 3.183.2 where FBC optimizes its power supply portfolio when possible by displacing higher cost BC Hydro purchases using future and spot market purchases.
[40] Exhibit B-10, BCUC 1.102.3
[41] Ibid.

approved and market opportunities do not change (prices remain low), then during the Proposed MRP earnings can be expected to increase by the same amount or more. Moreover, under the FBC proposed PSI customers assume all the risk of market prices, and FBC has the opportunity to capture a portion (10% above $7.5 million) of the upside when market prices are low. Clearly, this is not fair to customers.

75) In the event that the Commission concludes that a PSI is in the public interest, then the ICG recommends it be revised so that FBC receives a 2% incentive above $7.5 million of the Eligible Mitigation Benefit. The FBC upside potential should be no higher than 5 bps. As noted by FBC, a 5 bps incentive is considered the minimum threshold to make pursuit of the incentive material.[42] Under these circumstances, the incentive should be no higher than 5 bps, although with the benefit of market prices lower than in 2018, the incentive could be higher than 5 bps even at 2% above the $7.5 million threshold.

N. Clean Growth Innovation Fund

76) FortisBC justifies its proposal for the Clean Growth Innovation Fund as follows:

> Climate policies aimed at meeting ambitious GHG reduction objectives are being implemented across all levels of government. Innovation is widely recognized as being of paramount importance in adapting to meet these objectives.[43]

Given the stated purpose of the Clean Growth Innovation Fund is to incent the utility to respond to climate policies aimed at meeting ambitious GHG reduction objectives, the justification for the Clean Growth Innovation Fund may be compelling for FEI, but it is not for FBC. In fact, FortisBC acknowledges this difference, but nevertheless is proposing a Clean Growth Innovation Fund that is funded by customers of both FEI and FBC. The ICG submits that FBC customers should not be required to fund the Clean Growth Innovation Fund.

77) The Commission has consistently denied utility applications to pre-collect funds in

[42] Exhibit B-10, BCUC 1.96.7

[43] Exhibit B-1, page C-129, Section C6.2, see also selection criteria Exhibit B-12, BCUC 2.218.3

advance of costs being incurred. FBC argues that its Clean Growth Innovation Fund is essentially the same as the normal process to forecast and recover cost of service.[44] In the "normal process", investments and activities necessary to service customers are identified and then the cost of such investments and activities are forecast. In the case of the Clean Growth Innovation Fund, FBC is seeking to pre-collect funds that will then be spent on initiatives yet to be identified. It does not matter that FBC does not expect to exceed the total funding level. The funding is still a pre-collection of funds in advance of costs being incurred. In fact, the investments or activities to be funded have not yet been identified. Not only is the funding of the Clean Growth Innovation Fund not based on costs yet to be incurred, it is based on initiatives yet to be determined.

78) FBC cannot forecast the cost of the Clean Energy Fund initiatives because such initiatives have not yet been determined. As noted by the Commission: "Under these circumstances, such a rider would be inconsistent with "Cost of Service" rate design principles."[45] When the initiatives have been identified and costs are forecast for such initiatives, then FBC can seek Commission approval, and the Commission can consider the merits of both the initiatives and the costs to be incurred. Only after the Commission exercises its jurisdiction in this manner, can it conclude that the rates to customers are fair and reasonable. The Commission should not and cannot delegate its core mandate over rate-setting to the Clean Energy Innovation Fund governance structure proposed by FBC.

79) In the event that the Commission concludes that FBC customers should fund the Clean Energy Innovation Fund, then the ICG supports FBC to fund the Clean Energy Innovation Fund through a fixed per-customer rate rider, and not volumetrically. Funding by volume, instead of by a fixed per-customer rate rider, will result in substantial incremental costs wholesale customers, as much as $50,000 per year[46], with limited potential for benefits. The ICG believes volumetric funding of the Clean Energy Innovation Fund would be unfair, given the material increase in

[44] Exhibit B-10, BCUC 1.79.1
[45] Creative Energy CPCN Decision dated December 8, 2015, p. 40-44
[46] Exhibit B-12, BCUC 2.214.8

charges to large electric customers.

O. Conclusion

80) The ICG submits the Proposed MRP should not be approved and rate-setting should be based on COS. In both cases, a further proceeding will be required to set rates for 2020.

81) In the event the Commission disagrees and believes incentives are necessary and fair to customers, then the ICG submits that the term of the Current PBR should be extended by one or two years with no changes to the Current PBR, including no changes to the O&M Base, Base Capital, X-Factor and with no additional incentives, including the Targeted Incentives. In this case, a further proceeding may not be required to set rates for 2020.