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BRITISH COLUMBIA UTILITIES COMMISSION

ORDER NUMBER G-120-15

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IN THE MATTER OF
the *Utilities Commission Act*, RSBC 1996, Chapter 473

and

FortisBC Energy Inc. and FortisBC Inc.
Multi-Year Performance Based Ratemaking Plans for 2014 through 2019
Approved by Decisions and Orders G-138-14 and G-139-14
Capital Exclusion Criteria under PBR – Compliance Filing

BEFORE: D. M. Morton, Panel Chair/Commissioner
D. A. Cote, Commissioner
N. E. MacMurchy, Commissioner

July 22, 2015

O R D E R

WHEREAS:

A. On September 15, 2014, the British Columbia Utilities Commission (Commission) issued Orders G-138-14 and G-139-14 for FortisBC Inc. and FortisBC Energy Inc. (collectively, FortisBC) which set out the Performance Based Ratemaking Plans (PBR Plans) for 2014 through 2019 (FEI Decision and FBC Decision);

B. On pages 180 and 181 of the FEI Decision and pages 174 and 175 of the FBC Decision, the Commission invited submissions from all parties on issues related to how certain capital projects would be excluded from the capital spending formulas in the PBR Plans (Capital Exclusion Criteria);

C. By Order G-203-14 dated December 19, 2014, the Commission extended the submission dates for all parties and by letter dated February 6, 2015, appointed a panel to review the submissions;

D. Submissions were received from FortisBC (Exhibit B-1) which included proposed changes to the Capital Exclusion thresholds and criteria. Submissions from three interveners, the British Columbia Old Age Pensioners' Organization *et al.,* the Commercial Energy Consumers Association of British Columbia and the Industrial Customers Group, that participated in the PBR proceedings were also received, followed by FortisBC's reply submission;

E. The Commission has reviewed the submissions and proposed changes and finds that certain changes and clarifications to the PBR Capital Exclusion Criteria are warranted;

…/2

NOW THEREFORE for the attached reasons for decision, pursuant to section 60 of the *Utilities Commission Act,* the Commission orders, for the purpose and duration of the current Performance Based Ratemaking (PBR) Plans for FortisBC Inc. (FBC) and FortisBC Energy Inc. (FEI), that:

1. FBC's and FEI's PBR materiality thresholds are set at $20 million and $15 million, respectively. These materiality thresholds shall be used to determine whether capital costs are eligible for exclusion from the FBC's and FEI's formula-driven capital spending.

2. The Certificate of Public Convenience and Necessity (CPCN) dollar threshold will be maintained at $20 million dollars for FBC and increased from $5 to $15 million dollars for FEI However, the Commission may require a CPCN review for projects below this threshold if it finds that pursuant to section 45 of the *Utilities Commission Act* it is in the public interest to do so.

3. For any capital project applications that exceed the PBR materiality threshold, FBC and FEI are directed to demonstrate to the Commission that the project applied for is not the result of combining smaller projects and that the actual costs fall above the PBR threshold.

4. Should the dead-band for annual capital expenditures approved in the PBR Plans be exceeded FBC or FEI are directed to include in its next Annual Review filing, recommendations as to any adjustment to base capital (re-basing) for Commission approval.

DATED at the City of Vancouver, in the Province of British Columbia, this 22nd day of July 2015.

BY ORDER

Original signed by:

D. M. Morton
Panel Chair / Commissioner

Attachment

IN THE MATTER OF

FORTISBC ENERGY INC. AND FORTISBC INC.
MULTI-YEAR PERFORMANCE BASED RATEMAKING PLANS FOR 2014 THROUGH 2019
APPROVED BY DECISIONS AND ORDERS G-138-14 AND G-139-14
CAPITAL EXCLUSION CRITERIA UNDER PBR – COMPLIANCE FILING

REASONS FOR DECISION

July 22, 2015

BEFORE:

D. M. Morton, Panel Chair / Commissioner
D. A. Cote, Commissioner
N. E. MacMurchy, Commissioner

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1.0 INTRODUCTION

The Multi-Year Performance Based Ratemaking (PBR) Plans for 2014 through 2018 Decisions (PBR Decisions) for FortisBC Energy Inc. (FEI) and FortisBC Inc. (FBC) (collectively, FortisBC), established threshold levels of capital expenditures that are excluded from the formula-driven spending envelope. However, at that time, the Commission expressed the view that further examination of these thresholds was appropriate. This proceeding further explores the level of capital inclusiveness which is most appropriate to maximize efficiencies and determine principles and process to manage it for the balance of the FEI and FBC PBR Plans. The Commission requested further evidence and submissions from parties in the FEI and FBC PBR proceedings in order to make further determinations on the treatment and thresholds for capital expenditures.

1.1 Background

In the PBR Decisions, issued on September 15, 2014, capital inclusiveness within the PBR formula was very much at issue.[1] In those proceedings, FortisBC proposed that all Certificate of Public Convenience and Necessity (CPCN) projects be excluded from the PBR formula and be subject to existing CPCN criteria for determining the need for a project. This would exclude all projects from the PBR formula with a dollar value greater than $20 million for FBC and $5 million for FEI, in addition to certain additional projects for FBC that satisfied other, non-financial criteria.

FortisBC considers there to be “no practical way to capture CPCN capital projects under the PBR Plan” and states “the nature of capital expenditures is such that the controllable and generally planned investments are included in the plan while other capital should be outside the plan.”[2]

In the PBR proceedings, an intervener raised concerns with applying the PBR formula to capital, noting that even with the CPCN exclusion there remains an opportunity to underspend.[3] The PBR Decisions, while acknowledging this issue, pointed out that the more capital excluded from the formula, the less benefits that can accrue to ratepayers and shareholders as it reduces the ability of the utility to achieve operational efficiencies. This was tempered by the Commission’s acknowledgement that including more capital with larger and potentially lumpier expenditures could result in a possible increase of risk to ratepayers and shareholders.[4]

In its PBR Decisions, the Commission determined that reliance upon established CPCN criteria, as proposed by FortisBC, to identify exclusion capital is not appropriate.[5] The Commission pointed out that there are instances where exclusion of capital from the PBR formula is justified by the nature of the project and, in these circumstances, the threshold for such exclusion should be based on a dollar amount. Although it approved the existing CPCN thresholds as applied for by FortisBC the Commission also established a subsequent process to examine capital exclusions in more detail before making any further determinations on this matter. To aid in creating a better understanding of the issues at hand, all parties were invited to make further submissions on the following issues:

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[1] FEI Multi-Year Performance Based Ratemaking Plan for 2014 through 2018 Decision (PBR Decision), pp. 176–181; FBC PBR Decision, pp. 170–175.
[2] FEI PBR proceeding, Exhibit B-11, BCUC IR 1.10.2; FBC PBR proceeding, Exhibit B-7, BCUC IR 1.19.2.
[3] FEI and FBC PBR proceedings, BCOAPO Final Submission-PBR, p. 10.
[4] FEI PBR Decision, p. 176; FBC PBR Decision, p. 170.
[5] FEI PBR Decision, p. 180; FBC PBR Decision, p. 174.

1. What exogenous criteria should be established for excluded capital?
2. In addition to a capital exogenous factor, is a materiality threshold required?
3. If a materiality threshold is appropriate, at what level should it be set, in order to realize the full benefits of PBR? Given the response to 1, 2 and 3, what should the base capital be set for FEI and FBC for 2016?
4. Is a cumulative dead-band of 15 percent of the formula-driven capital over two years sufficient to protect both ratepayers and shareholders?
5. What reporting procedures should be in place to allow parties sufficient time to review the proposed capital spending?
6. Should the CPCN threshold be raised to match or exceed the PBR formula materiality threshold?[6]

1.2 FortisBC proposal

FortisBC submits that the materiality and CPCN thresholds should be aligned. It proposes a departure from what was approved in the PBR Decisions, and requests approval to reset the CPCN materiality threshold for the remainder of the PBR at a level based on 10 percent of the 2013 Approved Base Capital for both FEI and FBC effective 2016. This results in a materiality threshold of $5 million for FBC and $15 million for FEI. FortisBC believes setting the capital exclusion threshold at this level "considers both the lumpy nature of capital projects and the ability of FortisBC to manage that lumpiness, while maintaining regulatory efficiency." FortisBC asserts that under its proposal, no adjustments to Base Capital are necessary for either FEI or FBC at this time.[7]

FortisBC submits that increasing FEI's materiality threshold from $5 million to the proposed $15 million "would require an adjustment to its formula spending envelope (by way of a Base Capital adjustment), if the proposed higher CPCN threshold resulted in a need to incorporate additional capital work under the formula spending for capital projects between the current $5 million and the proposed $15 million thresholds." However, it "does not anticipate any capital projects within this range of expenditure during the PBR Period and therefore submits that no adjustment to its Base Capital is required to accommodate the proposed CPCN threshold."[8]

FortisBC further submits that in the case of FBC, decreasing the materiality threshold from $20 million to the proposed $5 million would require a downwards adjustment to Base Capital if the proposed lower threshold resulted in surplus funding under the formula. Such a scenario would occur if FBC identifies a capital project which costs less than the current $20 million threshold but exceeds the proposed $5 million threshold. This is because at the time of the PBR proceeding, capital projects within this cost range would have been considered "formula" capital expenditures and thus formed part of FBC's Base Capital. FBC to date has not identified any such projects "with certainty." It states a "very limited" number of smaller load-driven projects, such as substation transformer capacity upgrades, may be newly subject to CPCNs under the proposed criteria. However, due to the uncertainty of the timing of these projects, FBC is unable to state at this time whether any will fall within the PBR period.[9]

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[6] FEI PBR Decision, pp. 180–181; FBC PBR Decision, p. 174.
[7] Exhibit B-1, pp. 21–22.
[8] Ibid.
[9] Exhibit B-1, pp. 21–22.

FEI states that the practical outcome of this treatment would be that any capital exclusions are reviewed under the existing CPCN process and guidelines. Capital projects falling within the envelope would be deemed to have a CPCN pursuant to section 45 of the *Utilities Commission Act* (UCA) and are not subject to any further regulatory process. It considers this to be consistent with the UCA and upholds the principle of regulatory efficiency and simplicity.[10]

Concerning exogenous factor criteria that should be established for excluded capital, FortisBC states "[e]xceeding the materiality threshold should be the only factor for determining the exclusion of a capital project from the formula spending envelope and no further non-financial exogenous factor criteria need to be established." In a footnote to this statement, FortisBC states that z factor criteria have been determined in the PBR Decisions and are a separate consideration from capital threshold determination.[11]

The Panel interprets this to mean that it is FortisBC's intent to consider exogenous capital requirements as being separate from any dollar threshold capital exclusion amounts.

1.3 Approach to determining the level of capital to be excluded

The purpose of this proceeding is to further explore the level of capital inclusiveness which is most appropriate to maximize efficiencies and determine principles and process to manage it for the balance of the PBR Plans. The Panel makes determinations with respect to the following key capital exclusion issues:

- The level of inclusiveness of capital within the PBR formula;
- Criteria and process to determine whether a project should be excluded from the PBR formula;
- The effectiveness of existing dead bands in safeguarding ratepayer and shareholder interests;
- Process to manage capital expenditure levels outside of the dead band; and
- Whether there is justification for further adjustment to the X-factor.

2.0 CAPITAL EXCLUSION ISSUES

2.1 Level of capital inclusiveness

The first issue the Panel must consider is capital inclusiveness. The Panel must determine how much capital should be included within the formula-driven spending envelope and those cases where it is appropriate for capital expenditures to be excluded from this spending envelope. A more inclusive approach to capital results in most or all of the capital expenditures being driven by the PBR formula, while a less inclusive approach results in a greater balance between formula and non-formula capital. We begin our consideration of the level of capital inclusiveness with an examination of the practices in other Canadian jurisdictions such as the Alberta Utilities Commission (AUC) and the Ontario Energy Board (OEB). Both of these jurisdictions have opted for the more inclusive approach to capital while FortisBC is proposing a less inclusive approach. In addition to considering whether an inclusive or exclusive approach to capital would produce the best results, the Panel must consider in the context of our current PBR methodology, whether a more inclusive approach could be made to work.

[10] Ibid., p. 19.
[11] Ibid., p. 2.

From the evidence submitted, which can be found in Appendices A, B and C to Exhibit B-1, it is clear that both the AUC and the OEB have recognized that the formula spending envelope may not provide sufficient capital for all necessary expenditures and have put in place mechanisms to allow for the recovery of additional capital expenditures from ratepayers. AUC in its PBR plan has referred to these mechanisms as "capital trackers" and put in place three capital tracker criteria: (i) a material effect on company finances, (ii) outside the normal course of ongoing operations, and (iii) replacement of existing capital assets or as required by an outside party. These criteria are required to "permit the identification of capital projects, the cost of which cannot reasonably be expected to be recovered through the I-X mechanism."[12] The AUC issued a further decision a year later providing further clarifications and determinations on these criteria.[13]

Like the AUC, the OEB established mechanisms to allow for additional capital funding. In 2008, the OEB introduced what it termed the Incremental Capital Model (ICM) to deal with additional capital funding for electrical utilities. The ICM was "intended to address the treatment of capital investment needs that arise during the rate-setting plan which are incremental to a materiality threshold. The materiality threshold represented a distributor's financial capacities underpinned by existing rates, including growth." Criteria for acceptance under the ICM are materiality, need and prudence. In 2014, the ICM was augmented by the Advanced Capital Module (ACM). This was designed to advance review of future forecasted incremental excluded projects to be part of a utility's base year cost of service application and its 5 Year Distribution System Plan Review. [14]

FortisBC's examination concludes that "the AUC and OEB capital exclusion criteria would not be appropriate in this jurisdiction." Utilities in these jurisdictions operate under price-cap or revenue cap PBR plans. Under these PBR plans the decisive criterion determining the approval of incremental capital is "revenue sufficiency as provided by the PBR formula in relation to the direct financial requirements of the proposed capital projects." In both the AUC and OEB the emphasis is on demonstrating the extent to which the application of the I-X mechanism in the PBR formula results in underfunding of a proposed project.[15]

FortisBC submits that in the case of its approved PBR Plans, application of the AUC or OEB criteria is unnecessary due to fundamental design differences. By way of explanation, FortisBC reiterates key points from its joint Final Submission for FEI and FBC with reference to the AUC in the PBR proceedings as follows:

> In Alberta, the I-X mechanism escalates the full revenue requirements each year, including the cost of capital and the rate base in existence at the outset of the PBR plan. As a result, the depreciation expense in the revenue requirement is also escalated year over year. Since there is no corresponding adjustment to rate base by the amount of accumulated depreciation each year under Alberta's PBR plan, the dollars resulting from the escalated depreciation expense become dollars that are available in the going forward period. This provides the Alberta utilities significant room within the formula for new spending and to accommodate fluctuations in the cost of uncontrollable items.[16]

FortisBC submits that a similar case exists for electric distribution utilities in Ontario as well.[17]

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[12] Exhibit B-1, Appendix A, AUC Decision 2013-435, p. 31.
[13] Ibid., pp. 31–92.
[14] Exhibit B-1, Appendix B, Ontario Energy Board, New Policy Options for the Funding of Capital Investments: The Advanced Capital Model, pp. 4–5, 9–18.
[15] Exhibit B-1, p. 23.
[16] Ibid., pp. 23–24.
[17] Ibid.

By contrast, the FortisBC PBR Plans through the I-X mechanism escalate the actual incremental capital spending envelope available each year and do not escalate the full revenue requirements. Further, there are no additional dollars available in the base formula to invest in capital going forward as rate base is adjusted by the amount of accumulated depreciation each year. FortisBC concludes the AUC and OEB's requirement for utilities to demonstrate the extent to which the I-X mechanism underfunds the direct costs of a proposed capital project is inapplicable and unnecessary. This is because any capital projects proposed to be excluded via the CPCN process under PBR already satisfy this demonstration of a revenue shortfall.[18]

Commission determination

The Panel finds a less inclusive approach to capital continues to be the most effective means to promote efficiencies yet protect the interests of both the ratepayer and the shareholder.

The FortisBC PBR Plans in British Columbia differ significantly from the Revenue Cap and the Price Cap plans employed in either OEB or AUC jurisdictions. As discussed above, both the AUC and OEB PBR plans have taken what can best be described as an "inclusive" approach to capital. The original PBR plans in these jurisdictions proceeded on the assumption that all capital expenditures are provided for within the formulaic spending envelope. The Panel understands this was done to satisfy a desire to better capture total capital expenditure requirements and reduce or eliminate the need for further capital requests. However, we note the fact that both AUC and OEB have made further adjustments to their funding mechanisms, some of them very recent, to provide for additional capital funding. It could therefore be inferred that the approach to PBR capital in these jurisdictions is evolutionary with neither jurisdiction totally satisfied with their approach.

In contrast to the approach of the AUC and OEB, the FortisBC PBR plans are designed to provide for only a portion of total capital expenditure requirements in the formula driven spending envelope. The base capital is reduced by an amount that reflects those projects that are not intended to be funded by the formula. This has the benefit of incenting FortisBC to find efficiencies in "routine" capital projects, while providing sufficient opportunity to fund essential capital projects. This approach is based on a set of criteria for exclusion of capital projects, or "capital exclusion criteria," as opposed to a mechanism to fund projects for which the costs cannot reasonably be expected to be recovered under a PBR formula.

By applying the formula driven spending envelope to smaller capital projects only, and providing for funding of larger capital projects outside of the formula, there is less risk of needed projects being underfunded.[19] In addition, this approach also mitigates the risk of lumpy spending patterns by excluding any projects that are large enough to potentially distort the amount of formula spending, and result in gains or losses to either ratepayers or shareholders.

Lumpy capital spending patterns are not uncommon and have the potential to distort PBR results. If, for example, there were no capital amounts excluded, a single large project could easily result in an over expenditure, producing lower returns for the utility and potentially even exceeding a dead-band threshold. Alternatively, if capital spending pattern was significantly lower, returns to the utility could be significantly higher, or again potentially exceed a dead-band threshold.

[18] Ibid, p. 24.
[19] This risk is further mitigated by the Exogenous Factor discussed in section 2.3.

Given these concerns, the Panel agrees with the parties that the less inclusive approach to capital embodied in FortisBC's PBR plan makes the most sense and it is therefore appropriate to continue with this approach. We will address the issue of how much is included and how much is excluded (the capital exclusion criteria) in section 2.2 of these reasons for decision.

Given our less inclusive approach to the capital formula, the Panel sees limited value in considering AUC and OEB capital funding mechanisms in developing FortisBC's PBR capital exclusion framework. **Therefore, the Panel places little weight on the evidence concerning the application of OEB and AUC methodologies to FortisBC's PBR plans and criteria governing the management of exclusion capital.**

2.2 Capital exclusion criteria

2.2.1 Materiality thresholds and alignment with CPCN thresholds

A number of issues were raised in this proceeding concerning a materiality threshold and its alignment with a CPCN threshold. These issues are the following:

- Alignment of CPCN and materiality thresholds;
- Elimination of non-financial CPCN criteria;
- Whether to adopt AUC criteria; and
- Materiality threshold amounts.

In its submissions on the issues raised in the PBR Decisions (Application), FortisBC states "[t]he well established and transparent nature of the [CPCN] process led to the use of the CPCN requirements as the determinant of whether capital should be included or excluded from the formula for FEI."[20] FortisBC argues that although it agrees the CPCN threshold and capital exclusion threshold from a PBR formula serve different purposes, it would be more efficient to align the two thresholds during the PBR term. It states that the CPCN process is lengthy and involved and a requirement to apply for a CPCN will impede its ability to manage its formula capital spending to the mutual benefit of customers and utility.[21]

CPCN criteria generally include a financial threshold. Currently, for example, the financial threshold is $5 million for FEI and $20 million for FBC. However, exclusive to FBC is a list of non-financial criteria in addition to its $20 million financial threshold:

1. The project is likely to generate significant public concerns; or
2. FBC believes for any reason that a CPCN application should proceed; or
3. After presentation of a capital plan to FBC stakeholders, a credible majority of those stakeholders express a desire for a CPCN applications; or
4. The Commission deems necessary for a CPCN application regardless of the criteria.

FortisBC proposes to align the handling of FBC CPCNs with FEI by eliminating these four non-financial criteria.[22]

[20] Exhibit B-1, p. 7.
[21] Exhibit B-2, pp. 22–23.
[22] Exhibit B-1, p. 20.

However, it also submits that in the event the Commission still wishes to require a CPCN application for projects within the formula-driven spending envelope, FortisBC recommends the CPCN evaluation should:

(i) be expedited; and

(ii) focus on non-financial criteria, so as to reduce the extent to which the intent of including capital in the PBR I-X formula is undermined.[23]

As stated in section 1.2 of these reasons for decision, FortisBC considers a capital project requiring 10 percent or more of the 2013 Approved Base Capital to be material enough to warrant treatment outside of the PBR formula. This is based on the PBR Decision, which determined that a 10 percent variance (over or under) in capital spending in any given year was material in relation to the Base Capital and that such a variance would trigger rebasing for the following year.

Table 1 shows FortisBC's calculation of the proposed CPCN materiality thresholds for capital exclusion for each utility using this 10 percent criterion.

Table 1: Calculation of Capital Exclusion Material Threshold ($000s)[24]

	FEI	**FBC**
2013 Approved Base	123,365	48,616
FEVI Proposed Addition	27,822	
FEW Proposed Addition	400	
Total	**151,587**	**48,616**
Proposed Threshold @ 10% (rounded)	**$15,000**	**$5,000**

<u>Intervener submissions</u>

The Commercial Energy Consumers Association of British Columbia (CEC) disagrees that there is a "significant importance to aligning the CPCN criteria with the PBR capital exclusion criteria" and further suggests that the "purposes are distinctly different."[25] CEC submits that while the CPCN thresholds may not be especially suitable for the respective sizes of the utilities and may warrant changing, the analysis of the CPCN threshold should be undertaken separately. CEC recommends that the Commission not revise the CPCN threshold to match the PBR capital exclusion criteria.[26]

CEC "accepts the Fortis[BC] proposal of $15 million and $5 million as reasonable materiality criteria for FEI and FBC respectively."[27]

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[23] Exhibit B-2, p. 24.
[24] Exhibit B-1, Table 4, p. 21.
[25] Exhibit C2-2, p. 6.
[26] Ibid., p. 7.
[27] Ibid., p. 3.

The British Columbia Old Age Pensioners' Organization *et al.* (BCOAPO) submits the "CPCN criteria and the PBR Capital Exclusion criteria serve two fundamentally different purposes."[28] BCOAPO points out that "while in principle all projects should be subject to a CPCN review/approval, it is impractical for the BCUC to review and approve every capital project". However, BCOAPO submits that there will "clearly be projects which the BCUC should review… if the Commission is to fulfill its obligation to conserve the public interest," and any exclusion from requiring a CPCN should be viewed as the "exception to be made in the interest of practicality and regulatory efficiency."[29]

In contrast, when considering the concept of PBR Capital Exclusion, BCOAPO states that "in the ideal all capital projects would be <u>included</u> under the PBR formula and there would be no exclusions and utilities would be expected/required to manage their business within the spending envelope provided. Thus in the case of the PBR, inclusion in the capital formula (and thus exclusion from review and approval) should be considered the norm and exclusion from the PBR capital formula considered to be the exception."[30]

In BCOAPO's view, "[g]iven these fundamental differences in the intent and objectives of the criteria for CPCN vs PBR Capital Exclusion there is…no basis to link the exclusion from CPCN requirement to exclusion from the PBR formula."[31]

Notwithstanding these submissions, BCOAPO "sees no problem" with using the financial CPCN thresholds for the PBR materiality threshold, as proposed by FortisBC, provided:

i) the non-financial criteria currently applicable to FBC are retained; and

ii) the same non-financial criteria are applied to FEI.

Concerning FortisBC's proposal to eliminate the four non-financial criteria for FBC, BCOAPO submits that "the continued use of the non-financial criteria for FBC and extending their application to FEI is essential if the BCUC is to appropriately meet its obligations under the UCA as they relate to capital projects and ensuring that the public interest is conserved."[32]

BCOAPO takes no issue with FortisBC's proposed materiality thresholds of $5 million for FBC and $15 million for FEI.[33]

The Industrial Customers Group (ICG) submits that FortisBC's single capital exclusion criterion is not appropriate and recommends the Commission "adopt the capital exclusion criteria of the AUC."[34]

[28] Exhibit C1-2, p. 5.
[29] Ibid., p. 6.
[30] Ibid.
[31] Ibid.
[32] Ibid., p. 9.
[33] Ibid.
[34] Exhibit C3-2, p. 16.

Commission determination

Alignment of CPCN and materiality thresholds

The Panel agrees with CEC and BCOAPO that the CPCN criteria and the PBR capital exclusion criteria are not linked and their purposes are distinctly different. The Commission recognized this in the PBR Decisions, where it stated "the Panel is not persuaded there is any basis to link exclusion from CPCN requirement to exclusion from the PBR formula…. Exclusion from this requirement is based on a balance of regulatory efficiency and the broader public interest" and that "the use of CPCN criteria as an exclusion criterion for the PBR formula is arbitrary."[35]

However, the Panel is of the view that, while exclusion from CPCN requirements generally should not be linked to exclusion from the PBR formula, there may be similarities between the PBR materiality threshold and the CPCN financial threshold. CPCN criteria include consideration of both public interest issues and ratepayer impact. The financial threshold of the CPCN addresses, at least in part, ratepayer impact, and as such, serves a similar purpose to the PBR materiality threshold.

Accordingly, the Panel accepts FortisBC's argument that alignment of the two thresholds makes practical sense and will enable the companies to manage their capital spending under the PBR as intended and finds that aligning the financial threshold for CPCNs with the PBR materiality threshold is appropriate. However, the Panel would like to be clear that while this alignment is appropriate, it is the PBR materiality threshold, not the CPCN threshold that is the determining factor in whether a project is funded by the formula spending envelope.

Elimination of non-financial CPCN criteria

FortisBC proposes to eliminate the four non-financial criteria for FBC. It states that by so doing, it will eliminate the need for any CPCN review of projects that are funded in its spending envelope. FortisBC further states that eliminating FBC's four non-financial criteria would align FBC's CPCN criteria with that of FEI.[36] The Panel is not persuaded this interpretation is accurate or appropriate. The Commission can require any utility, including FEI and FBC, to apply for a CPCN if it is of the view that there is a significant public interest issue or issues. This responsibility of the Commission arises from the UCA, regardless whether that criterion is specifically enumerated. Therefore, criterion No. 1 and No. 4 are implicit in the legislation and apply equally to FEI and FBC and cannot be set aside.

In situations where a CPCN application is required for a project that is funded from FortisBC's base capital spending envelope, we are mindful of the concerns raised by FortisBC that the CPCN application process could potentially impede its ability to manage its formula capital spending to the mutual benefit of customers and utility. In the event that FortisBC is required to file a CPCN by the Commission or for general public interest reasons, FortisBC may request an expedited review that focusses on these non-financial criteria.

[35] FEI PBR Decision, p. 177; FBC PBR Decision, p. 171.
[36] Exhibit B-1, p. 20.

<u>Adoption of the AUC approach</u>

With regard to ICG's submission on the use of the AUC criteria, the Panel has previously discussed why we are not inclined to adopt the AUC approach to inclusiveness of capital amounts in the formula. The AUC criteria are not an appropriate comparator.

<u>Materiality threshold amount</u>

Having determined that a materiality threshold, the quantum of which is equal to the CPCN financial threshold, is appropriate, we will now consider what that quantum should be.

The Panel is not persuaded that a materiality threshold based on 10 percent of the 2013 Approved Base Capital, as proposed by FortisBC, is appropriate. There is no reason to link the materiality threshold to the 10 percent variance that triggers rebasing.

When setting a materiality threshold, the Panel considers the following factors:

1. The lumpy nature of capital spending. The threshold should be low enough that there is no distortion from very large irregularly occurring projects; and
2. The possibility of combining small projects that would ordinarily fall below the materiality threshold into larger projects that fall above the materiality threshold. The Panel discusses this issue further in Section 2.2.2 of these reasons for Decision. The higher the materiality threshold, all else equal, the less the risk of smaller projects being combined into a larger project.

FBC's existing threshold of $20 million strikes a balance between the two considerations outlined above, thereby mitigating risk to a reasonable extent. Lowering the threshold could potentially increase the risk that small projects could be aggregated. Increasing it could potentially lead to the inclusion of large, lumpy projects in the formulaic capital spending envelope. **Therefore, the Panel finds it appropriate to leave this threshold in place.**

Further, as noted in section 1.2 of these reasons for decision, leaving the threshold at $20 million would eliminate the possibility of an adjustment to base capital which may be required if FortisBC's proposed $5 million threshold resulted in surplus funding under the formula.

The Panel considers FEI's existing $5 million threshold to be low enough that it may be vulnerable to the possibility of combining projects. Raising it to $15 million will require no rebasing, will not be subject to the effects of distortion caused by large, lumpy projects and is supported by both CEC and BCOAPO. Further, the Panel is satisfied that because the Commission retains the authority to require a CPCN, the public interest is adequately protected if the CPCN financial threshold is raised to $15 million. **Accordingly, for FEI, the Panel approves $15 million as the threshold for both capital exclusion for the PBR formula and CPCN exemption.**

The Panel has discussed its concern with the possibility that smaller projects that would normally be funded from the formula spending envelope could potentially be combined into a single larger project, the cost of which exceeds the materiality threshold. We have a similar concern with projects that fall just above the materiality threshold. At the time of a CPCN application, the cost of the project is sensitive to estimates and contingencies and the actual project cost could potentially be lower than the threshold. This could result in projects that have been excluded from formula spending because of their estimated cost, having an actual cost that falls below the threshold. **The Panel directs FortisBC to address, in every CPCN application, both the issue of combining projects and whether the actual costs of the project exceed the PBR threshold.** FortisBC must demonstrate to the Commission that the project applied for is not the result of combining smaller projects and that the actual costs will fall above the capital exclusion threshold.

The Panel notes that pursuant to Order G-27-14, the Commission re-affirmed the CPCN threshold for FEI's Biomethane capital projects to be $5 million. Biomethane related expenditures are considered "non-formula" so they are not included in the PBR formula regardless of the CPCN threshold. Therefore, the Panel is not persuaded that this threshold should be adjusted at this time and the $5 million CPCN threshold for upgrading facilities will remain in place.

2.2.2 Need for additional non-financial criteria

The Panel will now consider whether there is a need for further criteria in addition to materiality to effectively manage the exclusion of capital from the formula.

FortisBC takes the position that it would be inappropriate for capital exclusion criteria to limit the scope of eligible projects and exclusion should be based solely upon whether the dollar-value threshold has been surpassed. FortisBC considers the existing CPCN filing requirements and current materiality CPCN criteria as being well suited to accommodate capital exclusion proposals over the PBR period. It points out that consistent with requirements for exclusion of certain projects in other jurisdictions, the filing requirements mandate a comprehensive regulatory review of a proposed project, which in most cases is more stringent than what is in place elsewhere.[37]

Intervener submissions

CEC submits that the criteria established by the AUC and OEB "go to the heart of the issue."[38] It describes the issue "is effectively whether or not the I-X mechanism 'should' reasonably be expected to cover such capital costs, rather than whether it does or does not, since the formula has been set based on this theoretical presumption." Therefore, in addition to the materiality threshold, CEC recommends the following criterion: "The project must demonstrate that it should not be funded under the I-X formula." It also recommends that appropriate tests to assess this criterion be developed by the Commission.[39]

ICG recommends the Commission "conclude that FortisBC's single capital exclusion criterion is not appropriate" and that the Commission "adopt the capital exclusion criteria of the AUC." Addressing transparency, ICG states there is no doubt that FortisBC's single criterion proposal will limit information as to savings achieved under the I-X mechanism. In its view "[i]ncremental capital funding should not be approved by the Commission in the absence of an examination of whether a particular project is already receiving adequate funding under the I-X mechanism." Further, it notes that while FortisBC is willing to provide information as required by the CPCN Guidelines, it proposes to limit information concerning the dollar value of capital projects under the I-X mechanism. ICG views the single exclusion criterion proposed by FortisBC as limiting information on the dollar value amount and lacking in transparency.[40]

[37] Exhibit B-1, p. 20.
[38] Exhibit C2-2, p. 2.
[39] Ibid.
[40] Exhibit C3-2, pp. 14–15.

ICG states a further reason to adopt the criteria of other jurisdictions is to avoid double counting and to avoid providing incremental capital funding when it has already been made available under the I-X mechanism. ICG considers this to be "why other jurisdictions have adopted capital exclusion criteria and financial tests."[41]

BCOAPO states it is in general agreement with FortisBC with respect to having no non-financial criteria for exclusion of capital projects from the PBR formula. However, it adds the following qualifiers:

(i) the project must be linked to the utility's regulated business and be eligible for inclusion in its regulated rate base, and

(ii) [it] is not already funded under the I-X formula.[42]

<u>FortisBC reply</u>

FortisBC considers CEC's approach "would require setting criteria to determine whether projects 'should' be funded under the I-X formula" and if it is suggesting an additional qualitative test to determine when capital should be excluded, it is not appropriate. FortisBC notes that "[n]either the AUC, nor the OEB currently limits the type of capital projects eligible for capital exclusion based on project characteristics." Reviewing the evolution of the treatment of PBR capital by the AUC and OEB, FortisBC asserts the experience in these jurisdictions demonstrates it is inappropriate and impractical to restrict capital projects' exclusion eligibility to those that are non-discretionary, extraordinary or unanticipated.[43]

FortisBC states that "ICG's argument is premised on characterizations of the PBR plans and capital exclusion criteria in Alberta and Ontario that are at odds with how those plans actually operate and how the exclusion criteria are applied." FortisBC provides a number of examples to demonstrate that ICG's characterization of the AUC plan is incorrect and submits that its proposals are consistent with both of these jurisdictions.[44]

The caveats outlined by BCOAPO, in FortisBC's view, are unnecessary as they are inherent in its proposals. With respect to the first of these, FortisBC submits that CPCN projects that may be proposed for exclusion would always be linked to the regulated business of the utility and eligible to be part of rate base. Concerning the second caveat, CPCN project expenditures are excluded from base capital and, as such, will not already be funded under the I-X formula.[45]

Commission determination

The Panel finds that reliance upon the single criterion of materiality to determine whether a capital project is excluded from the I-X mechanism provides adequate protection for ratepayers.

CEC bases its recommendation that projects demonstrate that they should not be funded under the I-X mechanism on the criteria established by the AUC and OEB. The issue of reliance on the experience and methodologies of other Canadian jurisdictions was addressed in section 2.1 of these reasons for decision and there is no need to readdress this here.

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[41] Ibid, p.16.
[42] Exhibit C1-2.
[43] Exhibit B-2, pp. 1–5.
[44] Ibid, pp. 7–12.
[45] Ibid., pp. 5–6.

ICG's concern appears to relate to the potential for a project which would normally be handled within the capital base to be approved outside of the base simply because it is of a size that exceeds the materiality criterion. In slightly different terms, BCOAPO raises the same point. The Panel has addressed this concern in the previous section, by requiring FortisBC to demonstrate that a project that falls above the PBR threshold does not result from combining smaller projects.

2.3 Exogenous capital

In the PBR Decisions, the Commission noted that the utility may be faced with undertaking required capital expenditures that are unforeseen, uncontrollable and are outside the normal course of business. The Commission characterized such events as being exogenous and established five criteria for determining whether an event should receive exogenous treatment, including a materiality threshold which is calculated based on 0.5 percent of FEI/FBC's 2013 Base O&M. The Commission determined that exogenous treatment could apply to O&M or Capital expenditures, as well as O&M or Capital savings.[46]

FortisBC submits that exceeding the materiality threshold should be the only factor for determining the exclusion of a capital project from the formula spending envelope and no further financial exogenous criteria should be established. It states that this is consistent with other jurisdictions. However, FortisBC also states that "The PBR Plan already contains provisions under which exogenous factors are evaluated for inclusion in revenue requirements, and no additional exogenous criteria are necessary."[47]

<u>Intervener submissions</u>

BCOAPO submits there should be no non-financial exogenous criteria for determining the exclusion of a capital project from the PBR capital formula.[48]

CEC submits that, in addition to a materiality threshold, a project must demonstrate that it should not be funded under the I-X formula. CEC recommends that the Commission devise such tests as it deems appropriate to assess this criterion.[49]

Commission determination

It is important to distinguish between exogenous factor treatment and other exclusions to which a materiality threshold may apply. The Oxford English Dictionary defines exogenous as "having an external cause or origin." It was in this context that, in the PBR proceedings, the Commission determined it appropriate where a capital project arising for reasons that are unforeseen and over which the utility has little or no control be afforded exogenous treatment. The Commission further defined exogenous events by establishing five criteria for evaluating whether expenditures or savings qualify for exogenous treatment, including a materiality threshold criterion.[50]

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[46] FEI PBR Decision, pp. 97–-99; FBC PBR Decision, pp. 94–96.
[47] Exhibit B-1, p. 2.
[48] Exhibit C1-2, p. 8.
[49] Exhibit C2-2, p. 2.
[50] FEI PBR Decision, pp. 97-99; FBC PBR Decision, pp. 94–96.

The Commission also directed that exogenous events not be aggregated. The materiality threshold must be applied to the costs/savings of each exogenous factor event and the costs/savings for a specific event must exceed the materiality threshold in order to be eligible for exogenous factor treatment.

No party has advanced an argument to persuade the Panel that the current exogenous criteria (namely being unforeseen and uncontrollable, and with a cost/savings that exceeds 0.5 percent of Base O&M) are not appropriate. **Accordingly, the Panel reaffirms the determinations made in the PBR decision, which outlines the exogenous criteria for capital.**

2.4 Managing the dead-band

In its PBR Applications, FortisBC proposed that limited rebasing is to occur in those instances where the annual capital expenditures are either above or below the formula based amounts by greater than 10 percent. In its PBR Decisions, the Commission expanded the proposed dead-band by adding a 15 percent two year cumulative dead-band. In addition, the Commission requested all parties to make submissions on whether the addition of this two-year cumulative 15 percent dead-band was sufficient to protect both ratepayers and shareholders. The Commission made no comment on an appropriate process to rebase capital in the event a dead-band is exceeded.[51]

FortisBC states that while the Company's ability to manage total capital over the PBR term may potentially be restricted, it has no concerns with the level of shareholder and ratepayer protection offered by the two-year cumulative 15 percent dead-band.[52]

Intervener submissions

CEC submits that the dead-bands as outlined in the PBR Decision are appropriate and there is no need to revise them based on any changes to the capital exclusion criteria.[53]

BCOAPO submits that both the one-year 10 percent and cumulative two-year 15 percent dead-bands are "after the fact adjustments and only protect the shareholder and ratepayer going forward." BCOAPO further submits that in those years where the over/under spending occurs the only protection available is the 50/50 earnings sharing mechanism built into the PBR plans. It further states that a continuing concern is the potential for "double dipping" where the utility applies for a capital project to be excluded from the PBR formula yet underspends its allowed base capital. BCOAPO submits that to address this circumstance there should be a requirement that approved excluded capital projects "establish a deferral account to track the revenue impact of any under spending of base capital that is less than 95% of the approved level of Base Capital for the year." Accordingly, Companies that expect their base capital expenditures will fall below threshold can acknowledge this and request "that only a portion of the project's full cost be used in determining the incremental revenue requirement impacts."[54]

ICG made no specific submissions on the sufficiency of existing dead-bands.

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[51] FEI PBR Decision, p. 181; FBC PBR Decision, p. 175.
[52] Exhibit B-1, p. 29.
[53] Exhibit C2-2, p. 6
[54] Exhibit C1-2, pp. 9–10.

FortisBC reply

FortisBC states that what BCOAPO pejoratively describes as "double dipping" is a PBR result that is expected and appropriate. FortisBC argues it is appropriate to promote base capital savings regardless of other projects outside of the formula. It considers the position taken by BCOAPO to be more of an objection to the inclusion of capital in the PBR formula or to the exclusion of any capital in the PBR formula, matters which were dealt with in the PBR Decisions. In FortisBC's view, BCOAPO's proposal would amount to funding capital projects eligible for exclusion from earnings resulting from efficiency gains in capital spending thereby removing them from the earnings sharing mechanism.

FortisBC further states that "[[t]]he practical implication is that unless there are no projects for exclusion, the Companies can only realize their share of earnings arising from efficiencies gained to a maximum of 5% under the approved level of Base Capital for the year when the Commission has determined that up to and including 10% is the appropriate threshold." FortisBC argues that the BCOAPO proposal is at odds with the earnings sharing mechanism (ESM) as approved by the Commission in the PBR Decision, is asymmetrical and favours ratepayers. In FortisBC's view, this is contradictory to the balance intended for the PBR as outlined in the Commission's determination that "the inclusion of a symmetrical ESM is beneficial to both Fortis[BC] and its customers." FortisBC considers the BCOAPO submission to be out of scope for this proceeding and should not be considered by the Commission.[55]

Commission determination

The Panel has reviewed the comments of the parties and is satisfied there is no need to change or adjust the one-year 10 percent dead-band and the two-year 15 percent dead-band as established in the FEI and FBC PBR Decisions.

The Panel agrees with FortisBC's assertions concerning the comments and proposals of BCOAPO. What BCOAPO is proposing would in effect mean a material change to the PBR Decision resulting in asymmetrical earnings sharing in favor of the ratepayer. As such, it would act as a disincentive for the Companies to work to create efficiencies and related savings in the capital amounts covered under the PBR formula and in effect, serve to eliminate the purpose for including any capital under the PBR formula.

As noted, the PBR Decisions provided direction on the setting of dead band parameters but provided no definitive direction with respect to the process to deal with rebasing future base capital amounts in the event that the dead band parameters are exceeded. This is addressed below.

The Panel accepts there are a number of reasons why a capital expenditure level may be higher or lower than the threshold. Some of these may support and justify raising or lowering base capital while others may demonstrate a particular result to be an anomaly, not necessarily requiring rebasing. Because of this, the Panel determines that the full circumstances of any variance from the dead-band must be examined in a transparent manner at the annual review process. **Where the dead band is exceeded for any year, FEI and FBC are directed in the next Annual Review filing to include recommendations as to any adjustment to base capital other than those driven by the I-X mechanism.** This will provide interveners the opportunity to review and comment on any such proposed changes prior to the Commission making its determination.

[55] Exhibit B-2, pp. 20–21.

2.5 Impact of capital exclusion criteria on the X-factor

In the PBR proceedings, evidence from productivity studies of utilities in other jurisdictions was presented. This evidence was, in part, relied upon by the Panel in its determination of the X-factor. These studies considered all of the capital spending of each utility in the study. The issue arose regarding whether the X-factor thus determined should be adjusted to account for the fact that it would be applied to approximately 30 to 40 percent, of FEI and FBC's capital.

In the PBR Decisions, the Commission directed that "this issue be revisited when a further determination on the dollar threshold is made."[56]

<u>Intervener submissions</u>

ICG submits that "this conclusion of the Commission must be applied to the [FBC] capital exclusion criterion, and an upward calibration of the X-factor will be required." However, in ICG's view, if the "Alberta capital exclusion criteria is adopted by the Commission no upward calibration of the X-factor will be necessary."[57]

No other interveners commented on the X-factor.

Commission determination

There is no persuasive evidence before the Panel regarding what, if any, adjustment should be made to the X-factor for either company. Although ICG argues in favour of an upward calibration, it provides no recommendations supported by evidence as to how that calibration is to be made. **The Panel concludes there is no reasonable basis on which it can rely to make an adjustment to the X-factor and therefore, declines to make any adjustment at this time.**

[56] FEI PBR Decision, pp. 90–91; FBC PBR Decision, pp. 87–90.
[57] Exhibit C3-2, pp. 15–16.