



**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER G-66-13A**

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IN THE MATTER OF
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473

and

FortisBC Energy (Vancouver Island) Inc.
Application for Approval of a Deferral Account in Connection with a Development Agreement
between FortisBC Energy (Vancouver Island) Inc. and Pacific Energy Corporation

BEFORE: L.A. O'Hara, Panel Chair/Commissioner
D.M. Morton, Commissioner April 26, 2013
R.D. Revel, Commissioner

O R D E R

WHEREAS:

- A. On March 5, 2013, FortisBC Energy (Vancouver Island) Inc. (FEVI) and Pacific Energy Corporation (PEC) entered into a Development Agreement, which, among other things, establishes a payment of Commitment Fees from PEC to FEVI and authorizes FEVI to incur Development Costs in connection with a gas pipeline reinforcement project would be required to provide natural gas transportation service to PEC (Pipeline Reinforcement Project) under a long term Transportation Service Agreement to be entered into between FEVI and PEC (Development Agreement);
- B. A Certificate of Public Convenience and Necessity (CPCN) will be required and applied for at a later date in order to construct the Pipeline Reinforcement Project;
- C. On March 13, 2013, pursuant to sections 59 to 61 of the *Utilities Commission Act (UCA)*, FEVI applied to the British Columbia Utilities Commission (Commission) for approval of a non-rate base deferral account, attracting Allowance for Funds Used During Construction (AFUDC) to capture the Development Costs and the Commitment Fees that will enable FEVI to commence development work (Application);
- D. The Application also seeks an order from the Commission approving the regulatory and accounting treatment of the Commitment Fees and Development Costs;
- E. A Streamlined Review Process for the review of the Application took place on April 23, 2013. Registered Interveners in attendance were British Columbia Pensioners' and Seniors' Organization, the Commercial Energy Consumers Association of British Columbia, B.C. Sustainable Energy Association *et al* and British Columbia Hydro and Power Authority;
- F. The Commission has considered the Application and concludes that it should be approved.

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2

NOW THEREFORE pursuant to sections 59-61 of the *Utilities Commission Act*, the Commission orders as follows:

1. FEVI is permitted to establish a non-rate base deferral account attracting AFUDC to capture the Development Costs and Commitment Fees, subject to the following conditions:
 - (a) In the event that the Pipeline Reinforcement Project and Transportation Service Agreement (TSA) proceed, the deferred Development Costs and associated AFUDC will become part of the capital costs of the Pipeline Reinforcement Project, and the Commitment Fees paid by PEC will be credited against future demand charges payable by PEC to FEVI under the TSA.
 - (b) In the event that PEC elects not to proceed or causes the Development Agreement to be terminated, the remaining balance of the deferral account after recovering the Development Costs from PEC will be credited to FEVI customers through future rates.
 - (c) In the event that FEVI fails to obtain the necessary approvals to proceed with the Pipeline Reinforcement Project or to obtain approvals with satisfactory conditions, the remaining balance of the deferral account after recovering the Development Costs from PEC and returning the Commitment Fees to PEC will be recovered from FEVI customers through future rates.
2. FEVI will track Development Costs incurred separately from payment of Commitment Fees.
3. FEVI is ordered to file progress reports with the Commission on the development of the Pipeline Reinforcement Project as follows:
 - (a) on or before March 31, 2014, status of development activities in Phase 1 as outlined in the Application and the Development Agreement and associated costs;
 - (b) on or before March 31, 2015, status of development activities in Phase 2 as outlined in the Application and the Development Agreement and associated costs;
 - (c) on or before March 16, 2016, status of development activities in Phase 3 as outlined in the Application and the Development Agreement and associated costs. Should FEVI obtain the Commission approval for a CPCN for the Pipeline Reinforcement Project on or before March 31, 2016, the Phase 3 report may be integrated into a CPCN progress report.

DATED at the City of Vancouver, in the Province of British Columbia, this 26th day of April 2013.

BY ORDER

Original signed by:

L.A. O'Hara
Panel Chair/Commissioner

FortisBC Energy (Vancouver Island) Inc.
Application for Approval of a Deferral Account in Connection with a Development Agreement
between FortisBC Energy (Vancouver Island) Inc. and Pacific Energy Corporation

REASONS FOR DECISION

Background

On March 5, 2013, FortisBC Energy (Vancouver Island) Inc. (FEVI) and Pacific Energy Corporation (PEC) entered into a Development Agreement, which, among other things, establishes a payment of Commitment Fees from PEC to FEVI and authorizes FEVI to incur Development Costs in connection with a gas pipeline reinforcement project that would be required to provide natural gas transportation service to PEC under a long term Transportation Service Agreement to be entered into between FEVI and PEC (Development Agreement). A Certificate of Public Convenience and Necessity (CPCN) will be required and applied for at a later date in order to construct the Pipeline Reinforcement Project. On March 13, 2013, pursuant to sections 59 to 61 of the *Utilities Commission Act (UCA)*, FEVI applied to the British Columbia Utilities Commission (Commission) for approval of a non-rate base deferral account, attracting Allowance for Funds Used During Construction (AFUDC) to capture the Development Costs and the Commitment Fees that will enable FEVI to commence development work (Application).

The Streamlined Review Process for this Application took place on April 23, 2013. At the conclusion of the proceeding all active registered Interveners; namely, British Columbia Pensioners' and Seniors' Organization (BCPSO), the Commercial Energy Consumers Association of British Columbia (CEC) and B.C. Sustainable Energy Association *et al* (BCSEA), unanimously supported the Application. Because the Commission Panel has decided to grant the relief requested, in accordance with section 124 of the *UCA* no Reasons for Decision are required. Nevertheless, the Panel wishes to articulate its reasoning for one particular area, to ensure that this ruling does not create the expectation that all future significant development projects will necessarily receive similar deferral account treatment.

Unique Circumstances Surrounding the Deferral Account in Connection with a Development Agreement between FEVI and PEC

FEVI explained the distinction between feasibility costs and design & development costs as follows:

Feasibility Costs (period expense or deferral upon approval of the BCUC)

- Includes assessment of project alternatives and options;
- Results in a recommendation as to the best option;
- Completion of the feasibility stage is when a decision is made to move forward with a project.

Design & Development Costs (capital or deferral upon approval of the BCUC)

- The capital project is clearly defined and the costs can be identified;
- The technical feasibility of the capital project has been established;
- Capital project approval has occurred.

FEVI further stated that a distinction between the feasibility and development stages of project development is important for “regular” capital, because FEU expense feasibility costs and capitalize development costs. For large CPCN type capital projects, where there is significant time lag between the outlay of feasibility/development costs and the project entering service FEVI would request approval of specific deferral accounts consistent with treatment in Account 172, Preliminary Survey & Investigation Costs of the BCUC Uniform System of Accounts (USoA). (Exhibit B-3, BCUC 1.3.1, 1.4.1, 1.4.1.1.)

Commission Determination

The Commission Panel has concerns over preliminary investigations and feasibility studies that could continue over a number of years, with accumulated cost balance resulting in a major write-off if the project does not proceed. Therefore, the Panel continues to prefer the GAAP defined accounting treatment of feasibility costs as period costs, to be expensed annually even in the cases of feasibility work that could eventually lead to a major capital project. Due to great uncertainty surrounding undefined projects without any certainty of them ever proceeding, the safer approach is the treatment of these feasibility study costs as O&M.

The deferral account proposal in this Application, however, has some unique circumstances:

- FEVI has taken a commendable approach by successfully negotiating a comprehensive Development Agreement with PEC to establish the key parameters for the development phase.
- The risk of non-recovery to FEVI, and therefore the risk to current ratepayers, is very low because of PEC’s contractual obligation to reimburse FEVI for Development Costs in the event the LNG Project does not proceed, is secured by an irrevocable Letter of Credit. The evidence indicates the maximum estimated amount that is non-recoverable from PEC is approximately \$200,000, which is the total estimated AFUDC amount.
- Because the most likely outcome is almost full recovery of the account if the project does not proceed, without the account, feasibility expenditures would be included in rates for two years, and subsequently the cost recovery would be included in rates. In contrast, the deferral account will provide a desirable rate smoothing effect. If the project does proceed, the feasibility and development costs that are prudently incurred will be part of the capital cost of the project.
- The development phase is lengthy, with expected CPCN application filing in mid 2015, with target in-service for the LNG facility of April 1, 2018.

For the above reasons, the Commission Panel approves the deferral account for both feasibility and development costs and commitment fees. It follows that a deferral account of this nature attracts AFUDC. Accordingly, the Panel approves AFUDC treatment on the balance of this account.