



**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER G-36-12**

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

and

FortisBC Inc.
The Kettle Valley Distribution Source Project
Commission Order C-5-06 for
A Stage 2 Prudency Expenditure Inquiry
Under Sections 59 and 60 of the Utilities Commission Act

BEFORE: L.F. Kelsey, Commissioner
D.M. Morton, Commissioner
R.D. Revel, Commissioner
March 15, 2012

ORDER

WHEREAS:

- A. On August 9, 2006, the British Columbia Utilities Commission (Commission) issued Order C-5-06 granting a Certificate of Public Convenience and Necessity (CPCN) to FortisBC Inc. (FortisBC) for the Kettle Valley Distribution Source Project (Project);
- B. On May 6, 2011, FortisBC submitted its Final Quarterly Progress Report No. 13 for the Project, pursuant to Commission Order C-5-06;
- C. On May 24, 2011, the Commission advised FortisBC that it may be considering a prudency review of the Project depending on the outcome of a factual review of the Project (Factual Review);
- D. On May 31, 2011, the Commission initiated a Factual Review and issued an information request to FortisBC on the Project;
- E. On June 1, 2011, FortisBC requested an extension to July 29, 2011, to provide a response to the Factual Review information request;
- F. On July 5, 2011, the Commission issued a revised Factual Review information request in recognition of FortisBC's current workloads, removing or rewording several questions;
- G. On July 29, 2011, FortisBC responded to the Commission's information request on the Factual Review;

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- H. On August 10, 2011, the Commission issued Information Request No. 1 (IR1) 180.1 in its review of the FortisBC Inc. 2012-2013 Revenue Requirements and Review of 2012 Integrated System Plan Application. In IR1 180.1, the Commission asked “As the Commission is conducting a factual review of the costs incurred on the Project, please confirm that any expenditures that may be found not to have been prudently incurred will be adjusted in the revenue requirements and hence the rates.”;
- I. On September 9, 2011, FortisBC responded to IR1 180.1 stating “The Company will comply with Commission Orders, subject to sections 99 and 101 of the Utilities Commission Act.”;
- J. On December 19, 2011, the Commission issued Order G-215-11 establishing a Stage 1 written comment process to address the questions as to whether there are reasonable grounds to question the prudence of the decisions of FortisBC that led to the expenditure and whether the Commission should establish a Stage 2 proceeding to review the prudence of the expenditures prior to allowing them into rates. The Commission also invited comment on the review process in the event the Commission determines that a Stage 2 proceeding is needed;
- K. On January 19, 2012, the Industrial Customer Group (ICG) responded to Order G-215-11 and stated that a Stage 2 review of the Project is justified and recommends a negotiated settlement process;
- L. On January 19, 2012, the British Columbia Old Age Pensioners’ Organization (BCOAPO) responded to Order G-215-11;
- M. On January 26, 2012, FortisBC stated that no Stage 2 process should occur, and that if a Stage 2 process is engaged, a written hearing should be adopted to minimize the costs;
- N. The Commission has considered the submissions of the ICG and BCOAPO and concluded that the magnitude of the overrun of 33.5 percent over the approved CPCN amount of \$21.48 million and the questions the parties have identified with regard to specific expenditures on the Project is a sufficient challenge to overcome the presumption of prudence, and that a Stage 2 written hearing is necessary to determine if any expenditure related to the Project will be disallowed for recovery in rates.

NOW THEREFORE pursuant to sections 59 and 60 of the *Utilities Commission Act*, the Commission orders as follows:

1. The Commission establishes a Stage 2 Written Hearing to review the prudence of the expenditures on the Project previously approved by Order C-5-06, prior to allowing them into rates in accordance with the Commission’s Determination set out in the Reasons for Decision attached as Appendix A to this Order.

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2. The Stage 2 Written Hearing for the review of expenditures on the Project will proceed according to the Regulatory Timetable attached as Appendix B to this Order.
3. Parties in the hearing may make submissions on the regulatory tests that are appropriate to apply in this hearing to determine if a utility expenditure should be allowed into rate base, on the role of progress reports with respect to a review of the prudence of Project expenditures, and the import of the project progress reports on determination of the prudence of an expenditure on the Project.
4. Parties in the hearing may make submissions on how past revenue requirements Negotiated Settlement Process Settlements affect the review of the prudence of Project expenditures.
5. The Commission denies FortisBC's requests to exclude any Project expenditure from the scope of the Stage 2 hearing.
6. FortisBC will provide a copy of this Order within 10 days of the date of the Order to the Interveners in the FortisBC Inc. 2012-2013 Revenue Requirements and Review of 2012 Integrated System Plan Application.

DATED at the City of Vancouver, in the Province of British Columbia, this 22nd day of March 2012.

BY ORDER

Original signed by:

D. Morton
Commissioner

FortisBC Inc.
The Kettle Valley Distribution Source Project
Commission Order C-5-06 for
A Stage 2 Prudency Expenditure Inquiry
Under Sections 59 and 60 of the Utilities Commission Act

REASONS FOR DECISION

1.0 SUMMARY

On August 9, 2006, the British Columbia Utilities Commission (Commission) approved for FortisBC Inc. (FortisBC) a Certificate of Public Convenience and Necessity (CPCN) for the Kettle Valley Distribution Source Project (Project) at \$21.48 million. On June 20, 2007, Commission staff was advised the cost estimate had increased to \$28.39 million. In FortisBC's final project progress report the Project cost was \$28.67 million. This triggered a factual review of Project expenditures.

On December 15, 2011, the Commission issued Order G-215-11 seeking comments on whether there are reasonable grounds to question the prudence of the decisions of FortisBC that led to the expenditure; and whether the Commission should establish a Stage 2¹ proceeding to review the prudence of the expenditures prior to allowing them into rates. British Columbia Old Age Pensioners' Organization *et al.* (BCOAPO), Industrial Customer Group (ICG), and FortisBC submitted comments.

The Commission has considered the submissions of ICG and BCOAPO and concluded that the magnitude of the overrun of 33.5 percent over the approved CPCN amount of \$21.48 million and the questions the parties have identified with regard to specific expenditures on the Project, is a sufficient challenge to overcome the presumption of prudence and that a Stage 2 Written Hearing is necessary to determine if any expenditure related to the Project will be disallowed for recovery in rates.

2.0 BACKGROUND

On November 26, 2004, FortisBC filed its 2005 Revenue Requirements Application with the Commission. In the FortisBC 2005 Revenue Requirements the estimated cost of the Project was estimated at \$7.650 million. (FortisBC 2005 Capital Plan – Exhibit B-1, Tab 9, Table 9.3.1, p. 21)

In Order G-52-05 dated May 31, 2005, the Commission directed FortisBC to submit a CPCN application for the Project as there appears to be some uncertainty with regard to the best solution for the Boundary area and considered that allowing public comment on the proposed solution would be of value.

On August 9, 2006, the Commission issued Order C-5-06 granting a CPCN to FortisBC for the Project as described in Option 2 of the Application. The CPCN for the Project was granted at a cost of \$21.48 million. On June 20, 2007, Commission staff was advised that cost increases placed the estimated cost of the Project at \$28.39 million.

¹ Refers to the two stage inquiry process in *Enbridge Gas Distribution Inc. v. Ontario Energy Board* (2006) O.J. No. 1355 (C.A.)

On May 6, 2011, FortisBC, pursuant to Commission Order C-5-06, submitted its Final Quarterly Progress Report No. 13 for the Project. In FortisBC's final project progress report the actual project cost was \$28.67 million.

On May 24, 2011, the Commission advised FortisBC that it may be considering a prudency review of the Project depending on the outcome of a factual review of the Project (Factual Review). On May 31, 2011, the Commission initiated a Factual Review and issued an information request to FortisBC on the Project. On July 29, 2011, FortisBC responded to the information request issued on the Factual Review.

On August 10, 2011, the Commission issued an information request in its review of the FortisBC Inc. 2012-2013 Revenue Requirements and Review of 2012 Integrated System Plan Application. In Information Request No. 180.1, the Commission asked "As the Commission is conducting a factual review of the costs incurred on the Kettle Valley Distribution Source Project, please confirm that any expenditures that may be found not to have been prudently incurred will be adjusted in the revenue requirements and hence the rates." On September 9, 2011, FortisBC responded to Information Request No. 180.1 stating "The Company will comply with Commission Orders, subject to sections 99 and 101 of the Utilities Commission Act."

3.0 STAGE 1 REGULATORY PROCESS

After completing the Factual Review, the Commission issued Order G-215-11 establishing a Stage 1 written comment process. The Commission also invited comment, in the event the Commission determines that a Stage 2 proceeding is needed, on whether the proceeding should be oral, written, a negotiated settlement process or other; what regulatory methodologies should be applied to determine if an expenditure should be recoverable in rates; and should all of the expenditures on the Project be reviewed in whole or should subsets of the expenditures be reviewed, and if subsets what expenditures should be reviewed.

4.0 INQUIRY PROCESS FOR A CAPITAL EXPENDITURE

The two stages of the inquiry process generally being followed are outlined in *Enbridge Gas Distribution Inc. v. Ontario Energy Board* (2006) O.J. No. 1355 (C.A.) as follows:

- (i) At the first stage of the inquiry, the decisions of the utility are presumed to be made prudently unless those challenging the decision demonstrate reasonable grounds to question the prudence of those decisions.
- (ii) At the second stage of the inquiry, reached only if the presumption of prudence is overcome, the utility must show that its business decision was reasonable under the circumstances that were known to, or ought to have been known to, the utility at the time it made the decision.

5.0 ISSUES

The Commission has primarily two issues to decide at this time. The first issue is the Stage 1 question on whether reasonable grounds have been demonstrated to overcome the presumption of prudence. If the Commission decides reasonable grounds have been demonstrated to overcome the presumption of prudence, then the Commission should establish a Stage 2 hearing process to determine if any expenditure, after applying the regulatory tests available, should be disallowed for recovery in rates. The second question is the type of hearing necessary for the Stage 2 expenditure review. If the inquiry proceeds to Stage 2, in that stage the

Commission will need to determine if any expenditure should be disallowed in rates, and the treatment of any disallowed expenditure already included in rates.

6.0 FORTISBC's STAGE 1 INITIAL COMMENTS

FortisBC stated the following reasons why actual expenditures on the Project exceeded the CPCN budget amount:

- The Commission's Decision was later than anticipated.
- There was hyperinflation and volatility in the world-wide materials markets.
(Exhibit B-1, p. 2)

7.0 INTERVENERS' STAGE 1 COMMENTS

7.1 ICG Comments

ICG believes that either the negative variance of 33 percent referred to in Order G-215-11 or the Project schedule delay of two years provides sufficient grounds to overcome the presumption of prudence so as to justify a Stage 2 review of the Project. IGC raised other issues related to the Highway 3 Corridor - Midway to Greenwood, Procurement and Delivery of Transformers, Substation Transmission Tap, Engineering and Project Management Cost Variance, and the meaning and implied approval assigned to the quarterly progress reports.

ICG submitted that the Commission should establish a Stage 2 proceeding to review the prudence of the expenditures. In response to the Commission's request for comments on the Stage 2 process, ICG recommended a negotiated settlement process. However, in the unusual circumstances of a Stage 2 prudence review, ICG will support the Stage 2 process that is recommended by FortisBC to the Commission. (Exhibit C2-1)

7.2 BCOAPO Comments

BCOAPO stated it is in general agreement with the submissions provided by IGC. In light of the 33 percent cost overrun on the Project and the explanation for the cost variance provided by FortisBC in its Quarterly Reports and responses to Commission information requests, BCOAPO submits that there are reasonable grounds to review the prudence of the FortisBC expenditures on the Project. BCOAPO stated that FortisBC did not account for how potential inflationary pressures and material/labour cost volatility might affect the ultimate Project costs. BCOAPO noted the change to the route for the Midway to Greenwood distribution line upgrade, the cost for transformers for the Project, and the additional costs relating to an increase in transformer tap complexity, including the need for shield wires and ground wells, that seem to be due, at least in part, to a change in the siting of the transformer.

BCOAPO submits that these concerns, taken together, constitute reasonable grounds to question the prudence of the decisions of FortisBC that led to the cost overruns for the Project prior to these costs being recovered from customers.

BCOAPO believes the Commission should proceed to a Stage 2 proceeding to review the prudence of the expenditures prior to allowing these costs to be flowed through into rates. In the event the Commission determines that a Stage 2 proceeding is needed, BCOAPO submits that the expenditure review should take place

through a negotiated settlement process and that all of the expenditures on the Project should be open to review. (Exhibit C1-1)

8.0 FORTISBC'S STAGE 1 FINAL COMMENTS

FortisBC stated that if the Commission had not intended the quarterly progress report filings to have some meaning, presumably it would have required only the filing of a final report after completion of the Project, not a considerable number of other documents throughout the process.

FortisBC stated that in prior negotiated settlement agreements it was agreed that ratepayers would pay the revenue requirement that included the Project in rate base. FortisBC stated that the result would be an unpacking of firm rates that have already been paid by customers.

FortisBC's position is that no Stage 2 process should occur. If there is a Stage 2 inquiry, no part of that inquiry should relate to expenditures up to the total estimated cost of the Project plus anticipated variance, namely \$25.6 million. Further, it is respectfully submitted that even if the \$3,070,000 balance is not automatically excluded from a Stage 2 review on the strength of the Project itself having been in the public interest, substantial portions of that balance should be, given certain considerations noted in its submission. Even if the Commission finds reasonable grounds to question portions of the \$3,070,000, it is not reasonable to question all of it. If any Stage 2 process occurs, the issues that ICG has raised in respect of the Project schedule should only be taken into account, if at all, in respect of the impact of schedule on cost.

If any Stage 2 process is engaged in, a written hearing should be adopted.

9.0 COMMISSION DIRECTIVES

Stage 1 Inquiry

After reviewing the exhibits, the submissions of FortisBC, BCOAPO and ICG, the Commission concludes that the magnitude of the overrun of 33.5 percent over the approved CPCN amount of \$21.48 million and the questions the parties have identified with regard to specific expenditures on the Project are sufficient to overcome the presumption of prudence, and that the matter should proceed to a Stage 2 inquiry.

The Commission establishes a Stage 2 Written Hearing to review the prudence of the expenditures on the Project previously approved by Order C-5-06, prior to allowing them into rates.

Stage 2 Inquiry

In Stage 2, the burden of proof now shifts to FortisBC; and FortisBC must show, at a minimum, that the decisions taken by FortisBC were prudent under a standard of reasonableness pertaining to the circumstances that were known or reasonably knowable at the time.

Both ICG and BCOAPO requested a negotiated settlement process for a Stage 2 inquiry, while FortisBC stated that if a Stage 2 inquiry is required then it should be a written proceeding. The lack of FortisBC's support for a negotiated settlement process rules out this option. The Commission concludes that to hold an oral hearing more or less concurrently with the oral hearing for FortisBC's revenue requirements may be extremely taxing on

the resources of all parties and for these reasons the Commission concludes a written hearing would be appropriate. **The Stage 2 Written Hearing for the review of expenditures on the Project will proceed according to the Regulatory Timetable attached as Appendix B.**

Regulatory practice has identified several tests for whether a utility expenditure should be allowed into rate base. **Parties in the hearing may make submissions on the regulatory tests that are appropriate to apply in this hearing to determine if a utility expenditure should be allowed into rate base.**

FortisBC raised questions about the role of progress reports with respect to a review of the prudence of Project expenditures. **Parties in the hearing may make submissions on the role and the import of project progress reports with respect to the determination of prudence of expenditures on the Project.**

Prior Negotiated Settlement Processes (NSPs)

At this time, it is not clear what Project expenditures FortisBC has taken into rate base to date or how past revenue requirements NSP settlements affect the review of the prudence of these expenditures. **These matters may be the subject of investigation and submissions in the Stage 2 Written Hearing.** Any differences between amounts that have been taken into rate base and the approved amount can be reconciled using a deferral account.

FortisBC's Request on Scope of the Stage 2 Inquiry

After reviewing FortisBC's request on scoping the hearing, the Commission considers FortisBC's request to exclude certain expenditures from the Stage 2 review to be overly restrictive and akin to seeking Commission pre-approval of expenditures that have not yet been determined to be prudent or imprudent. The Commission finds that all expenditures including those affected by scheduling, resources and scope that impact costs are to be included in the Stage 2 process. Hence, all expenditures can be examined and any expenditure that fails the regulatory tests may be disallowed in rates. Therefore, the Commission concludes all expenditures can be examined.

The Commission denies FortisBC's requests to exclude any Project expenditure from the scope of the Stage 2 hearing.

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REGULATORY TIMETABLE

ACTION	DATE (2012)
Registration of Interveners	Wednesday, April 4
Filing of Participant Assistance/Cost Award Budgets	Tuesday, April 10
Submission of comments by FortisBC on the regulatory tests that are appropriate to apply in this hearing to determine if a utility expenditure should be allowed into rate base, and on the role and import of the project progress reports on determination of the prudency of an expenditure on the Project.	Friday, April 13
Submission of comments by Interveners on the regulatory tests that are appropriate to apply in this hearing to determine if a utility expenditure should be allowed into rate base, and on the role and import of the project progress reports on determination of the prudency of an expenditure on the Project.	Friday, April 20
Final Reply by FortisBC on the regulatory tests that are appropriate to apply in this hearing to determine if a utility expenditure should be allowed into rate base, and on the role and import of the project progress reports on determination of the prudency of an expenditure on the Project.	Friday, April 27
Commission Decision on other regulatory tests to be applied to the review of Project expenditures, and on the role and import of project progress reports with respect to the determination of prudency of expenditures on the Project.	To Be Advised
Commission Information Request No. 1 to FortisBC	To Be Determined
FortisBC Response to Commission Information Request No. 1	To Be Determined
Intervener Information Request No. 1 to FortisBC	To Be Determined

REGULATORY TIMETABLE
(continued)

FortisBC Response to Intervener Information Request No. 1	To Be Determined
Commission and Intervener Information Request No. 2 to FortisBC	To Be Determined
FortisBC Response to Commission Information Request No. 2	To Be Determined
FortisBC Final Submission	To Be Determined
Intervener Reply	To Be Determined
FortisBC Final Reply	To Be Determined