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August 12, 2013

<u>Via Email</u>
Original via Mail

Association of Vancouver Island
and Coastal Communities
525 Government Street
Victoria BC V8V 0A8

<u>Attention:</u> Ms. Iris Hesketh-Boles, Executive Coordinator

Dear Ms. Hesketh-Boles:

Re: FortisBC Energy Utilities (FEU)[1]

Applications for Reconsideration and Variance of Commission Order G-26-13 Common Rates, Amalgamation, and Rate Design Decision (the Reconsideration Applications) - Phase Two

Response to the Association of Vancouver Island and Coastal Communities (AVICC) Information Request (IR) No. 1

On June 26, 2013, the Commission issued Order G-100-13 establishing a Regulatory Timetable for Phase Two of the Reconsideration Applications. In accordance with Commission Letter L-46-13 setting out the Amended Regulatory Timetable, the FEU respectfully submit the attached response to AVICC IR No. 1.

If further information is required, please contact the undersigned.

Sincerely,

on behalf of the FortisBC Energy Utilities

Original signed:

Diane Roy

Attachments

cc (e-mail only): Commission Secretary
Registered Parties

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[1] Consisting of FortisBC Energy Inc., FortisBC Energy (Vancouver Island) Inc. and FortisBC Energy (Whistler) Inc.

1.0 Capital structure and cost of equity

In their Argument, the FEU stated that:

> "As stated in Exhibit B-15, BCUC IR 2.3.6, while the FEU believe the 12 basis point risk premium is a reasonable premium over the current benchmark ROE, the FEU would proceed with amalgamation and postage stamp rates if it is determined by the Commission that FEI Amalco should have either a lower or no risk premium relative to the benchmark ROE" (FEU Argument, para 230).

1.1 Please confirm that this is still the FEU's position.

Response:

Confirmed. Although the evidence supports the position that Amalgamation results in marginally higher risk for FEI Amalco, and the 12 basis point risk premium is reasonable, the FEU would proceed with Amalgamation if the Commission were to determine that the Amalgamated entity should have either a lower or no risk premium relative to the benchmark ROE at this time.

1.2 What is the FEU's proposal for the appropriate capital structure for the amalgamated entity? If it differs from that allowed FEI by the Commission in its most recent decision, please identify the increased business risks that might justify the use of a different equity ratio.

Response:

The appropriate capital structure and ROE is the blended capital structure and ROE of the entities pre-amalgamation. The below table shows the weighted average ROE and capital structure now, after the Stage 1 GCOC decision and also reflects FEU's proposal in Stage 2 of the current GCOC proceeding.

Stage 1

	Rate Base	Equity %	Equity	W.A. Equity %	ROE%	ROE$	W.A. ROE
FEI	2,767,988	38.5%	1,065,675		8.75%	93,247	
FEVI	808,829	40.0%	323,532		9.25%	29,927	
FEW	39,960	40.0%	15,984		9.25%	1,479	
FN	6,426	38.5%	2,474		8.75%	216	
	3,623,203		1,407,665	38.85%		124,868	**8.87%**

Stage 2

	Rate Base	Equity %	Equity	W.A. Equity %	ROE%	ROE$	W.A. ROE
FEI	2,767,988	38.5%	1,065,675		8.75%	93,247	
FEVI	808,829	43.5%	351,841		9.25%	32,545	
FEW	39,960	45.0%	17,982		9.50%	1,708	
FN	6,426	38.5%	2,474		8.75%	216	
	3,623,203		1,437,972	39.69%		127,717	**8.88%**

The FEU filed evidence in the original proceeding that FEI Amalco will have higher risk than FEI the benchmark and that the risk would justify the higher equity thickness and risk premium to the benchmark.

2.0 Cost savings from amalgamation

2.1 Please identify all the functions that will have to continue to be performed for the existing (unamalgamated) corporations that would cease upon amalgamation.

Please consider (inter alia) statutory audit, tax returns, separate governance and secretarial requirements, separate regulatory requirements, separate regulatory hearings, the requirement for individual corporate books of account and computer programming.

Response:

Upon amalgamation, all functions of the amalgamated entity would continue to be performed. However, instead of completing three (FEI, FEVI and FEW) individual processes, only a single consolidated process would be performed for FEI Amalco. This benefit applies to the specific functions noted above where the individual accounting, tax, governance and regulatory requirements would be reduced to those of just FEI Amalco. In the regulatory arena, this would greatly reduce the number of filings and streamline the regulatory process, resulting in avoided costs and regulatory efficiencies for all stakeholders.

2.2 Please calculate the annual savings that would flow from amalgamation of the entities (including FEFN).

Response:

As stated at paragraph 59 of the Reconsideration Application filed April 26, 2013, the FEU estimated the benefits of amalgamation and postage stamp rates to be in the range of $901,000 to $2,128,000 per year, depending on the average short-term debt that would be applicable to the FEVI service area. As detailed in Section 6.6 of the Application, BCUC IR 1.5.11 and in Section 5.1 of the FEU's Final Argument filed on September 14, 2012, these savings would flow from the following:

1. **Interest Savings**: Interest expense savings of approximately $2.0 million are forecast to occur primarily as a result of the application of the FEI short-term debt rate to the FEVI and FEW short-term debt components of approximately $144.2 million.
2. **Financial Efficiencies**: FEU will experience savings of approximately $18,000/year for auditing requirements and $100,000/year for rating agency fees.
3. **Legal Efficiencies**: Minor costs savings will be realized due to the need for only one set of company records and to administer only one legal corporation.

In addition, the FEU identified other regulatory savings due to streamlined filings and reduced number of applications under an amalgamated entity with one unified structure and a harmonized tariff. While not quantified, these savings would be significant. Please see paragraph 59 of the Reconsideration Application.

Furthermore, as noted in paragraph 63 of the Reconsideration Application, the FEU also identified other regulatory efficiencies of amalgamation and postage stamp rates including efficiencies realized by facilitating consistent access to service offerings as a result of amalgamation and postage stamp rates. See Section 6.5 of the FEU's Amalgamation, Common Rates and Rate Design Application and Exhibit B-15, BCUC IR 2.54.1 in the original proceeding.

2.3 Please estimate the costs that would remain if FEFN were excluded from the arrangement.

Response:

If FEFN were excluded from the implementation of postage stamp rates, the change in savings overall is expected to be limited to the legal and regulatory expenses associated with excluding Fort Nelson from the adoption of common rates, due to the additional legal and regulatory requirements associated with maintaining separate rates for FEFN. The exact amount of the additional expense has not been estimated as it is dependent on the number and nature of regulatory filings and rate changes.

3.0 Intercompany agreements

3.1 Please identify all the intercompany agreements, and the entities that are party to them, that would cease to be in effect upon amalgamation.

Response:

As outlined in Appendix K-2 of the FEU Common Rates, Amalgamation and Rate Design Application, the intercompany agreements between the FEU entities (FEI, FEVI and FEW) that would cease to be effect upon amalgamation include:

Agreement	Entities Involved	Annual Value of Agreement
Wheeling Agreement	FEI and FEVI	$3.5 million
Transportation Agreement	FEVI and FEW	$2.5 million
Squamish Transportation Agreement	FEVI and FEI	$0.4 million
Storage and Delivery Agreement for Mount Hayes LNG services	FEVI and FEI	$18.0 million
Contribution Agreement in respect of Whistler Facilities	FEW and FEVI	$14.6 million *
Shared Services Agreements	FEI and FEW FEI and FEVI	$9.6 million

* Represents original contribution

3.2 How many of these agreements require the exercise of judgement in matters of cost allocation between the separate entities?

Response:

All the agreements and associated cost allocations were developed by the FEU based on the information available to ensure appropriate recovery of costs between the separate entities.

As stated in the past, allocation of costs between the separate entities, given the high level of integration achieved in terms of infrastructure and operations, requires the exercise of judgement. This is particularly relevant with respect to the Shared Services agreements between FEI and FEVI/FEW where shared departmental costs are pooled and allocated to the different entities using selected representative cost drivers. Under the approved Shared

Services agreement, costs are allocated based on the use of cost drivers such as the number of customers and employees and management time estimates, which are only representations of the costs.

In addition, the exercise of judgement in matters of cost allocation different than discussed above may occur on review and approval from the Commission. For example, regarding the Shared Services allocation between FEI and FEVI, the 2010/2011 FEVI RRA negotiated settlement agreement dated November 5, 2009, as approved by the Commission, stated the following:

> ***Shared Services/Corporate Services***
>
> *The Parties agree that the amount of Shared Services costs allocated to TGVI from TGI should be reduced by $0.339 million in 2010 and $0.491 million in 2011 as a result of the outcome of the concurrent TGI RRA.*
>
> *The Parties agree that the amount of Corporate Services costs allocated to TGVI from Terasen Inc. should be reduced by $0.535 million in 2010 and $0.540 million in 2011. As a result of these Corporate Services reductions, and as contemplated in the TGI 2010-2011 RRA Settlement Agreement, the amount of Corporate Services allocated to TGI from Terasen Inc. will increase by a corresponding amount in each year to ensure recovery of all of the combined Corporate Services.*

This example demonstrates that cost allocations between the separate entities in the past have involved the exercise of judgement.

3.3 Are any of the amounts significant?

Response:

The amounts have been included in the response to AVICC IR 1.3.1.

3.4 Please discuss whether the cessation of the need for the exercise of judgement would be beneficial or detrimental to ratepayers.

Response:

Given that costs are currently allocated involving the exercise of judgement with the cost allocation based on use of cost drivers and estimates which are only representations of the costs, amalgamation of separate entities as requested by FEU would be beneficial as it would reflect the integrated nature of the service provided, would be simpler, would not be open to contention and save the time currently associated with administering the agreements.

5.0 Midstream Charges and Rate Zones

5.1 Please define the constituent elements of midstream charges.

Response:

The table below provides a summary of the midstream components.

Midstream Cost Elements	Description
Commodity	The costs related to purchasing the non-baseload commodity requirements (e.g. seasonal, spot, and peaking gas purchases).
Transportation	The costs related to contracted transportation pipeline capacity (e.g. Westcoast T-South demand charges).
Storage	The costs related to gas storage, includes the contracted storage demand charges as well as the value of the net change in the gas in contracted and owned storage during the period.
Mitigation	The revenues credited against midstream costs related to the mitigation of the gas supply resources (e.g. commodity resell and transportation and storage mitigation) that are not required to meet the short term load throughout the period.
Gas Supply Management Cost	The costs allocated to midstream related to managing the gas supply functions to ensure reliable, secure, and cost effective supplies of gas for customers.

5.2 If they include storage, please identify the percentage of storage capacity and annual expense

- that is provided by i) the FEU owned facilities at Tilbury and Mt Hays and ii) by third parties in the US; and
- that is provided by the FEU elsewhere in the province.

Response:

The table below provides a summary of the owned and contracted storage facilities in the FEI and the FEVI gas supply portfolios that would be combined in the FEU using the 2013 forecast amalgamated midstream portfolio.

FEU 2013 Forecast Midstream Gas Storage	Costs *($000)*	%	Capacity *(TJ)*	%
FEU Owned LNG Facilities	18,348	36.4%	2,275	7.5%
FEU Contracted Third Party US Storage	18,037	35.8%	5,731	18.8%
FEU Contracted Third Party BC / Alberta Storage	13,963	27.7%	22,451	73.7%
Total	**50,348**	100.0%	**30,457**	100.0%

5.3 Please identify the benefits that FEU customers in the North of the province presently receive from the storage provided by the FEU.

<u>Response:</u>

The FEU gas supply storage resources provide benefits to customers located in the North of the province (such as Fort Nelson), and this was reflected in the FEU response to BCUC IR 1.47.2 on the FEU Common Rates, Amalgamation and Rate Design Application.

For ease of reference, the BCUC IR question and full response are provided below.

47.2 Is any portion of the FEI and FEVI on-system storage resources (i.e. Tilbury and Mt Hayes) currently allocated to meet the peak day design load requirement of Fort Nelson? If so, please provide the quantities.

Response:

No portion of Tilbury and Mt. Hayes LNG is currently specifically allocated to serve Fort Nelson. However, in certain situations, these resources provide a benefit to customers located in Fort Nelson because they are part of a diversified portfolio that is flexible enough to provide service during an emergency or critical event.

As discussed in the response to BCUC IR 1.47.1.1, FEI contracts for resources based on the regional needs across its diverse system. The resources of FEI are designed to provide security of supply and diversity in the portfolio while minimizing the costs of the total portfolio. As a result, the supply of gas during cold and peak weather conditions required in the FEU"s large operating region is provided by a variety of resources located in various places.

Although Tilbury and Mt. Hayes LNG do not directly provide supply for the town of Fort Nelson, they can be used to ensure that supply is available there via other means. An example would be if the Fort Nelson gas plant had an upset or outage during the winter months and it is only able to provide very limited gas supply during that period to producers. In such a situation, the producers would only allocate a portion of required volumes to each of their customers. This situation could lead to a scenario whereby a *producer is unable to provide the full scheduled quantity of gas to Fort Nelson. However, FEI has other contracted gas supply that it purchases at the outlet of the Fort Nelson gas plant for delivery to its other regions, such as the Lower Mainland. Therefore, it has the ability to redirect an appropriate level of supply to Fort Nelson that minimizes the likelihood of delivery cuts to the town. Subsequently, FEI would use supply from Tilbury and Mt. Hayes LNG as alternate resources for the customers of the Lower Mainland. It is by this means that Tilbury and Mt. Hayes LNG could be employed to assist the town of Fort Nelson during an emergency or critical event. This method of substituting gas supply from one point to another point is known as displacement. Other resources such as gas purchased in Alberta or storage resources such as seasonal and market area contracted by FEI can also be used via displacement to serve the other regions of FEI including Fort Nelson during certain situations.*

FEI has employed the Tilbury plant to provide supply during upstream outages in the winter months, which has aided in maintaining the integrity of our own and third-party pipeline systems that interconnect with the FEI system. The availability of Mt. Hayes LNG has further strengthened the ability of FEI to manage and balance its various load centres during critical winter periods and emergencies. FEI"s diversified portfolio of resources has the ability to provide reliable service to all customers, including customers that are located in smaller and remote areas like Fort Nelson.

5.4 Did the FEU consider splitting their service area into two zones (such as one north of compressor station 2, the other south of it) to recognize i) the difference in service levels (if they do indeed exist) and ii) the distance from the wellhead to the burner-tip?

Response:

The FEU did not specifically consider the option of two zones, with one zone north of compressor station 2 and the other south of it, although this is similar to the existing situation where postage stamp rates are essentially extended to all customers of FEI except for those in the Fort Nelson service area. However, FEI did consider the option of common delivery rates with regional midstream rates in the option analysis presented in section 5 of the FEU Common Rate, Amalgamation and Rate Design Application (see description of Option D on page 82). Regardless, FEI believes that differences in service levels in the different regions do not exist, and that all customers realise the benefit of FEI's midstream and gas portfolio procurement and management activities regardless of the "distance from the wellhead to the burner tip". This view was discussed in detail in the response to BCUC IR 1.47.1 and 1.47.2 in the Common Rate Amalgamation and Rate Design Application (Exhibit B-9 pages 185-187) and summarised in paragraph 175, pages 66-67 in the Final Argument of that proceeding. As such, FEI believes that common midstream rates, as with common delivery rates, are fair.

5.5 Please comment on the fairness issues that such a proposal would raise or resolve.

Response:

Please refer to the response to AVICC IR 1.5.4.

6.0 Benefits to AVICC member communities

By letter to FEI dated April 15, 2013 the Ministry stated:

> "[W]hile many factors may affect the competitive position of commercial enterprises in a particular locale, a disadvantage in the area of energy input costs may be significant and lead to diminished economic development and job creation opportunities as a result" (Exhibit C3-1).

6.1 Are the FEU aware of jobs being created in, say, Langley rather than Langford as a result of a significant disadvantage in the area of energy input costs? Where do the FEU see the most significant barriers to investment and economic growth in the AVICC region as a result of not having postage stamp rates?

Response:

The FEU have not done any research on this issue and therefore cannot point to any specific examples in which jobs are being created in an area outside of FEVI rather than in FEVI's service territory as a result of not having postage stamp rates. However, the current large difference in natural gas rates between the two regions (FEI and FEVI) may lead to a business picking one area over the other as a potential location. But with postage stamp rates, this variable to the cost of a business would be the same in all areas helping equalize the opportunity for communities to compete for new businesses, all else being equal.

The FEU do have a number of potential customers that are weighing investment decisions based in part on geographic location and rate structure. For instance, a potential customer, Pacific Energy Corp. (PEC), has begun feasibility work on constructing an LNG exporting terminal and is evaluating it to be located at the former Wood Fibre pulp mill site in Squamish. This location falls under FEVI's service territory, and therefore would be evaluated under FEVI's rate structure.

One of the key variables that PEC will evaluate as part of their feasibility work is what the costs for this project are under amalgamation being approved and under the current scenario of separate rate structures for the FEU entities. With amalgamation and common rates, the project economics are likely more favourable and this could positively impact PEC's decision regarding the project's economic feasibility and their decision to proceed. The economic benefits that would be gained as a result of PEC proceeding would have an impact on all existing customers such as higher throughput on the system and delivery margin benefits.

6.2 Please comment on the above statement in the context of the FEU being able to increase its penetration of the energy market in the AVICC region and the benefits that would flow from such increased penetration and throughput.

Response:

Higher penetration rates and increased throughput are beneficial to all customers as increased utilization of the FEU distribution system results in fixed costs being spread out over a larger volume of consumption. FEU's distribution system is a seasonal system whereby utilization rates are higher in the winter months than in the summer months. On an overall annual basis, the average utilization rate of FEU's system is relatively low. There is adequate room to add additional load onto the system, which would benefit all customers through lower delivery rates, all else being equal.

6.3 Please provide an estimate of the number and annual consumption of BC Hydro's "E Plus customers" (residential and general service) in the AVICC region, whose rate schedule will be terminated in 2017.

Response:

The FEU are not aware of BC Hydro's E-Plus rate schedules being terminated in 2017. BC Hydro had proposed a 10 year phase-out of the E-Plus rates in its 2007 Rate Design Application, with April 1, 2018 being the proposed date for E-Plus rates no longer being available. However, in its 2007 BC Hydro Rate Design Phase 1 Decision dated October 26, 2007 the Commission did not approve BC Hydro's proposal for the 10-year phase-out (see page 136 of the Decision). Instead the Commission approved a tariff amendment restricting the transfer of E-Plus accounts to another party. This tariff change was expected to result in the number of E-Plus accounts decreasing over time as E-Plus account holders sought to close their accounts for reasons such as moving residences. At the time of BC Hydro's 2007 Rate Design proceeding there were an estimated 12,750 residential E-Plus customers and 159 general service E-plus customers. Approximately 70% of the residential E-Plus customers were on Vancouver Island. Residential E-Plus customers consumed 12,000 kWh per year on average through their E-Plus meters. (E-Plus customers have two electricity meters with space and water heating load being metered through the E-Plus meter and all other electricity consumption being metered through the other residential meter.)

BC Hydro estimated that the tariff restriction on E-Plus account transfers would reduce the number of E-Plus accounts to about 5,000 by 2018 (see page 129 of the 2007 RDA Phase 1 Decision). Other details on the estimated 5,000 remaining customers in 2018, such as their location in the province or their average E-Plus consumption levels are not known.

6.4 Please comment on the choices facing these customers in 2017 when BC Hydro terminates Rate Schedules 1105 and 1205-7, on the assumption that postage stamp rates are not approved by the Commission.

<u>Response:</u>

As mentioned in the response to AVICC IR 1.6.3 the E-plus program does not have a firm expiration date but if the availability of the E-Plus rate ceases at a particular premise because the existing E-Plus customer decides to move, the new occupant of the residence or commercial premise would have the options of (1) combining the E-Plus load with the other electricity consumption at the site and taking service on the applicable BC Hydro rate schedule such as the residential RIB rate, or (2) converting their space and water heating appliances (along with other modifications such as ducting) to an alternative energy source such as natural gas, propane or heating oil. E-Plus customers have been required to maintain a back-up heating system since the E-Plus service is interruptible. In some cases it may be possible to use the back-up heating system as the primary heating system; however, the suitability of this will vary for several reasons from one case to the next. The alternatives facing a new occupant at a former E-Plus site on Vancouver Island will be the same whether postage stamp rates are approved or not. However, the economics of selecting natural gas as the new energy source for space and water heating on Vancouver Island will be poorer if postage stamp rates are not approved.

7.0 CECBC's new principle

CECBC submits that the Commission has effectively put forward a new principle which "appears to be a determination that cost causation makes postage stamp rates unfair when a difference in a regional cost or cross subsidization is significant but with no determination as to the relevant threshold" (Exhibit C1-2, p.2).

7.1 Do the FEU agree with this comment?

Response:

Please refer to the response to BCUC IR 1.10.1.

7.2 Are the FEU aware of any region or city within their Mainland service area that has either a similar consumption profile to an AVICC community or a similar cost to serve?

Response:

As stated in the response to BCUC IR 2.32.2 there are variations in consumption levels by community within regions:

There are some variations amongst the service areas of FEI, FEVI, FEW and FEFN in customer types, customer growth levels and customer price responsiveness. However, similar variation exists within a service area for some customers. For instance, residential customers in the Fraser Valley would have some variations in the above mentioned factors as compared to customers in Vancouver. However, these customers, despite their variations, are paying the same rate as they are both located in the Lower Mainland service area.

The table below demonstrates the amount of disparity between customers in various cities within the Lower Mainland service area.

2011 Actual Rate 1	Consumption (GJs)	Premises	UPC (GJ)
Abbotsford	2,746,293	29,026	94.6
Chilliwack	1,821,464	23,823	76.5
Hope	175,180	2,276	77.0
New Westminster	813,661	8,342	97.5
Surrey	10,807,224	100,273	107.8
Vancouver	10,617,435	93,739	113.3
West Vancouver	2,071,535	12,379	167.3

The FEU provide the following information on AVICC communities some of which are similar in consumption per customer to Lower Mainland communities:

2011 Actual Rate RGS	Consumption (GJ)	Premises	UPC (GJ)
Lantzville	24,341	402	60.6
Lazo	10,803	243	44.5
Metchosin	8,913	117	76.2
Merville	696	13	53.5
Oak Bay	241,489	3034	79.6

For example the AVICC communities of Metchosin and Oak Bay have very similar consumption to the Lower Mainland communities of Chilliwack and Hope. A similar comparison can be made with the FEU Interior communities.

The FEU have not prepared a cost of service study at the community level, so the Companies cannot say what the comparable cost to serve at the community level would be.

8.0 The history of gas service to the AVICC region.

CEC submits that:

> "[T]his issues [sic] needs to be viewed in the context of the origin of the natural gas service on Vancouver Island, which was initiated by the government of the day with significant subsidies from the Federal and Provincial governments") ...... "[T]he various levels of government seem to have set all of this in place in response to fairness in access to natural gas and or to reduce the environmental impacts of the use of oil as the main fuel supply on Vancouver Island" (Exhibit C1-2, p.4).

8.1 Please comment on the success of both governments' objective to create fairness in access to natural gas and/or to reduce the environmental impacts of the use of oil as the main fuel supply on Vancouver Island.

<u>Response:</u>

The Companies believe that in general the governments have been successful in these areas to date. As discussed on pages 37 to 40 of the FEU's Common Rates, Amalgamation and Rate Design Application and further discussed in Exhibit B-9, BCUC IR 1.20.1 in the original proceeding, natural gas has been made accessible to Vancouver Island through a series of arrangements. The original construction of the distribution system included the conversion of heating oil equipment to natural gas and seven pulp mills on the Sunshine Coast and Vancouver Island switched to natural gas from oil and wood waste as a fuel source. The result is that natural gas has successfully displaced heating oil on Vancouver Island. However, as discussed in the response to AVICC IR 1.8.2, heating oil continues to be used by residential and commercial buildings within the FEVI service territory. In the FEU's view, amalgamation and postage stamp rates is the next logical step in the development of natural gas service on Vancouver Island, will further the objective of reducing the impacts of the use of heating oil on Vancouver Island and will ensure that the efforts of stakeholders to bring natural gas to Vancouver Island are not ultimately undermined by significant rate increases.

8.2 Please provide the FEU's estimate for the number of commercial and residential customers in the AVICC region that use RFO for heating purposes, and who might be able to switch to natural gas with postage stamp rates, and compare it with the FEU's estimate of the number under the status quo. Please also provide estimates of volumes and contribution under the two scenarios.

Response:

FEI assumes that the the acronym "RFO" in the question stands for Recycled Fuel Oil. The company does not have any information that would indicate how many residential or commercial buildings are currently using Recycled Fuel Oil in the AVICC region. However, we estimate that 22,100 to 30,000 residential and 850 to 1,100 commercial buildings are still using fuel oil for space heating in the AVICC region.

While it is difficult to provide an accurate estimate of the market potential under a postage stamp versus a status quo rate scenario, more customers would be likely to switch to natural gas with postage stamp rates since the operating costs would be lower and consequently the value proposition would be more compelling to switch. As the FEU stated in their Common Rates, Amalgamation and Rate Design Application at page 129, more affordable natural gas prices have the potential to encourage the customers to switch to natural gas from higher GHG emitting energy resources, such as furnace oil and propane. As noted in Exhibit B-15, BCUC IR 2.52.1, unlike a home using electricity for heating, a home using heating oil will generally be appropriately configured to accommodate natural gas heating equipment.

There are currently between 800 and 1,000 conversions to natural gas in FEVI's service territory annually and the vast majority of these conversions are residential and from oil. With postage stamp rates as proposed, along with a campaign to ensure potential customers become aware of the operating cost differential and all other benefits of natural gas, it would be reasonable to anticipate accelerating the amount of conversion from oil.

By extension, there would be a positive impact on carbon emissions with postage stamp rates since more customers would be likely to convert from oil than under the status quo scenario. This is one reason why the FEU have consistently maintained that amalgamation and postage stamp rates are consistent with the government's GHG reduction policies. (See, e.g., pages 58 to 59 of the FEU's Final Argument in the original proceeding.)

Under the status quo, homeowners who use oil for heating consume between 60 and 70 GJs of oil per year. Customers converting to natural gas from oil would replace this load with approximately 45 to 50 GJs annually. This is a result of new natural gas equipment being on average 20%-25% more efficient than older oil equipment. The increase in efficiency along with the smaller carbon footprint of natural gas results in a net benefit to the environment of approximately 1.8 to 2.4 metric tonnes of carbon emissions per customer saved annually, or 1,440 to 1,800 metric tonnes annually. Over the life span of the equipment at approximately 25 years, this represents as much as 45,000 metric tonnes of CO_2 emissions saved. With postage stamp rates, there is potential to significantly increase these CO_2 emission savings.

The FEU have not undertaken an economics benefits study, but would expect economic benefit to the region due to the reduced household and commercial expense for natural gas relative to the status quo.

8.3 Please estimate the reduction in CO_2 emissions that might flow from such a switch under the two scenarios, as well as any other economic benefits that could be anticipated to flow to the AVICC region and the Province.

Response:

Please refer to the response to AVICC IR 1.8.2.

9.0 The postage stamp concept

By letter to FEI dated April 15, 2013 the Ministry stated:

> "[G]overnment policy has been to promote access to energy services on a postage stamp rate basis so that all British Columbians benefit from access to services at the lowest average cost" (Exhibit C3-1).

9.1 Do the FEU agree with the characterization of "postage stamp rate design" as being to ensure that customers of a similar class or type see identical rates regardless of their location, their consumption, or the size of the community in which they live?

Response:

The FEU agree the postage stamp rate design ensures identical rates regardless of location and size of the community. However, postage stamp rates do not ensure that the rates would not differ across consumption levels. While the rate design would be the same, the average rate per unit would differ based on consumption due to the inclusion of the basic charge in the rate design.

9.2 Please confirm that the cost of providing distribution service and customer care costs are lower on a unit or per customer basis in a large community than they are in smaller communities, (all else being equal).

Response:

Yes, in general, the distribution costs to serve a larger community would be lower than serving a smaller community because the fixed costs associated with serving a community would be shared over a larger number of customers.

For customer care costs, assets and personnel are not specific to serving a community but rather exist to serve all of the customers on the system. Thus, as more customers are added to the system the unit cost per customer decreases. This is true regardless of the size of the community that is served.

10.0 Treatment of the RSDA

10.1 Please discuss why the FEU has proposed to apply the balance on the RSDA to mitigate the impact on FEI's customers over a three year period, as opposed to alternative regulatory treatments such as longer amortization period, or applying the balance to reduce the rate base of the FEVI assets being amalgamated.

Response:

Please see the original Common Rates, Amalgamation and Rate Design Application, pages 168 to 171. Various amortization periods were also explored during the information request process in the original proceeding. Please see Section 4.5 of the FEU's Final Argument for references to the evidence and the FEU's position on the various options.

Please see the response to BCUC IR 1.89.1 regarding the impact of applying the RSDA balance to reduce the rate base of FEI Amalco. The FEU did not adopt such an approach because it would not result in a reasonable phase-in of the rate impacts to FEI customers.

11.0 The FEU's offer to phase in the rate increases

11.1 Given the recent pronouncements by the Energy Minister of future rate increases required by BC Hydro, do the FEU consider that this offer is still necessary?

Response:

Yes, the phase-in proposal is important in order to mitigate the effect of rate increases due to the implementation of postage stamp rates for customers in the FEI service territory. The potential for BC Hydro rate increases therefore does not affect the FEU's decision to propose a phase-in of the rate impacts.

11.2 Do the FEU consider that such mitigation would continue to send conflicting signals to customers in the AVICC region as to the true marginal prices of electricity and natural gas?

Response:

The FEU do not believe that phasing in the rate impacts of postage stamp rates over a relatively short period such as 3 to 5 years will have a material impact on the price signals with respect to consumer energy choices. Both future electricity rate increases and postage stamp rates for natural gas across FEI, FEVI and FEW will be well publicized and will allow consumers and other decision makers such as builders and developers to consider the cost impacts in their energy decisions, even if there is a transitional period before the full effect of postage stamp rates comes into effect.

12.0 Magnitude of rate increases

The FEU provides Table 1 to summarize the incremental and total annual bill impacts that are forecast to occur during the last four years of the PBR period under a 3 year RSDA allocation period for a typical Lower Mainland residential customer. The table suggests that the aggregate rate impact over a four year period ending 2018 is 9.4%.

12.1 What is the FEU's estimate if Fort Nelson is not excluded from the reconsideration amalgamation and rate harmonization processes?

Response:

If Fort Nelson was not excluded from the reconsideration process, the impact on delivery rates is negligible. The amalgamated delivery rate including Fort Nelson is $4.361. The amalgamated delivery rate excluding Fort Nelson is $4.365, for a difference of $0.004.

The aggregate impact over a four year period therefore remains as presented in Table 1. However, if Fort Nelson is not excluded from the rate harmonization proposal and FEU's original proposal is adopted whereby a portion of the RSDA is allocated to phase in the rate increases for Fort Nelson customers, then the amount of RSDA available to FEI customers would be reduced and the annual rate changes presented would differ from what has been provided in Table 1. Since the FEU's proposal now excludes Fort Nelson from the common rates proposal, Table 1 has not been recalculated under this scenario.

12.2 Please confirm that Table 1 was based on the FEU's proposed capital structure and not the benchmark capital structure and return.

Response:

The first line of Table 1 which showed the high level forecasts of rate changes resulting from FEI's 2014-2018 Performance Based Ratemaking (PBR) proposal already reflected the new benchmark ROE and Capital Structure approved by BCUC Order G-75-13 on May 10, 2013 (38.5% equity thickness and 8.75% ROE). Note that these rate impacts were subsequently updated in FEI's Evidentiary Update of July 16, 2013.

The second line of Table 1 which showed the rate impacts to FEI residential customers of phasing in the impacts of amalgamation and the adoption of common rates were based on the ROE and capital structure proposed in the Common Rates, Amalgamation and Rate Design Application (40% equity thickness and 9.62% ROE).

12.3 For illustrative purposes, please re-calculate Table 1, on the basis that the Commission were to find that the cost of equity and the capital structure of the amalgamated entity should be those of the benchmark low risk utility (FEI).

Response:

Table 1 shows the impact on FEI's residential rates of amalgamation and the adoption of common rates. In Table 1, the ROE and equity component of the stand-alone FEI was substantially the same as the amalgamated entity (ROE for the amalgamated entity was slightly higher at 9.62% vs. 9.50%). In the scenario proposed above, the ROE and equity component of the stand-alone FEI would be the same as the amalgamated entity (at 8.75% ROE and 38.5% equity). Therefore, there should be no material change to the rate impacts set out in Table 1 as a result of the lower ROE and equity component.

13.0 Fort Nelson

13.1 Please explain why the FEU have chosen to exclude FEFN from its proposed amalgamation.

Response:

Since FEFN is already part of the legal entity FEI, it is not part of the amalgamation. In its Common Rates, Amalgamation and Rate Design Application, the FEU included FEFN in its postage stamp rates proposal. As part of the original proceeding, FEU stated that should the Commission decide to exclude FEFN from the adoption of postage stamp rates, the FEU would still proceed with amalgamation of FEI, FEVI and FEW and implementation of postage stamp rates across all the other service territories. This position was based on the fact that the exclusion of FEFN did not impact the overall adoption of postage stamp rates and maintained the historical practice related to FEFN.

With respect to the scope of the FEU's Reconsideration Application, please refer to the response to BCUC IR 1.8.1.

13.2 Please confirm that Fort Nelson is now considered to be connected to BC Hydro's integrated transmission system and is no longer considered a NIA and enjoys all the benefits of the "Heritage assets" of BC Hydro.

Response:

Fort Nelson is not connected to the BC Hydro grid but is connected to the Alberta grid. BC Hydro has a gas fired co-generation plant (the Fort Nelson Generating Station) at Mile 284 on the Alaska Highway. Electricity supply to the Fort Nelson area is provided by the Fort Nelson Generating Station with backup supply from Alberta. The following quotes from pages 18 and 20 of the Phase II and III Decision on the BC Hydro 2007 Rate Design Application provide context on the electricity rates for BC Hydro's service to the Fort Nelson area:

> *"Fort Nelson*
>
> *BC Hydro testified that Fort Nelson is not directly connected to BC's transmission grid, but is connected to the Alberta integrated transmission system (T11:1856), and that Fort Nelson was classified as being in Zone II until 1987, when it first became Zone I-B, and was eventually classified as being in Zone I in December 2000 (T11:1798). BC Hydro testified that during 13 year period that Fort Nelson was classified as Zone I-B, customers in that zone were charged the equivalent of Zone I rates (T11:1798-1799)."*
> (BCUC Decision, BC Hydro 2007 RDA Phase II and III, page 18)

> *"… BC Hydro maintains on the basis of the record of this proceeding that Fort Nelson is the only community it has served that has not been connected to the high-voltage transmission grid and which has had Zone I rates."* (BCUC Decision, BC Hydro 2007 RDA Phase II and III, page 20)

> *"… in establishing tier 1 rates in the NIA communities at the same level as Zone I rates, BC Hydro has indirectly extended the benefit of the Heritage Resources to the NIA communities." (BCUC Decision, BC Hydro 2007 RDA Phase II and III, page 20)*

As Zone I customers Fort Nelson residents and businesses receive the benefits of BC Hydro's Heritage Resources, however as noted above NIA customers also benefit from Heritage Resources.

No designation similar to the Non-Integrated Areas exists for natural gas customers. All natural gas customers in BC receive their natural gas deliveries through upstream pipelines such as the Spectra pipeline or the TransCanada BC system.

13.3 Please confirm that Fort Nelson's rates are lower than those of FEI's Lower Mainland customers primarily by virtue of a depreciated rate base. What, if any, other factors contribute to the rate differential?

<u>Response:</u>

Fort Nelson's rates are lower than those of FEI's Lower Mainland customers due to a lower rate base per customer. Fort Nelson has lower midstream costs than the other FEI service areas, and Fort Nelson customers have a high overall use rate per customer which contributes to a lower cost per GJ.

Please also refer to the responses to BCUC IRs 1.143.1 to 1.143.5 in the FEU Common Rates, Amalgamation and Rate Design Application for further discussion of Fort Nelson midstream related resources.

13.4 All else being equal, what factors would need to occur to cause Fort Nelson's rates to equal or exceed those of FEI's Lower Mainland customers?

Response:

Fort Nelson is vulnerable to significant rate increases over a period of time due to loss of load from industrial customers, integrity capital expenditures including the upgrade of the Muskwa River crossing, and potential rate rebalancing. FEFN's vulnerability to rate instability was discussed on pages 76 to 78 of the FEU's Common Rates, Amalgamation and Rate Design Application and explored in the information requests of the original proceeding. See, e.g., Exhibit B-9, BCUC IR 1.99.1 and 1.100 series and Exhibit B-15, BCUC IR 2.48 series in the original proceeding. See also Section 6.3.1, pages 62 to 64, of the FEU's Final Argument in the original proceeding.