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**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER G-101-12**

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

and

**An Application by FortisBC Energy Inc.
for Approval of Kingsvale-Oliver Reinforcement Project
Stage 2a Project Development Costs and Accounting Treatment**

BEFORE: D.M. Morton, Panel Chair/Commissioner
N.E. MacMurphy, Commissioner July 23, 2012

ORDER

WHEREAS:

- A. On April 13, 2010, the British Columbia Utilities Commission (Commission), after a short written hearing process, issued Order G-70-10 whereby the Commission approved a Firm Transportation Service Agreement between FortisBC Energy Inc. (FEI) and Westcoast Energy Inc. (Spectra Energy) as Tariff Supplement No. I-9, effective to April 30, 2012. The Commission also approved the proposed accounting treatment for the revenue from that Agreement and Stage 1 preliminary feasibility assessment costs related to the expansion of the capacity of the Fortis Energy Inc. (FEI) gas transmission system known as the Kingsvale-Oliver Reinforcement Project (KORP or the Project) for up to \$2.0 million to be charged to the Southern Crossing Pipeline Mitigation Revenues Variance (SCP Mitigation) deferral account;
- B. On April 14, 2011, the Commission issued Order G-69-11 approving an Amending Agreement for Firm Transportation Service between FEI and Spectra Energy as a revised Tariff Supplement No. I-9, effective to October 31, 2014;
- C. On July 4, 2011, FEI filed a status report on the Stage 1 preliminary assessment study for the Project;
- D. On March 30, 2012 FEI filed a Comprehensive Update Report Stage 1 (Report) and applied for approval of further funding of \$850,000 for Stage 2a feasibility assessment activities and to continue to charge theses project development costs to the SCP Mitigation deferral account (Application) and thereby be offset against the Amending Agreement Tariff Supplement No. I-9 revenues;

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- E. FEI describes Stage 2a development activities as necessary to address specific issues identified in the Report and to advance development of the Project prior to entering the full scope of the Stage 2 Regulatory Requirements;
- F. The Commission has reviewed the Application and has concluded that the ongoing feasibility work and funding for the KORP project are in the public interest and should be approved.

NOW THEREFORE pursuant to sections 60 and 61 of the *Utilities Commission Act*, and with Reasons for Decision attached as Appendix A to this Order, the Commission orders as follows:

1. The approval of Stage 2A feasibility costs, to a maximum of \$850,000.
2. The recording of these feasibility costs in the SCP Mitigation deferral account is denied.
3. FEI is directed to establish a new non-rate base deferral account for recording of Stage 2a feasibility expenses with treatment of interest rate and deferral period to be determined at the next Revenue Requirement.
4. FEI is to provide an update Report within 30 days of the end of the first calendar quarter of 2013 detailing progress on its Stage 1, Stage 2a activities, costs and Open Season project plan.

DATED at the City of Vancouver, in the Province of British Columbia, this 23rd day of July 2012.

BY ORDER

Original signed by:

D.M. Morton
Commissioner

Attachment



IN THE MATTER OF

**FORTISBC ENERGY INC.
KINGSVALE-OLIVER REINFORCEMENT PROJECT STAGE 2A
PROJECT DEVELOPMENT COSTS AND ACCOUNTING TREATMENT**

REASONS FOR DECISION

July 23, 2012

BEFORE:

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

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1.0 EXECUTIVE SUMMARY

This decision deals with the application made by FortisBC Energy Inc. (FEI) for approval of additional feasibility funds of up to \$850,000 to progress the Kingsvale to Oliver Reinforcement Project (KORP, the Project) and to continue to record those expenses in the Southern Crossing Pipeline Mitigation deferral account.

As part of its application, FEI submitted a comprehensive report describing the progress of the Stage 1 pre-feasibility activities and drivers for the Project including results of the pilot T-South Enhanced Service (Service, T-South) offered to Westcoast Energy Inc. (Spectra Energy) and its shippers using existing FEI pipeline capacity. The Service is important to gauge the interest from shippers for an expanded service utilizing FEI's interior pipeline system including the KORP expansion and the existing Southern Crossing Pipeline. FEI reports the T-South Enhanced Service will deliver at least \$36 million in total benefits to FEI customers by 2014 based on the limited 87 million standard cubic feet per day (mmscfd) capacity offered for the Service. KORP would expand the existing pipeline capacity between Kingsvale and Oliver B.C. and allow shippers to contract for significantly larger capacities with a corresponding increase in revenues to FEI to the benefit of its customers. The KORP involves a significant system expansion of 161 kilometers of pipeline and related compression with preliminary cost estimates in the \$450 million range.

FEI notes that Stage 1 activities are nearly complete and is requesting additional feasibility funds to continue with the development of the Project of Stage 2a activities and avoid delaying or suspending development work at this stage. FEI argue that this is a conservative approach, allowing for further advancement of the Project while not entering into the more costly aspects of full Stage 2 Regulatory Requirements without more definitive commitments from shippers.

Through the review process involving a single round of Information Requests from Interveners and Commission Staff, along with Final Submissions and a Reply Submission by FEI, the Commission has made the following determinations:

1. The Panel approves the funding of up to \$850,000 in Stage 2a feasibility study costs for the work described in the Application as being both reasonable and, for this stage of the Project, in the public interest.
2. The Commission directs FEI to establish a separate non-rate base deferral account for Stage 2a feasibility costs. The review of these costs, rate of return and any deferral period can be determined at the next Revenue Requirement.
3. FEI is directed to provide a project plan with or prior to its Q1/2013 update report detailing the key tasks, milestones and timeline relating the Open Season and any firm shipper commitment agreements with the Stage 2a and Stage 2b project tasks.

2.0 INTRODUCTION

2.1 Background

By application in March, 2010, FEI requested approval of Stage 1 preliminary feasibility study costs of up to \$2.0 million for the expansion of the capacity of the FEI transmission system in the B.C. Interior from Kingsvale to Oliver. In part, the justification for the expansion would be 'tested' by evaluating gas shipper interest in a service that would allow shippers to contract with Spectra Energy for service from Station 2 in the north of B.C. to the Kingsgate hub in the southeast of B.C. utilizing spare capacity on FEI's existing Interior Transmission System from Kingsvale to Kingsgate. FEI's Kingsvale to Kingsgate system includes a twelve inch line from Kingsvale to Oliver connecting to a twenty-four inch line from Oliver to Yahk, B.C. known as the Southern Crossing Pipeline (SCP). The Firm Transportation Service Agreement between FEI and Spectra Energy called T-South Enhanced Service was for a term of 2 years and was limited to 87 million standard cubic feet per day (mmscf) equivalent to the excess capacity that FEI did not need to meet its core customer demands. The March 2010 application combined FEI requests for:

- approval of the Transportation Agreement under Tariff Supplement No. I-9,
- the allocation of the T-South Enhanced revenues to both the SCP Mitigation Revenues Variance (SCP Mitigation) deferral account and the Midstream Commodity Reconciliation Account (MCRA), and
- approval for preliminary feasibility study costs of up to \$2.0 million to expand the system capacity and record cost against revenues in the SCP Mitigation deferral account.

On April 13, 2010, by Commission Order G-70-10, FEI was granted approval of the application as requested. The T-South Enhanced Service was subsequently extended to October 2014 by separate application by FEI due to continued shipper interest and positive revenue benefits to FEI and its customers.

At the end of March 2012 FEI submitted a comprehensive update report (Report) detailing the progress of the prefeasibility activities, reporting on the results of the T-South Enhanced Service and plans to expand the Service along with an application for approval of additional funds for ongoing feasibility work. FEI responded to Commission staff questions by submitting a clarification letter to the Commission (Exhibit B-1-1).

2.2 Application

In its March 2012 Report, FEI describes the benefits of the T-South Enhanced Service and provides an update on the progress of the Stage 1 pre-feasibility activities to date. In its submission of the Report FEI includes an application for approval of Stage 2a funding of up to \$850,000 for the KORP and to continue to record these expenses against revenues within the SCP Mitigation deferral account (Application). In the Report and Application, FEI concludes that there is sufficient interest and benefits to continue feasibility assessment beyond Stage 1 and to address specific risk issues raised in the Stage 1 pre-feasibility work to justify additional expenses in Stage 2a feasibility activities. Stage 2a activities include acquiring and analyzing additional pipeline route survey data to confirm routing, commencing traditional use studies, furthering landowner contact and consultation and progressing the commercial aspects of an expanded service offering with Spectra Energy and its shippers. (Exhibit B-1-1, Appendix B)

2.3 Orders Sought

In its Application FEI is seeking:

1. Approval of Stage 2a feasibility expenses of up to \$850,000 related to the KORP project.
2. Approval to record Stage 2a expenses in the SCP Mitigation deferral account similar to Stage 1 expenses.

2.4 Regulatory Process

The regulatory process established for this proceeding by Commission Order G-64-12 was for a written hearing with a single round of Commission and Intervener Information Requests as shown in Appendix A of the Order. Interveners for the proceeding were the British Columbia Old Age Pensioners' Organization *et al.* (BCOAPO) and the Commercial Energy Consumers Association (CEC).

3.0 KEY ISSUES AND DETERMINATIONS

3.1 Extended Feasibility Stage Funding

3.1.1 Project fundamentals continue to support Project Feasibility Expenses

In its Application and Final Submissions, FEI discusses the justification for ongoing feasibility assessment work and expenses to advance the Project in an efficient way. FEI submits that the evidence in its Application, Clarification Letter and Information Requests demonstrates that the \$850,000 funding sought for Stage 2a feasibility for the KORP is prudent and in the public interest. (Final Submission, p. 4) FEI points to a number of factors that collectively support the public interest for additional feasibility work and funding, including: Market Dynamics; Success of the T-South Enhanced Service demonstrating potential for significant benefits to Customers; and positive indications from the Stage 1 pre-feasibility assessment to date.

FEI and the Interveners generally agree that the North American natural gas market is changing rapidly on both the production and consumption sides of the equation. According to the National Energy Board (NEB) and reports by other industry consultants including the Navigant 2011 report prepared for FEI, British Columbia is expected to participate if not lead many of these market movements by the rapid growth of shale gas production with large reserves identified in north eastern B.C., gas pipeline infrastructure projects to bring this gas to market, and significant export potential such as LNG exports, exports to Alberta to fuel growth in oil sands production, and exports to the Pacific North West and/or California. These dynamics have been magnified and accelerated by the historically low price for North American natural gas currently being experienced as a result of the supply to demand imbalance that many analysts predict will persist for some time. FEI highlights that these market dynamics could affect its ability to compete for gas for its customers by impacting the liquidity and price volatility at Station 2, a key trading hub. FEI summarizes these KORP benefits as "removing pipeline capacity constraints would build on the success of the T-South Enhanced Service offering for FEI customers, including additional demand charge revenue, T-South toll

savings, and improved access to competitively priced (sic) and reliable gas supply, as well as additional security of supply and liquidity in the region.” (Exhibit B-1, Report, p. 5)

The CEC recommends approval of the expenditure of \$850,000 and highlights the potential of a lost opportunity costs of a delay suggesting the Project should not be delayed unless a significant risk is found to diminish the Project’s prospects or probability of success. (CEC Final Argument, p. 6)

FEI expects the T-South Enhanced Service to provide a benefit of at least \$36 million of accumulated benefits from secured demand charge revenues and forecasted toll savings on T-South for its customers by 2014. (Exhibit B-1, Report, pp. 2, 7). It has worked closely with Spectra Energy and its shippers to offer this pilot service with a view to expanding the service through increased capacities that a KORP would provide on FEI’s system. Part of the Stage 2a funding will be to progress the commercial aspects leading to an ‘Open Season’ to gauge firm support and interest in the Service as a key justification for the KORP expansion. Current feasibility level cost estimates for the KORP expansion are in the \$450 million range. The Report states that approximately \$1.48 million of Stage 1 pre-feasibility costs had been incurred as of February 29, 2012, with a forecast completion at the \$2.0 million Stage 1 budget. (Exhibit B-1, Report, pp. 49, 50) FEI clarifies that the additional work for Stage 2a activities are part of the previously estimated overall Stage 2 work expected to cost approximately \$6 million and not simply an extension of Stage 1 activities. (Exhibit B-1-1, Clarification Letter, p. 3)

3.1.2 Interim Stage 2a Funding

FEI’s March 2010 Application described two project development stages for KORP in Appendix B. Stage 1 involved preliminary assessment and issue identification. Based on the results of Stage 1, Stage 2 will involve field studies, options analysis, consultation and regulatory applications and approvals. FEI states that by starting the certain activities, such as acquiring and analyzing additional survey data, commencing traditional use studies and furthering landowner contact of Stage 2, the overall development of the Project can be conducted in a more cost effective manner by continuance of project work to advance the Project while not entering into the more costly aspects of Stage 2, such as environmental field studies and regulatory applications, without more definitive commercial commitments. (Exhibit B-1-1, Clarification Letter, pp. 2, 3)

BCOAPO supports of this proposed conservative approach by dividing Stage 2 costs into Stage 2a and 2b. (BCOAPO Final Argument, pp. 1, 2)

COMMISSION DETERMINATION

The Panel recognizes the significance of the current market dynamics and their potential impacts on all aspects of the industry including FEI, its customers and the public in general. Though the Panel cannot predict what changes and challenges might arise from the current and evolving natural gas market it does support a proactive approach to planning for cost effective strategies to mitigate potential outcomes that could have significant impacts to the public and FEI customers.

FEI identifies these significant market dynamics as both a risk and a potential opportunity to FEI customers. The benefits include: the opportunity to maintain access to a liquid gas market; the potential to reduce tolls on T-South through increased utilization; the generation of new revenues from shippers from the expansion of its system capacity through the KORP; and increased utilization of the existing Southern Crossing Pipeline.

FEI has reported on these benefits and the initial interest from Spectra Energy and shippers through the pilot scale T-South Enhanced Service. FEI has nearly completed work with the \$2.0 million pre-feasibility funding previously approved with no technical barriers identified and initial consultation and preparations for environmental reviews to proceed. FEI and Spectra Energy continue to work together on the commercial interests of an expanded service with the objective of an Open Season to sign shippers to firm commitments should the Project proceed. No interveners have objected to the proposed expenditure of \$850,000 in funding to better understand the technical and commercial risks of the Project.

The KORP expansion is somewhat different from most system expansion projects in that it is not the result of increased utility customer demand or replacement requirements. Market risks and commercial opportunity with benefits accruing to FEI customers are the primary motivators for the KORP expansion. The Panel is satisfied that FEI is taking a conservative approach to progressing the Project toward a more certain understanding of the project risks and opportunity without creating potentially costly delays. The Panel shares the view that more certainty on the level of commercial commitment is necessary before embarking on the significantly larger expenses of environmental studies, detailed engineering and regulatory approval including Certificate of Public Convenience and Necessity applications. The Panel recognizes that both the project feasibility and to some extent development work has some intricate meshing consideration with the commercial development and risks and that this is somewhat unique for the type of system expansions for FEI.

The Panel approves the funding of up to \$850,000 in Stage 2a feasibility study costs for the work described in the Application as being both reasonable and, for this stage of the Project, in the public interest.

3.2 Accounting Practice and Use of SCP Mitigation Variance Deferral Account

The Application also seeks approval to charge the Stage 2a costs to the SCP Mitigation deferral account, consistent with the treatment of Stage 1 costs. For this request the Commission will consider the following issues in its determination:

- Consistency with Stage 1 expenses,
- Recording of project feasibility costs as expenses,
- Type of Deferral Account, and
- Transparency and Consistency with Regulatory Accounting Practice.

FEI argues that since Stage 1 feasibility costs were approved by Commission Order G-70-10 to be recorded in the SCP Mitigation deferral account, where they would be offset by revenues from the T-South Enhanced Service, and that Stage 2a feasibility costs are similar to Stage 1 it is therefore appropriate to continue with the same accounting treatment. (FEI Final Argument, p. 1; Exhibit B-3, BCUC 1.1.6) FEI further argues that the T-South Enhanced Service is a pilot project for the KORP and it is therefore appropriate to link the revenue flowing from it with the development costs of the KORP. (FEI Final Argument, p. 1)

It is usual regulatory practice that feasibility costs are treated as expenses whereas project development costs are treated as capital costs. These two types of activities are differentiated by the stage of a project

and the commitment to proceed with full development of the Project. Expenses and capital costs attract different rates of return, expenses generally receiving a Cost of Debt rate of return and capital costs receiving a Return on Equity (ROE) from rate base level of return. In FEI's case the ROE is set at a higher level than Cost of Debt. The SCP Mitigation Revenue Variance deferral account is described below as a Rate Base deferral account in FEI's 2012-2013 Revenue Requirement Application.

"The SCP Mitigation Revenues Variance Account, approved by Commission Orders No. G-124-00, No. G-123-01, No. G-7-03 and No. G-141-09, relates to the use of SCP transportation capacity that has not been utilized by the firm transportation agreement customers and is sold to others, and the third party back-haul movements from Kingsvale to Yahk which relate to transportation service in a West to East direction through the system. As discussed in Section 5.5, Other Revenue, FEI has increased the forecast SCP mitigation revenues for 2012 and 2013 to \$5.7 million as a result of the T-South Enhanced Service initiative between Spectra Energy and FEI. Any variation from this \$5.7 million and actual revenues received will be captured in the SCP Mitigation Revenues Variance Account and returned to or recovered from customers over a three year period through delivery rates." (FEU 2012-2013 Revenue Requirement Application, Exhibit B-1- Application, Section 6.3.1.8, p. 391)

COMMISSION DETERMINATION

The Panel agrees that the revenues from the Service be allocated between the MCRA and the SCP Mitigation deferral account by the approved allocation methodology since the Service revenues are derived from efficient and beneficial use of existing assets including the SCP pipeline. The Commission is less convinced that the T-South Enhanced Service remains a 'pilot' project and the success and extension of the Service rather shows the Project has stand-alone credibility and therefore should continue to be part of optimizing the efficient use of existing resources.

The Commission previously allowed Stage 1 costs to be recorded in a rate base deferral account (SCP Mitigation Variance deferral account). However, a more appropriate regulatory treatment of these costs would be to record feasibility expenses in an expense account either as part of a revenue requirement or upon separate application. FEI confirms it did not include either Stage 1 or Stage 2a forecast expenses in its 2012-2013 Revenue Requirement. (Exhibit B-3, BCUC 1.1.3.2) The CEC notes that FEI is proposing an unconventional treatment of the feasibility costs and raises the issue of whether or not FEI is avoiding a shareholder risk by recording the costs against revenues as opposed to dealing with them as an operating expense but submits that given the amounts are relatively small in regard to their likely rate impact for customers the CEC has no interest in pursuing changes to the accounting treatment proposed. (CEC Final Submission, p. 6) The Commission is satisfied that the types of activities described for Stage 2a are properly categorized as feasibility costs and therefore should be treated as expenses. The Commission believes that the importance of proper and transparent regulatory accounting dictates that a separate non-rate base deferral account be established to record Stage 2a costs. **The Commission directs FEI to establish a separate non-rate base deferral account for Stage 2a feasibility costs. The review of these costs, applicable return and any deferral period can be determined at the next Revenue Requirement.**

3.3. Open Season and Stage 2b Expenditures

The CEC raises the issue that the evidence and information from Stage 1 work to date is less than sufficient to justify proceeding with the full development of KORP due largely to the commercial risks and uncertainty. Both the CEC and BCOAPO have expressed their support of the Open Season to enable FEI to have firm shipper commitments for capacity before committing to Stage 2b expenditures. (CEC Final Argument, p. 3; BCOAPO Final Argument, p. 2)

Both Interveners noted some confusion from FEI statements over the timing and commitment to proceed with an Open Season process. In its Reply Submission, FEI states that it will file a second assessment report with the Commission in Q1/2013 regarding the completed results of the Stage 1 and Stage 2a activities and that the concerns raised would be addressed through the Open Season, which would occur before FEI would continue with Stage 2b activities. (FEI Reply Submission, p. 2)

COMMISSION DETERMINATION

The issue of whether the results of the Open Season or other justification to approve any further expenditures beyond Stage 2a as well as any prudence of expenses will be the subject of a future application and proceeding. **FEI is directed to provide a project plan with or prior to its Q1/2013 update report detailing the key tasks, milestones and timeline relating the Open Season and any firm shipper commitment agreements with the Stage 2a and Stage 2b project tasks.** Should FEI have results from the Open Season at that time they are requested to include them. The Commission recognizes that there are intricacies of planning for and executing an Open Season with shippers and generally accepts that Spectra Energy is in a better position to conduct such an exercise with its shippers than FEI. The Commission also shares in the concerns raised by the Interveners that ongoing funding and project development approvals for the KORP are highly dependent on the degree to which FEI can quantify and validate the benefits and risks of the Project going forward.

4.0 SUMMARY OF DIRECTIVES

The Panel approves the funding of up to \$850,000 in Stage 2a feasibility study costs for the work described in the Application as being both reasonable and, for this stage of the Project, in the public interest.

The Commission directs FEI to establish a separate non-rate base deferral account for Stage 2a feasibility costs. The review of these costs, rate of return and any deferral period can be determined at the next Revenue Requirement.

FEI is directed to provide a project plan with or prior to its Q1/2013 update report detailing the key tasks, milestones and timeline relating the Open Season and any firm shipper commitment agreements with the Stage 2a and Stage 2b project tasks.