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**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER G-5-10A**

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

and

**An Application by FortisBC Inc.
For Approval of a Revised Code of Conduct and Transfer Pricing Policy
And Request for Final Approval of the Brilliant Expansion Subcontractor Agreement**

BEFORE: P.E. Vivian, Commissioner/Panel Chair
A.A. Rhodes, Commissioner January 8, 2010

O R D E R

WHEREAS:

- A. On August 26, 2008, FortisBC Inc. ("FortisBC") submitted a proposed Subcontractor Agreement (the "Subcontractor Agreement") made May 31, 2008 for British Columbia Utilities Commission ("Commission") approval. The Subcontractor Agreement concerns the supply of FortisBC resources to Fortis Pacific Holdings Inc. ("FPHI") in connection with an operations and maintenance Services Agreement between FPHI and the Brilliant Expansion Power Corporation ("BEPC"). The Subcontractor Agreement was filed under the applicable provisions of the *Utilities Commission Act* (the "Act"), in particular section 60; and
- B. On December 18, 2008, the Commission issued Order G-199-08 granting interim approval of the Subcontractor Agreement. Order G-199-08 also specified that permanent terms under the Subcontractor Agreement would be established after Commission review of the updated FortisBC Code of Conduct and Transfer Pricing Policy Application, which FortisBC planned to file; and
- C. By letter of February 26, 2009, the Commission requested FortisBC to include particular detailed information as part of its updated Code of Conduct and Transfer Pricing submission; and
- D. On March 31, 2009, FortisBC submitted its updated Code of Conduct and Transfer Pricing Policy Application (the "Application") for Commission approval; and
- E. By Order G-71-09 dated June 11, 2009, the Commission, among other things, ordered that the Application proceed by way of a written hearing and that the Commission's determination concerning the Subcontractor Agreement would be determined after the decision on the Application; and

**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER** G-5-10A

2

- F. FortisBC filed its Final Written Submission on July 16, 2009. By July 24, 2009, the Commission had received Final Submissions from the following Intervenors: Columbia Power Corporation, British Columbia Old Age Pensioners Organization, et al., British Columbia Municipal Electrical Utilities, and the City of Kelowna. FortisBC submitted its Reply Submission on July 28, 2009; and
- G. The Commission Panel has considered the Application, the evidence and the submissions of the parties.

NOW THEREFORE for the reasons set out in the Reasons for Decision attached as Appendix A to this Order, the Commission orders as follows:

1. The FortisBC Revised Code of Conduct and Transfer Pricing Policy is approved.
2. The Subcontractor Agreement made May 31, 2008, between FPHI and FortisBC for the supply of FortisBC resources to BEPC, is approved.
3. The interim rates under the Subcontractor Agreement between FPHI and FortisBC for the supply of FortisBC resources to the BEPC are approved as permanent subject to the adjustments in Section 4.2 of the Reasons for Decision.
4. FortisBC will charge to FPHI, any difference between the interim and permanent rates including interest under the Subcontractor Agreement.
5. In respect of other contracts for non-regulated products or services that FortisBC has with FPHI or any other Non-Regulated Business, the rates and loadings are effective from the date of this Order.

DATED at the City of Vancouver, in the Province of British Columbia, this 12th day of January 2010.

BY ORDER

Original signed by:

P.E. Vivian
Commissioner/Panel Chair

Attachment

FORTISBC INC.
Revised Code of Conduct and Transfer Pricing Policy and
Request for Final Approval of the Brilliant Expansion Subcontractor Agreement

REASONS FOR DECISION

1.0 INTRODUCTION

On March 31, 2009, FortisBC Inc. ("FortisBC" or the "Company") filed its Revised Code of Conduct and Transfer Pricing Policy with the Commission for approval ("the Application"). (Exhibit B-1)

The Revised Code of Conduct ("Revised Code"), if approved, will govern the relationships between FortisBC and its Non-Regulated Businesses ("NRBs"). These are the affiliates of the Company that are not regulated by the Commission or divisions of the Company offering unregulated products and services. The Code is intended to replace the Company's Code of Conduct dated May 25, 2008.

The Revised Transfer Pricing Policy ("Revised TPP") updates the Company's existing policy with respect to the appropriate loading rates to be applied to transactions between FortisBC and NRBs.

The Application further addresses inter-corporate relationships between FortisBC and Terasen Gas Inc., another regulated affiliated entity.

In addition, pursuant to Commission Order G-199-08, the Application seeks final approval of the Subcontractor Agreement between FortisBC and Fortis Pacific Holdings Inc. ("FPHI") made May 31, 2008, in connection with the ultimate supply of services by FortisBC to Brilliant Expansion Power Corporation ("BEPC"; "Subcontractor Agreement").

2.0 RETAIL MARKETS DOWNSTREAM OF THE UTILITY METER GUIDELINES

The relationships between a regulated utility and non-regulated affiliates are of importance to a regulatory agency such as the Commission in that it is possible through transfer pricing of goods and services exchanged between affiliates, to transfer revenues, profits, and business risk to the detriment of the ratepayers of the regulated utility.

Regulated utilities under the jurisdiction of the Commission are guided in their relationships with non-regulated affiliates by a Commission publication entitled *"Retail Markets Downstream of the Utility Meter Guidelines"* ("Guidelines"). The Guidelines were published by the Commission in April, 1997 and can be found on the Commission's website at www.bcuc.com.

The Guidelines address:

- Jurisdiction of the Commission
- Objectives
- Criteria

- Principles
- Transfer pricing policy
- Code of Conduct.

The Guidelines provide an analysis of the public policy issues that are at play when examining the relationships between regulated and non-regulated businesses. However they do not deal explicitly with relationships between two **regulated** utilities that are affiliates under common ownership and control (e.g. FortisBC and Terasen Gas Inc.).

The Guidelines canvass the scope and ambit of the various non-regulated products and services that could be provided by a regulated entity although the categories shown do not necessarily provide an exhaustive list of all of the types of things that might be provided by a modern utility. Alternative corporate structures through which a regulated entity could provide non-regulated products or services are also discussed together with their respective *pros* and *cons*. (Guidelines, p. 6)

The Guidelines set out the objectives that will guide the Commission's decision-making with respect to utility and NRB participation in the retail markets downstream of the utility meter:

- There must be no subsidy of unregulated business activities, whether undertaken by the utility or its NRB, by utility ratepayers.
- The risks associated with participation in the unregulated market must be borne entirely by the unregulated business activity; that is, the risks must have no impact on utility ratepayers.
- The most economically efficient allocation of goods and resources for ratepayers should be sought.

The Commission notes that "greater achievement of one objective may require a lesser achievement of another objective so that trade-offs may be required." (Guidelines, p. 23)

Pursuant to the Guidelines, the Commission accepts five principles that should govern the choice of corporate structure. The principles are as follows:

- i) If a natural monopoly exists for the good or service, it should be provided as a regulated tariff item (Corporate Structure 1 in Figure 4);
- ii) Utility participation in the unregulated downstream market by completely stand-alone NRBs using no utility resources is the preferred option since it provides the maximum protection to utility ratepayers (Corporate Structure 4 in Figure 4). Variations from this option should be undertaken only when it can be shown that this option would result in substantial stranded costs for the utility and/or that a transfer pricing policy mechanism will act to provide sufficient protection for ratepayers;

- iii) The onus should always be on the utility to prove that the benefits associated with use of utility resources are sufficient to warrant the changed structure and that the transfer pricing policy mechanism will provide sufficient protection to ratepayers;
- iv) If the Commission decides to allow the use of utility resources in the provision of the unregulated good or service, the preferred option is through a related-NRB (Corporate Structure 3 in Figure 4). Direct participation by the utility in the provision of an unregulated good or service should be allowed only when the costs associated with forcing the provision through the related-NRB structure would significantly offset the benefits associated with the use of the utility's resources and it can be shown that a transfer pricing policy mechanism will provide sufficient protection for ratepayers (Corporate Structure 2 in Figure 4); and
- v) Utilities and their related-NRBs will be encouraged to move unregulated products which use utility resources into stand-alone NRBs as soon as market conditions warrant (Corporate Structure 4 in Figure 4). When a utility-provided product is moved to an NRB, the NRB will be required to pay fair market value to the utility for the assets, including goodwill, associated with the product. In addition, utilities will be required to provide periodic proof that the benefits associated with the use of utility services continue to exist and that ratepayers continue to be sufficiently protected. The Commission will make directions to prohibit the use of utility assets and services in the provision of goods and services downstream of the retail market at any time that it finds it in the interests of ratepayers to do so.

(Guidelines, p. 24)

Figure 4 referred to in the principles governing the choice of corporate structure is found at page 7 of these Reasons for Decision.

Also, pursuant to the Guidelines, a utility's transfer pricing policy should ensure the following:

- i) The operating costs of non-regulated activities are not reflected in the utility's cost of service;
- ii) The costs of developing new business ventures are charged to and recovered from the NRB;
- iii) The accounting costs are transparent and will normally fully recover for all services, including overhead, space, employee benefits, inconvenience, and a profit margin where appropriate. If the service provided by the utility to the related-NRB could also be obtained from an independent supplier, the price paid by the related-NRB to the utility should be no less than the competitive market price and will never be below the incremental cost;
- iv) The financial costs of each business are borne by the business. In the exceptional case where the utility provides guarantees, it must be given financial compensation; and

- v) Utilities will be required to file periodic reports which demonstrate that they are adhering to the transfer pricing policy. The form and timing of the report will be determined by the Commission.

(Guidelines, p. 25)

Further, pursuant to the Guidelines, the code of conduct principles are as follows:

- i) The regulated company will not provide to the NRB any market-sensitive or confidential information that would inhibit a competitive energy services market from functioning. If customers agree to a release of customer information to the NRB, it should be provided to other market participants under the same terms and conditions and for the same price. Should an individual customer make a specific request to have information released to a particular third party, it will be released to that party only. The utility will be able to recover from the customer the costs associated with the provision of this information;
- ii) No regulated company personnel will state or imply that favoured treatment will be available to customers of the company as a result of using any service of an NRB. In addition, no regulated company personnel will condone or acquiesce in any other person stating or implying that favoured treatment will be available to customers of the company as a result of using any service of an NRB;
- iii) No regulated company personnel will preferentially direct customers seeking competitively offered services to an NRB. If a customer, or potential customer, requests from the regulated company information about products or services offered by an NRB or its competitors in downstream markets, the regulated company may provide such information, including a directory of retailers of the product or service, but shall not promote any specific retailer in preference to any other retailer;
- iv) The regulated company will formally advise all employees of expected conduct related to these principles and it will undertake to perform periodic audits of the relationships to ensure compliance with these principles. These audits will be performed no less than once a calendar year and filed with the Commission;
- v) Complaints by non-affiliated parties about the application of these principles, or any alleged breach thereof, will be brought to the immediate attention of the senior management of the regulated company and subsequently a report of the complaints, and action taken, will be filed with the Commission. The report will be filed with the Commission within one month of the complaint being made;
- vi) The financing of the utility and NRB will be accounted for entirely separately with the financing costs reflecting the risk profile of each entity. No cross-guarantees or any form of financial assistance whatsoever should be provided directly or indirectly by a utility to its NRB without approval of the Commission; and
- vii) Use of the utility name by a related-NRB will require approval by the Commission to ensure that its use will not interfere with the Commission's ability to protect ratepayers.

In those cases where retail customers have direct market access to the commodity, the utility's code of conduct will also include the following provision:

- viii) The regulated company will treat all requests for distribution system access for the purpose of direct commodity marketing equitably and according to the requirements approved for direct commodity marketing in British Columbia.

(Guidelines, pp. 26 and 27)

By Letter L-20-97, dated May 15, 1997, the Commission requested each utility subject to its jurisdiction to report upon the then current non-regulated activities undertaken by the utility. The letter requested details of relationships with NRBs and sought the filing of draft transfer pricing and code of conduct policies for each utility. Since that date, there has been some limited monitoring of relationships between regulated utilities and their respective NRBs by the Commission and dispute resolution of complaints on an as required basis.

Most utilities have not filed with the Commission any annual/periodic audits or reports updating their corporate policies in these areas or reporting any deficiencies discovered by way of internal audit of the policies in place as required by the Guidelines. (Guidelines, p. 25, Section 5.2(v) regarding a utility's transfer pricing policy and p. 27, Section 5.3(iv) regarding a utility's code of conduct)

To its credit, FortisBC undertook two internal audits (2008 and 2009) and reported the findings to the Commission. FortisBC intends to conduct and file annual internal audits in this area. This will satisfy the Guidelines.

3.0 BACKGROUND TO THE APPLICATION

The Application results in part from Commission Order G-199-08, dated December 18, 2008. The proceedings which culminated in that Order involved an application by FortisBC for approval, pursuant to the *Utilities Commission Act* and in particular section 60, of the Subcontractor Agreement. That application was dealt with by a written hearing process. Order G-199-08, in part, granted interim approval of the Subcontractor Agreement and stated that the Commission would establish permanent rates and terms under the Subcontractor Agreement after it completed its review of the Company's updated Code of Conduct and Transfer Pricing Policy that the Company planned to file. The Order and Reasons for Decision can be found on the Commission's website at www.bccuc.com.

On July 16, 2008, during the course of the Subcontractor Agreement proceeding, FortisBC filed, a confidential Internal Audit Report dated July 3, 2008 on its existing Code of Conduct and Transfer Pricing Policy (the "2008 Report"). On April 27, 2009 FortisBC filed its 2009 Internal Audit Report on its existing Code of Conduct and Transfer Pricing Policy (the "2009 Report"). While both reports were originally filed on a confidential basis, the request for confidentiality was later withdrawn. (Exhibit B-3)

The 2008 Report notes some deficiencies in the existing policies. As management's response to the findings in the 2008 Report, FortisBC undertook to file with the Commission updated Code of Conduct and Transfer Pricing Policy documents by March 31, 2009. These were duly filed for approval on March 31, 2009 and became part of the subject matter of this proceeding.

The Internal Audit Department of FortisBC is relatively small (two employees), and reports to the Chief Financial Officer of the Company. There are quarterly meetings with management, including a private meeting with the Audit Committee of the Board. Occasionally, externally sourced consultants are retained. (IR BCUC 1-A25.3 and A25.5) The Audit Department has been quite active over the past few years and the audit activities undertaken recently are reported in IR BCUC 1-A25.1. The audits completed include the 2008 and 2009 audits of existing the Code of Conduct and Transfer Pricing Policy.

The following parties intervened in the proceedings: the District of Summerland ("Summerland"), the Columbia Power Corporation ("CPC"), a provincial Crown corporation that is not regulated by the Commission, the British Columbia Old Age Pensioners Organization et al. ("BCOAPO"), the BC Municipal Electrical Utilities ("BCMEU"), and the City of Kelowna ("Kelowna").

FortisBC filed its Final Written Submission on July 16, 2009. All intervenors (except Summerland) also filed Final Submissions. FortisBC filed its Reply on July 28, 2009. All intervenors generally supported the Application as filed, although some suggestions for updating the Guidelines were made and some small changes suggested to the updated policies filed by FortisBC.

4.0 ISSUES IN THE PROCEEDING

The balance of these Reasons for Decision are divided as follows:

4.1 Corporate Structure and Governance

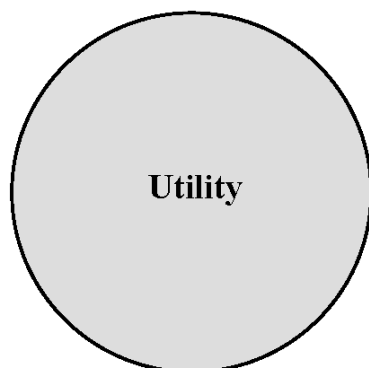
Is the FortisBC and affiliate corporate structure consistent with the principles in the Guidelines governing the choice of corporate structure? In answering this question, the Commission Panel notes that FortisBC is a subsidiary of Fortis Pacific Holdings Inc. FPHI, in turn, is a subsidiary of FortisWest Inc., which in turn is a subsidiary of the ultimate parent holding company, Fortis Inc., a Canadian publicly traded company. The Organizational Chart of FortisBC and affiliates is found in Exhibit B-1, Attachment F, page 2.

The transactions that are of primary interest in this proceeding are those between FortisBC and FPHI. Other contracts also exist between FortisBC and another regulated affiliate, Terasen Gas Inc. While as noted above, the Guidelines do not explicitly cover transactions between two regulated utility, FortisBC has applied its Code of Conduct and Transfer Pricing Policy to transactions between FortisBC and Terasen Gas Inc., "as it seemed appropriate to do so." (IR BCOAPO A7.a) The Commission Panel applauds FortisBC for electing to apply the spirit of the Guidelines to its regulated-affiliate transactions.

Figure 4 of the Guidelines, reproduced below, presents four corporate structures under which retail products and services could potentially be provided:

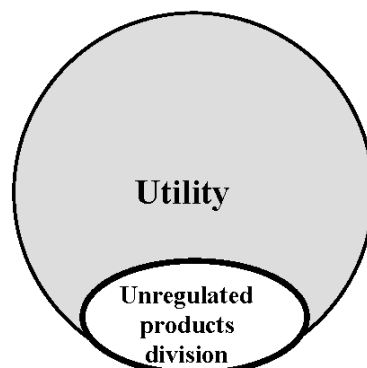
Figure 4

Potential Corporate Structures



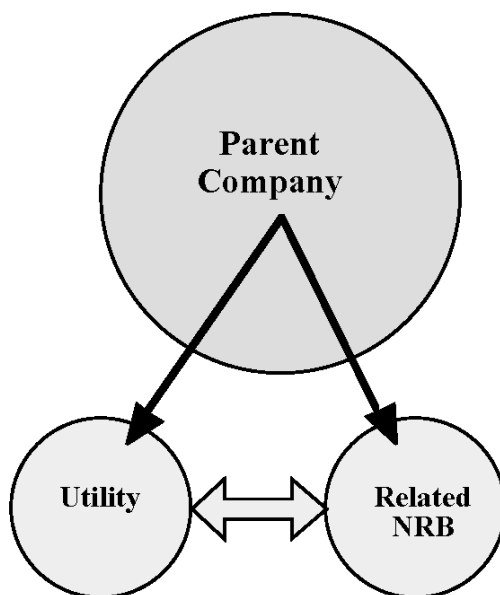
1

The utility is the sole corporate entity, providing downstream products through a regulated tariff.



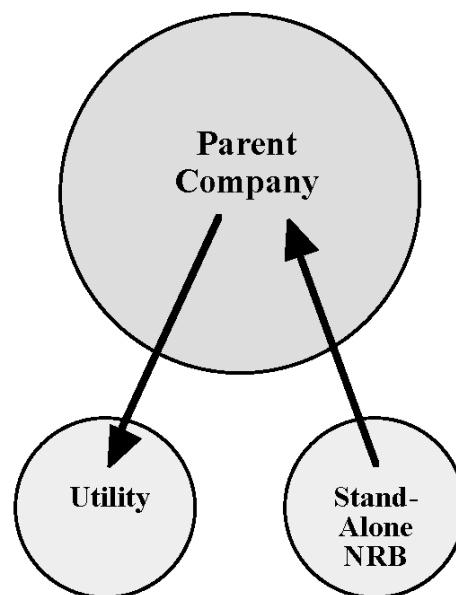
2

The utility is the sole corporate entity, providing downstream products on an unregulated basis, perhaps through a division.



3

Unregulated retail products provided by related NRB using some utility facilities and services.



4

Unregulated retail products provided by stand-alone NRB using no utility facilities or services.

FortisBC provides both products and services to FPHI, its direct parent and a non-regulated affiliate. This is a variation of Option 3 in Figure 4. FortisBC also supplies services directly to an unregulated division of the utility, Walden Power Partnership (“Walden”). (Application, p. 6) This is Option 2 in Figure 4. In addition, FortisBC provides to and receives services from Terasen Gas Inc. a regulated affiliate. The details of the revenues involved in these inter-corporate relationships are detailed in the Application at page 5. Approximately 22 Full Time Equivalent employees (“FTEs”) of FortisBC are deployed in servicing the NRBs. (IR BCUC 1.A6.3)

4.1.1 The Nature of Services Provided

In addition to granting interim approval of the Subcontractor Agreement, Order G-199-08 directed FortisBC to “...submit evidence regarding a competitive market price or a Fair Market Value price (including interest) for the services offered to FPHI in [the] Subcontractor Agreement as part of its updated [Code of Conduct] and [Transfer Pricing Policy] filing.”

FortisBC responded to this directive at p. 16 of the Application. The Company also replied to Commission Information Requests on this issue. In brief, its position is that there is no directly comparable competitive market price and that no one area contractor could provide the scope of services that are covered under the various subcontracts with NRBs. (IR BCUC 1.9 and 1.10)

While the Commission Panel is of the view that the nature of the non-regulated services being supplied by FortisBC (generally through its parent company affiliate) are not monopoly services *per se*, they are of a nature and scope that any other private sector player would have great difficulty supplying, particularly given the remote nature of the territories being serviced, the FortisBC presence throughout the territory, and the non-price preferences for FortisBC that exist.

For instance, Kelowna reports that it carried out an “exhaustive review of the alternatives for contracting out the operations and maintenance of its electric distribution utility. The contractual arrangements with [Utilicorp British Columbia Ltd.], and then FortisBC [sic], were not driven solely by price but with overriding safety and service concerns.” (Kelowna Final Submission, July 22, 2009, para 4) Kelowna supports approval of the Application.

CPC’s Final Submission addresses, in part, the need of specialized skills for its generation facilities that are not available from private suppliers. In doing so, it states: “CPC is not aware of any alternate supplier already existing in the region that could provide the same range of specialized skills.” (CPC Final Submission, p. 2)

FortisBC notes that “there is no independent supplier in the Kootenay area for the same scope of services provided under the Brilliant Expansion Subcontract, and hence no comparable “competitive market price”. (Application, p. 16) CPC agrees that there is no competitive market for the types of services that FPHI provides. (CPC Final Submission, p. 2)

FortisBC acknowledges “[t]hat there are a number of entities in the Kootenay area that provide components of the full service package that FortisBC provides to FPHI.” The Company provided a matrix that analysed the ability of several private sector entities in the area who could supply portions of the products and services sold by FortisBC to FPHI. (Application, pp. 16 and 17, Table 2)

To the extent that there is no viable competitor that could supply the same range of services as FortisBC, the services so provided take on the attributes of monopoly services and the vendor NRB could attempt to exact monopoly pricing. However, the Commission Panel is of the view that the services being provided do not fit with the concept of “Core Monopoly Products” as found in a “natural monopoly” as that term is commonly used. (Guidelines, p. 4, Figure 1; p. 24, Section 5.1.4(i)) The Commission Panel therefore concludes that the services provided under the Subcontractor Agreement need not be provided as a regulated tariff item. In this proceeding, the Commission’s primary focus is on the ratepayers of the regulated entity. The Commission must assure itself that at a minimum, there is no detriment to ratepayers.

FortisBC has filed its Revised TPP as Attachment C to the Application. Paragraph 6(c) of Attachment C provides that:

“If the facility or service provided by the Utility to the related NRB could also be practically obtained from an independent supplier, the price paid by the related NRB to the Utility will be no less than the competitive market price and will never be below the incremental price.”

Paragraph 6(c) is generally consistent with the Ontario Energy Board’s Affiliate Relationship Code. In so doing FortisBC earns the support of CPC. (CPC Final Submission, pp. 2-3)

The Commission Panel concludes that there is protection for ratepayers under the Revised TPP. Products or services that are sourced in the regulated utility will not be sold at less than a competitor’s market price and thereby amount to a subsidy from the utility to the NRB. There being no comparable competitor for the services being supplied, it is problematic to determine what a “Fair Market Value” price is. The Commission Panel understands the phrase to mean “fair” in the sense that there is no detriment to the ratepayers, the regulated utility and “fair” to the ultimate purchasers of the subcontracted services. In respect of the latter, Kelowna is of the view that it is paying a premium for the services that are being provided. (Kelowna Final Submission, para 10) A “premium” notwithstanding, the City goes on to say:

“In conclusion the City of Kelowna believes that it has entered into a fair, reasonable agreement in the public interest and of benefit to FortisBC, the FortisBC rate payers, the City of Kelowna and its rate payers. We would hope that the Commission will reach the same conclusion.” (Kelowna Final Submission, para 11)

This lends weight to the Commission Panel’s view that pricing has been established at a fair level.

The extent to which ratepayers should benefit from the profit-making activities of an NRB (if at all), is discussed below in Section 4.2.2 in the context of cost loadings and profit.

4.1.2 The Preferred Corporate Structures

The five principles that should govern the choice of corporate structure under the Guidelines have already been set out in Section 2.0 of this Decision.

In the main, FortisBC uses its parent company affiliate, FPHI, as the channel through which FortisBC resources are made available to outside unregulated parties. The Commission Panel notes that FortisBC reported revenues of \$5.6 million from FPHI in 2008 whereas revenues from its other NRBs were substantially less. The revenues from Walden, the unregulated division of the utility, were reported at \$255,000 with a cash infusion from FortisBC to Walden of \$700,000 for 2008. (Affiliate Transactions Report for the year ended December 31, 2008, Application, Appendix F)

These corporate relationships do not fit tidily and congruently into the variations set out in Figure 4 above. However, there are many variations that could be envisaged that are slightly different than the options shown in Figure 4. The test is to assess to what extent the chosen relationships serve the principles set out in the Guidelines.

The use of a parent company, FPHI, as the channel through which the non-regulated services (using the resources of the utility) are provided is not discussed explicitly in the Guidelines. Accordingly, the Commission Panel must be cautious in determining if there is any adverse effect or undue risk imposed upon the ratepayers of the utility. The revenue amounts from NRBs, reported in the context of the overall revenues of FortisBC, are small.

Similarly, the use of an unregulated division (Walden) of the regulated utility to provide unregulated services is not the preferred corporate arrangement. However, given the relatively small revenues involved, the Commission Panel is persuaded that the use of an unregulated division within the regulated utility, in this instance, poses no significant financial risk to the utility and therefore to ratepayers. However, in time, it would seem prudent to standardize and consolidate the channels used to provide services from FortisBC to NRBs. In the Commission Panel's view, the use of a single stand-alone affiliate of the regulated utility for this purpose would provide further isolation of business risk, simplify the regulatory accounting of the regulated entity, and provide greater internal corporate accountability for the NRBs.

4.1.3 Isolating Risk and the Parent Company Guarantee

Section 2 (g) of the Application discusses the risk-related advantages associated with the current FortisBC affiliate relationship structure. In particular, there is reference to the indemnity clause that is found in the subcontract agreements between FortisBC and FPHI. The purpose of this type of indemnity is to isolate the business risk associated with the provision of non-regulated services to outside third parties and to indemnify and hold the operating utility, together with, its directors, officers, employees or other persons for whom it is legally responsible, harmless from liability for direct losses, costs and expenses that may arise as the direct result of the provision by FortisBC of services pursuant to the agreements or as a result of the breach of FPHI (or persons for whom it is legally responsible) under the terms of the agreements.

The viability of any indemnification rests upon the strength of the company offering the indemnity, in this case FPHI. According to FortisBC, "... the terms of the subcontractor agreements are legally enforceable and help protect regulated operations from NRB business risk." (IR BCUC 1.A3.2; FortisBC's Final Written Submission, p. 5, para 27) No party took issue with or criticized the indemnity arrangement.

4.1.4 Use of the Utility's Corporate Name

At Paragraphs 9 to 12 of its Final Submission, BCOAPO suggested that the Revised Code should be amended by deleting Section 10. Section 10 reads as follows:

“10. Use of Name

An NRB may indicate an affiliation with FortisBC Inc. without approval of the Commission and carry on business in the name of FortisBC Inc. with approval of the Commission.”

The possible evil that concerns BCOAPO is that in permitting NRBs to indicate an affiliation with the regulated utility, FortisBC may imply that the NRB receives preferential treatment, even if there is none in fact. In its Reply Submission, FortisBC said it had no objection to removing Section 10. The Commission Panel notes that use of the corporate name of the utility was addressed in the staff paper that preceded the Guidelines which had suggested that “NRBs will not be allowed to use the utility name as the primary identifier of the company, but can make reference to the name of its parent company on letterhead, advertisements, etc.” (Guidelines, p. 17) The Commission ultimately modified staff’s suggested wording, so that the principle now reads as follows: “Use of the utility name by a related -NRB will require approval by the Commission to ensure its use will not interfere with the Commission’s ability to protect ratepayers.” (Guidelines, Section 5.3 vii, p. 27)

On balance, the Commission Panel approves the existing corporate arrangements for the delivery of products and services to NRBs but encourages FortisBC to consider the advisability of consolidating its channels to the non-regulated markets that it serves, through a single stand-alone affiliate, preferably not its direct parent. This would include moving the unregulated business division of the regulated entity into the stand-alone affiliate.

The Commission Panel finds that Section 10 of the FortisBC Revised Code of Conduct will not pose any substantive limitation on the Commission in protecting the interests of the ratepayers of FortisBC.

4.2 Revised Transfer Pricing Policy

Is the revised Transfer Pricing Policy consistent with the principles in the Guidelines governing Transfer Pricing Policy? The objective in this area is to ensure that the transfer pricing policies adopted by a regulated utility will ensure adherence to the Guidelines principles for a transfer pricing policy, which have been quoted in Section 2 of this Decision.

4.2.1 Loading Rates

The concept of a fair transfer pricing policy often precipitates an examination of causal costs and cost recovery as between related entities. Rigorous cost loading studies tend to be very resource intensive, can be lengthy, and usually involve judgment (if not art) in the definition of the load allocators chosen.

No such detailed load study has been undertaken by FortisBC in the context of this proceeding, nor in the Commission Panel’s view, is one required for the purposes of this Application, given the nature and extent of the contracting with NRBs. In general, FortisBC sets out internal loading procedures that amount to full cost recovery. The methodologies adopted will be reviewed annually with a view to confirming that they will accurately reflect costs that should be met by the NRBs. Updates will be made as necessary.

In defining cost based price loadings in respect of the Subcontractor Agreement, including the General and Administrative ("G & A") Overhead loadings, FortisBC has used "an allocation factor based on management's best estimate or, where appropriate, based on the proportion of NRB to total FortisBC activity." This methodology was applied "...on a departmental basis to the revised [Operations and Maintenance] cost to determine the cost that should be allocated to NRBs." (Application, p. 10)

The cost allocation process within FortisBC is accommodated "... as a matter of course in FortisBC's annual budget process. All costs are compiled and those costs that are incurred in order to support a NRB are identified. During this process, managers determine costs and cost causation. Therefore, costs incurred in order to support a NRB are identified and separated. At the end of the process, budgets are ultimately approved by the appropriate Vice President." (IR BCUC 1.A2.1) As a result, to some extent, FortisBC relies upon departmental management judgment to set the allocation of costs as between regulated utility and services provided to NRBs.

Generally speaking, FortisBC appears to have appropriately addressed the issues associated with cost allocation, but has chosen simplicity over precision. Given the relative size of the revenues achieved from NRBs, the Commission Panel is of the view that the cost allocation methodologies adopted are sufficient. The Commission Panel is reinforced in this view by the fact that the transfer pricing and its administration under the FortisBC Revised TPP, will be reviewed periodically by the internal auditors and the results filed with the Commission. (Exhibit B-3, Attachment A, p. 5)

The Commission Panel approves the loading methodologies proposed by FortisBC as set out in the Application.

4.2.2 Calculation of Appropriate Loadings

FortisBC's proposal for loading rates is summarized in Schedule 1 of the Revised TPP at page 5 as follows:

- Labour loading at 72.5% for all labour expense;
- Material loading at 7%;
- G & A Overhead loading at 5.5% (as calculated in Attachment E);
- Profit margin of 10% (applied to total invoice price excluding third party contracting expenses).

These loadings represent substantial changes and/or simplifications from the previous loading schedule. Maintenance of facilities rentals is included in the calculation of G & A Overhead loadings as shown in Attachment E, and these costs are over and above incremental costs for facilities that are directly billed to an NRB. (Application, p. 4)

The labour loadings are increased from the existing loading rates of 55 percent (salaried employees) and 45 percent (hourly employees) and the proposed flat loading rate will be monitored and updated to remain current. (Application, p. 4) The calculation of the labour loading rate is set out in the response to IR BCUC 1.A18.4.

The revised G & A cost recoveries will generate an estimated increase in revenues of \$226,000 (for a total of \$405,000) based on 2008 revenues. Profit margins will remain the same at 10 percent. The NRB revenues will act to reduce the related costs of the regulated utility. Wherever possible, real costs that can be separately identified, will be charged directly to the NRB, rather than estimated or allocated. (IRBCOAPO 1.A2.d)

The added profit margin of 10 percent is applied to the total invoice price. The following questions arise with respect to the profit margin. To what extent should the ratepayers of the regulated utility benefit from the profit potential in subcontracting services to outside third parties? And what level of profit is reasonable where, as is the case here, the services have some attributes of monopoly services? At what profit level does the provision of services to outside third parties become unattractive to the prospective purchaser and force uneconomic business decisions? How can any possible detriment to ratepayers and the regulated entity's workforce be measured in dollar terms? The Panel is of the view that, at present, a 10 percent profit mark-up strikes an acceptable balance between these mutually competing drivers.

CPC suggests that G & A expenses charged to a NRB should be direct billed rather than calculated using the 5.5 percent overhead loading. The Commission Panel is of the view that the cost recovery systems that would be necessary to support such direct billing for what are shared services, would not be cost effective and would result in increased costs being charged to the NRBs and hence, increased costs to the companies receiving contracted services. However, where specific G & A costs can be identified and tracked, these should be continued to be direct billed. The Commission Panel notes that in Attachment E which sets out the calculation of the G & A 5.5 percent loading factor, the calculation shows that \$123 thousand of direct expenses were billed in 2008.

BCOAPO also questioned whether the direct billed G & A costs should be removed from the G & A loading calculation. (BCOAPO Final Submission p. 6, C.4.ii) The Commission Panel agrees with FortisBC that the calculation correctly reflects full cost allocation recovery. To try to factor in the direct billed G & A costs, as an input to establishing the loading factor would, in the Panel's view, not be cost efficient or provide any more precision to the loading factor calculation.

The Commission Panel has reviewed the revised loading rates and finds that they are reasonable and set at a level to ensure that there are no subsidies from the regulated utility to the NRBs. Also, the Commission Panel accepts the annual corporate review of the numerical inputs to the loading calculations, as additional support for the on-going adequacy of the loadings.

4.2.3 Benefits to the Ratepayers and the Labour Force

FortisBC submits that "Revenues generated by these [NRB] contracts have positive impacts on ratepayers by offsetting revenue requirements and mitigating rate impacts. They also provide intangible benefits to the labour force by producing and maintaining a more experienced and capable labour force." By way of example in respect of the utility revenues from NRB contracts, FortisBC cites the following: "If FortisBC were to discontinue all non-regulated third party work (related to the Brilliant Expansion, Arrow Lakes Hydro and the City of Kelowna subcontracts, the overall revenue impact would be approximately \$0.9 million with a corresponding rate impact of 0.4 percent." (Application p. 19) The City of Kelowna supports this position and states:

“The record in this proceeding demonstrates not only that FortisBC and its customers have benefited from the contractual relationships with the City but that the relationship has resulted in a reduction in the cost of service for FortisBC customers, which reduction would not exist but for the contractual relationships.” (Kelowna Final Submission, para 7)

The Commission Panel finds that there are positive benefits of subcontracting FortisBC personnel, both in terms of incremental revenue to the regulated utility and labour force enrichment.

Also, given the remote areas served under the various subcontracts and the inability of any other local contractor to supply the same scope of services, the Commission Panel is of the view that there are broader public policy objectives served. There are distinct advantages to the subcontract customers and to the general well-being of the communities in which they are found. (Kelowna Final Submission, para 8)

The Commission Panel is of the view that the principles are reflected in the Revised TPP. The Revised Transfer Pricing Policy is approved.

4.3 Revised Code of Conduct

Is the revised Code of Conduct consistent with the principles in the Guidelines governing Code of Conduct? Some aspects of the Revised Code have already been discussed above. The Revised Code of Conduct is found at Attachment A of the Application.

BCOAPO notes that the Ontario Energy Code of Conduct also addresses the price payable by the regulated business for services received **from** affiliates (BCOAPO IR 1.8). FortisBC replied that its policy in any transaction is to achieve “value for money” and that for the most part, when FortisBC purchases services from an affiliate, it does so with the affiliate receiving fully loaded cost recovery. In its Final Submission, BCOAPO suggests that the Code of Conduct be revised to include provisions dealing with the purchase of goods and services **from** an affiliate. This suggestion, while having merit, goes beyond the scope of the Guidelines and this proceeding. In any event, the existing purchasing practises that FortisBC has in place, seem on their face to be fair, not overly complex or expensive to administer.

The Commission Panel finds that the FortisBC Revised Code of Conduct reflects the principles set out in the Guidelines at pages 26 and 27 and is therefore approved.

5.0 APPROVAL OF THE SUBCONTRACTOR AGREEMENT BETWEEN FORTISBC INC AND FORTIS PACIFIC HOLDINGS INC.FOR THE SUPPLY OF SERVICES TO BRILLIANT EXPANSION POWER CORPORATION

Should the Commission Panel grant final approval to the Subcontractor Agreement between FortisBC and FPHI? As noted above, no other competitor can provide the range of services. No intervenor opposed approval of the Subcontractor Agreement.

For these reasons, **the Commission Panel approves the Subcontractor Agreement between FPHI and FortisBC and approves the interim rates under the Subcontractor Agreement as permanent subject to the adjustments in Section 4.2 of these Reasons for Decision.**

FortisBC is to charge to FPHI, any difference between the interim and permanent rates including interest under the Subcontractor Agreement.

6.0 OTHER SUBCONTRACTS

Are changes required to other subcontracts involving FortisBC and FPHI that may be impacted by the increased loadings set out in this proceeding? If so, what is the timing of the implementation of the new loadings in respect of such contracts?

An issue arises as to the effective date for the Revised TPP as between FortisBC and FPHI in respect of other contracts, as well as the loadings to be used by the NRB division of the utility.

Kelowna requests that “the Commission not make any changes to the charges levied by FortisBC to the City of Kelowna under its existing agreements. [The Panel believes this sentence to be in error and was probably meant to refer to charges as between FPHI and Kelowna.] In the event that the Commission does determine that changes be made, Kelowna requests that those changes be made effective the end of the term of the agreement such that they impact a renewal as opposed to the balance of the three years which remains on the contract.” (Kelowna Final Submission, para 12) FortisBC states that it “is aware that the agreement between FPHI and Kelowna expressly acknowledges the potential for the changes to the Commission-approved Transfer Pricing Policy during the term of the agreement.” (Reply Submission, para 16)

Similarly, CPC, in the face of any increases in rates, requests that “the Commission grant sufficient transition time for FPHI customers to develop alternate strategies for obtaining necessary services.” (CPC Final Submission, para 9)

With the exception of the Subcontractor Agreement, the Commission Panel determines that the loadings and consequent pricing of products and services to be applied to all subcontract arrangements between FortisBC and FPHI (and all other NRBs), are to be effective as of the date the Order issued concurrently with these Reasons for Decision.

In the absence of any evidence as to the terms and conditions in other contracts as between FPHI and its other customers, the Commission Panel makes no determination as to how, if or when the Transfer Pricing Policy as approved in this Application, is applied by FPHI to such contracts.