

# **Performance Based Regulation (‘PBR’) Streamlining the Process**

## **History/Background**

Vertically integrated electric utility servicing the West Kootenay and South Okanagan regions of BC.

Incorporated in 1897.

Acquired by Aquila Inc (Utilicorp United). in September 1987.

August 2000, Aquila Inc. acquired TransAlta's distribution assets in Alberta.

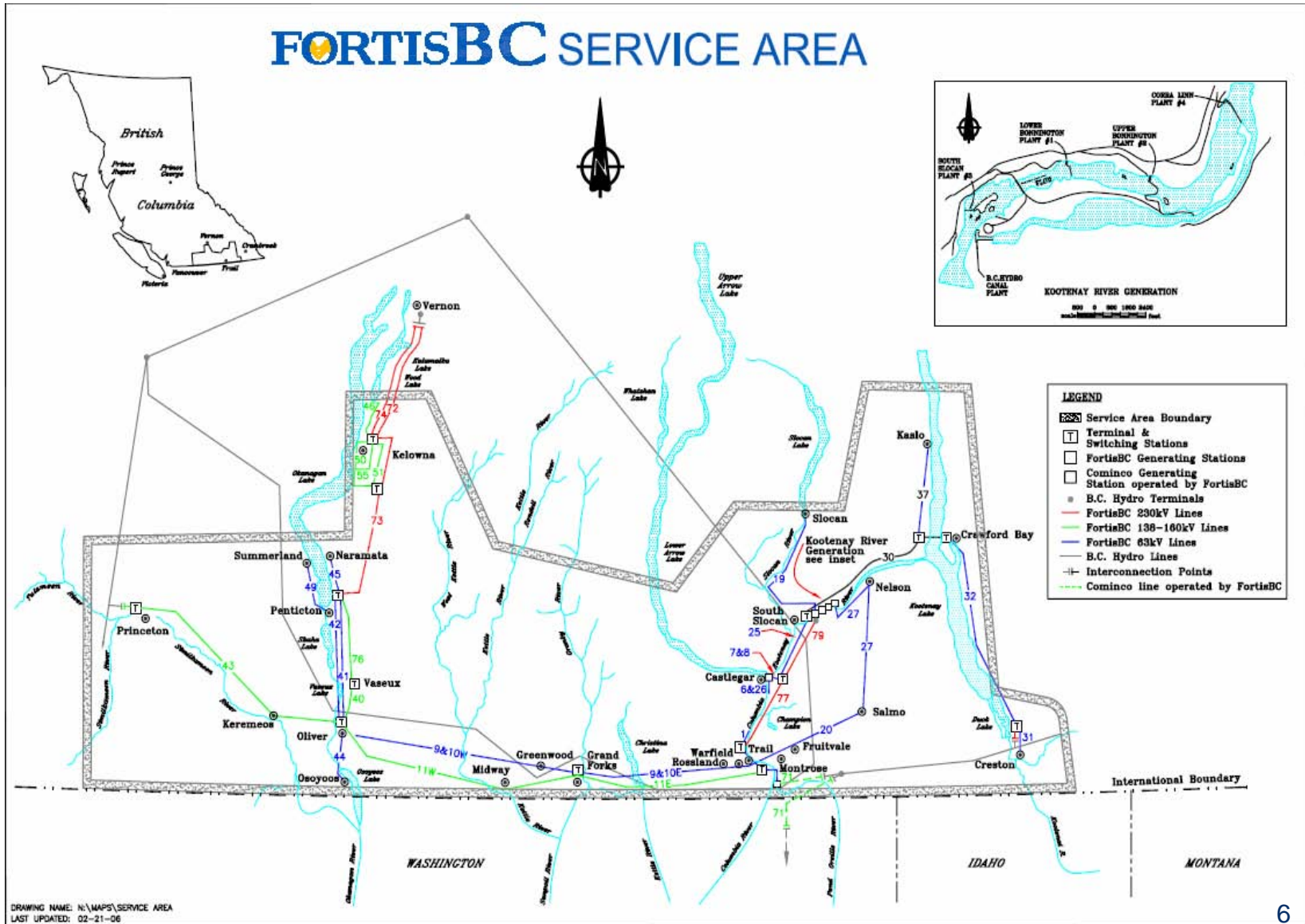
Shared management model for Alberta and BC operations.

May 31, 2004 Fortis Inc. purchased Aquila Inc.'s Canadian operations in BC and Alberta.

June 1, 2004 name change for FortisBC Inc.

Transitioned structure of FortisBC back to stand-alone operation.

## FORTISBC SERVICE AREA

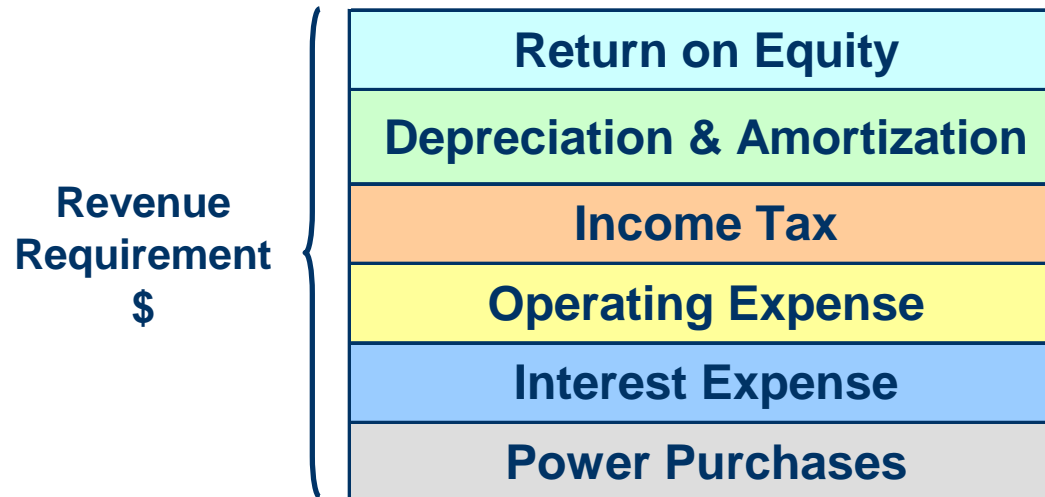


## PBR Basics

- **PBR = A more efficient way to set rates that naturally motivates the utility and the stakeholders to align their interests.**
- **Why do utilities/regulators/customers want to do PBR?**
- **What are Revenue Requirements?**
- **Cost of Service vs Performance Based Regulation**

## Revenue Requirements

### Components



## Revenue Requirements

	Approved 2005	Increase or (Decrease)	2006
Sales Volume (GW.h)	2,924		3,031
Rate Base (000s)	597,688		682,312
Return on Rate Base	7.69%		7.39%
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Revenue Deficiency		(\$000s)	
Power Supply	59,451	5,616	65,067
Operating	36,141	(6,145)	29,996
Taxes	23,248	(89)	23,159
Financing	61,771	14,913	76,684
Incentive Adjustments	(1,791)	1,316	(475)
Total Revenue Requirements	178,820	15,610	194,430
Adjustment for Overstatement of 2005 Rate Base			(349)
Adjusted Revenue Requirement			194,081
Less: Revenue at Approved Rates			185,541
Revenue Deficiency for Rate Setting			8,540
Rate Increase			4.6%

## Common Attributes of PBR

- Multi-year
- Base Year that has been tested
- Simpler revenue requirements determination – formula/forecast w/o line by line examination
- Some level of decoupling of costs and revenues
- Sharing/Incentive mechanism(s)
- Performance Standards
- Linkage of perf stds to incentive eligibility
- Bypass (i.e. Z factor)
- Off Ramp

## **FortisBC's Performance Based Regulation Experience 1996-2004**

- **Component Based PBR**
- **“PBR was not harmful”**
- **Significant reduction in regulatory burden**
- **Financial Performance: “Marginally beneficial in some areas (i.e. O&M Costs up to 2002)”**
- **Anecdotal comments from stakeholders**



## FortisBC's Performance Based Regulation Experience 1996-2004

- **Things that worked well**
  - O&M Formula
    - $\text{Cost/Customer} \times \text{BCCPI} \times \text{Customer Growth} \times \text{PIF}$
  - Technical Committees
  - Performance Standards: “Soft wired” to Incentives
  - Annual Review
- **Things that did not work**
  - Bad base year in Cap and O&M – forecasting ‘crime’
  - Escalation factors worsened the situation
  - Lack of Rebasing
  - Different treatments of revenue requirement line items led to unintended results
  - Incentive Sharing Mechanisms too complicated - errors
    - O&M
    - Other Income
    - Power Purchases

## Moving Forward with PBR

- **Sound, tested Base Year**
- **Simplification - KISS**
  - Collared RoE – everything except interest expense flows to the mechanism
  - Moved away from multiple formulas.
  - More uniform treatment of RR components – ‘strength in diversity’
  - Capex separate
- **Transparency**
  - Retained a “component based/indexed form of PBR
  - Annual Reviews
- **Sharing Mechanism for variances to target ROE**
- **Incentives linked to Performance Standards**
- **Productivity Factor**
- **Z Factor**
- **Extraordinary Items**
- **No Surprises**
- **No Technical Committees! Not good!**

## How Do You Get There from Here?

- **SUCCESSFUL NEGOTIATION**
  - NSP is critical – cannot be prescriptive
  - Strong mediation
  - Get past the ‘point of despair’ – both sides have to want a deal
  - No litigation of base year or PBR Mechanism – its gotta be voluntary.
- **PBR STRUCTURE**
  - Avoid Perfection - be pragmatic – keep it simple
  - Only apply it to the components of RR that make sense
  - Mechanisms should work with natural business forces (i.e. bottom line focus for private sector companies/risk allocation)