LAWSON LUNDELL LLP

BARRISTERS & SOLICITORS

1600 Cathedral Place
925 West Georgia Street
Vancouver, British Columbia
Canada V6C 3L2
Telephone 604.685.3456
Facsimile 604.669.1620

www.lawsonlundell.com

DIRECT LINE: (604) 631-9115
jchristian@lawsonlundell.com

January 26, 2007

Mr. Robert J. Pellatt
Commission Secretary
British Columbia Utilities Commission
Sixth Floor – 900 Howe Street
Vancouver, BC V6Z 2N3

Dear Mr. Pellatt:

British Columbia Utilities Commission (Commission)
British Columbia Hydro and Power Authority (BC Hydro)
Aberfeldie Redevelopment Project: Project No. 3698447

As noted in BC Hydro's December 6, 2006 application for a certificate of public convenience and necessity (CPCN) regarding the Aberfeldie Redevelopment Project, the writer is counsel to BC Hydro on this matter. This letter contains submissions on behalf of BC Hydro that are supplemental to those filed today under BC Hydro letterhead, and in response to submissions by intervenors in this matter, as provided for by Commission Order G-149-06.

The Commission Should Not Rule on These Supplementary Submissions Unless It Is Necessary

The subject matter of these supplementary submissions is the jurisdiction of the Commission to condition CPCNs on "cost collars", or other cost control mechanisms that purport to limit the extent to which utility costs arising from the subject matter of the CPCN may be later recovered in rates. As explained in BC Hydro's primary submissions, no such mechanism is necessary or appropriate in the circumstances of the Aberfeldie Project at this time. If the Commission agrees with BC Hydro that such mechanisms are unwarranted, then it is not necessary for the Commission to make any ruling on the merits of these supplementary submissions. Moreover, BC Hydro submits that it would be appropriate if the Commission positively refrained from making such a ruling, unless it has to (ie because despite BC Hydro's primary submissions it concludes that a cost control mechanism is appropriate or necessary). The reasons are outlined in BC Hydro's primary submissions, and are expanded upon here.

First, BC Hydro is aware that the Commission has conditioned CPCNs on cost control mechanisms for a number of years, in different contexts, and with different utilities. The legality of such mechanisms is therefore an issue that affects not only BC Hydro and its stakeholders, but all regulated utilities in the province and their stakeholders. One can reasonably expect that different parties will have different views and bring different perspectives forward in regard to this issue. Allowing those views to be presented gives a legitimate and proper voice to stakeholders, and ultimately ought to allow for a better decision by the Commission. However,

not all the parties who can be expected to have an interest in this issue are participants in this proceeding. Moreover, given the timing issues and the resulting hearing schedule of this application, there is no opportunity for parties who are intervenors in this proceeding to reply to these supplemental submissions. Thus it would be unfortunate and unhelpful if the Commission ruled on this jurisdiction issue when it did not need to.

Second, at this time the record of this proceeding is very thin on what types of cost control mechanism are being proposed; what the mechanics would be; and what their statutory basis would be (despite BC Hydro raising the jurisdictional issue in its response to BCUC IR 1.4.2).[1] In this regard it is important to note again that no Commission order in regard to BC Hydro has purported to condition a CPCN on a cost control mechanism, which is significant in light of BC Hydro's unique circumstances. Thus in the absence of a specific cost control proposal, and an articulated statutory basis upon which the proposal rests, the most BC Hydro can do in these submissions is summarize its view of the law in a somewhat generalized and high-level nature. Clearly, such high-level submissions are not an ideal basis upon which to base a jurisdictional decision of provincial import.

Finally, BC Hydro is concerned that unnecessarily addressing the jurisdictional issue may make the application moot, to the extent that it delays the issuance of a final decision after February 15.

Just and Reasonable Rates Must Include an Allowance for a Reasonable Return

The starting point for the jurisdictional analysis is the observation that in the normal course utility costs arising from capital projects do not impact rates until the first rate proceeding after the project is in service, at which time there will be incremental finance, depreciation and OM&A charges in the proposed revenue requirement. At this point the Commission may, *in the course of setting just and reasonable rates*, determine that the revenue requirement, and hence the rates, may be less than what the utility believes is appropriate, on the basis that some or all of the incremental charges arising from the capital project were imprudent.

A rate is unjust or unreasonable if it is "insufficient to yield a fair and reasonable return" (section 59(5)(b) of the UCA). In the specific case of BC Hydro, and pursuant to paragraph 4(d) of Heritage Special Direction No.HC2, the rates must "allow the authority [BC Hydro] to collect sufficient revenue in each fiscal year to enable the authority to...achieve an annual rate of return on equity equal to the pre-income tax annual rate of return allowed by the commission [sic] to the most comparable investor-owned energy utility regulated under the *Utilities Commission Act*". Thus, the Commission can lawfully set rates only to the extent that it has not precluded a utility from recovering in rates a reasonable return (or in the case of BC Hydro, the prescribed return on equity) – which it cannot ensure where it has previously limited recovery of costs in a CPCN.

The over-arching importance of the Commission's duty to set just and reasonable rates in way that does not prevent a utility from earning a reasonable rate of return is illustrated by *Hemlock*

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[1] For example, are the cost caps meant to be indexed to inflation, or not? Are there circumstances under which BC Hydro would be able to recover costs beyond the proposed cost control mechanism, or not?

Valley Electrical Services Ltd. v. British Columbia (Utilities Commission) (1992), 66 B.C.L.R. (2d) 1 (C.A.).[2] In that case, the utility had sought rate relief and the Commission found that a 13 percent rate of return was just and reasonable on each of the utility's debt and equity components. However, to avoid rate shock, the Commission ordered the rate increase to be phased in over three years. The Court of Appeal allowed an appeal on the basis that, although the Commission had correctly exercised its discretion to determine a just and reasonable rate of return, it had incorrectly prevented the utility from charging a rate that would give it an opportunity to earn that return. The Commission's balancing of interests, said the Court at paragraph 59, "was done and completed when it settled the rate base, fixed the rate of return and determined the costs of operation allowable for rate-making purposes". The Court referred the matter back to the Commission so that the utility could file new tariff schedules that would allow it to earn its authorized rate of return.

The Commission Must Not Preclude the Setting of Just and Reasonable Rates

In light of the foregoing, BC Hydro is concerned that to the extent the Commission pre-determines in a CPCN the amount of costs that it will allow a utility to later recover in rates it is putting itself in a position that it will be unable to later fulfill its statutory duties to set to set just and reasonable rates. The easiest way to understand how this can occur in the context of this application is to consider a CPCN that limits cost recovery to some specified amount. At a later rate hearing that amount, no matter how reasonable it appeared at the time, can appear too small for any number of reasons beyond the control or even knowledge of the utility, intervenors, or the Commission, and greater amounts may readily be found prudent. Having made the CPCN conditional upon limited cost recovery rights, the Commission will have put itself in the position of being unable to set rates that allow the recovery of prudently incurred expenditures, thus effectively reducing the reasonable return that the utility would otherwise recover in rates.

The foregoing principle is illustrated in *Prince George Gas Co. v. Inland Natural Gas Co.* (1958), 14 D.L.R. (2d) 247 (C.A.).[3] In that case, the Commission's predecessor – the Public Utilities Commission – had granted the Prince George Gas Co. (Prince George) a CPCN to build a gas pipeline on condition that Prince George bought its gas from the Inland Natural Gas Co. (Inland) for a price that would have required Prince George consumers to make a contribution to the overall costs of the Inland system by way of subsidy to other customers. Prince George appealed the Commission's decision on the ground that it lacked the jurisdiction to impose the condition as to price.

In accepting Prince George's submissions, the Court held at page 279:

> "It is true the Commission was not engaged in rate fixing when it prescribed that condition and approved the price; it is likewise true that Prince George Gas is not obliged to take up its certificate on that condition. But if it does not agree to the condition it gets no certificate, and if it accepts the certificate and enters into the prescribed agreement with Inland, it will have agreed to the

[2] At Tab 2 of the Book of Authorities (filed under cover of BC Hydro's letter of today's date).

[3] At Tab 3 of the Book of Authorities.

> principle that it and its consumers shall pay a price that may to a greater or lesser degree subsidize other consumers on the Inland system. The reservation of the right of the Commission to vary the price after one year's operation does not affect the principle, but only the degree to which the Prince George consumers may be obliged to subsidize other consumers if, in the judgment of the Commission, subsidies continue to be necessary."

The Court further held that if Prince George were to accept the certificate on that condition and enter into the agreement with Inland, the price approved by the Commission would become a rate. It then said that a rate set without regard to what is a fair and reasonable charge for the services rendered, for the purpose of compelling some consumers to subsidize others, would not be in harmony with the legislation (at page 279).

The Court found that the condition had a prejudicial effect because if Prince George should attempt to invoke the powers of the Commission to enforce its statutory right to rates that are fair and reasonable, it would be met with the contention that by taking the CPCN on that condition attached and agreeing to pay the price set by the Commission, it had precluded itself from moving on that ground. As a result, the Court held that the condition was beyond the Commission's jurisdiction (at page 280).

In BC Hydro's view the over-riding principle in the Prince George case is equally applicable to this application: conditioning the Aberfeldie CPCN in a way that precludes BC Hydro from seeking just and reasonable rates – rates that would allow the recovery of *all* prudently incurred expenditures arising from the Aberfeldie Project – would be unlawful.

Subsection 45(9) of The UCA Is No Answer

BC Hydro notes that subsection 45(9) of the *UCA* may, at first reading, be interpreted as conferring on the Commission the express power to impose conditions on CPCNs regarding rates. Indeed, section 45(9) seems to have been relied on to this effect in the recent reasons for decision regarding the reconsideration applications of Big White Ski Resort Ltd. and FortisBC Inc. See Order G-154-06 and accompanying Appendix A. However, BC Hydro submits that subsection 45(9) applies only to the approval of privileges, concessions and franchises granted to a public utility by a municipality or other public authority, which are referred to in subsections 45(7) and (8). In fact, the words "approved" and "approval" appear, within sections 45 and 46, only in subsections 45(7), (8) and (9). Those words are not used in the remainder of sections 45 and 46 in the context of CPCNs. Given the presumption that the legislature's choice of different words is intentional and indicative of a different meaning (Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed. (Toronto: Butterworths, 2002) at 164),[4] the use of the words "approved" and "approval" only in the context of privileges, concessions and franchises granted by a municipality or other public authority, and not in the remainder of sections 45 and 46, is indicative that subsection 45(9) applies only to those subsections in which those words are used – namely, 45(7) and 45(8).

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[4] At Tab 4 of the Book of Authorities.

This analysis is consistent with the statutory predecessors of ss. 45 and 46 of the *UCA*, including ss. 12-15 of the *Public Utilities Act*, R.S.B.C. 1948, c. 277 ("*1948 Act*").[5] Upon review of those provisions it is apparent that section 12(a) of the *1948 Act* is the predecessor of subsections 45(7), (8) and (9) of the *UCA*, while section 12(b) of the *1948 Act* is the predecessor of subsection 45(1). The Supreme Court of Canada held in *Surrey (District) v. British Columbia Electric Co.* (1957), 7 D.L.R. (2d) 129 (S.C.C.),[6] that section 12(a) of the *1948 Act* provided for CPCN applications where a franchise had been granted to a public utility by a municipality or other public authority, while section 12(b) provided for applications for CPCNs in cases where no such franchise had been granted. Further, it is apparent from the structure of section 12 that the conditioning powers listed under s. 12(a) did not apply to a CPCN granted under s. 12(b). Likewise, the Commission's rate powers under s. 45(9) of the *UCA* (previously s. 12(a) of the *1948 Act*) are inapplicable where no franchise has been granted by municipality or other public authority (previously governed by s. 12(b) of the *1948 Act*). This distinction between the Commission's CPCN conditioning powers in the different circumstances is consistent with and indeed necessary to ensure that the Commission's pre-eminent role in the regulation of public utilities vis-a-vis municipalities is maintained, and in particular that a franchise agreement doesn't purport to impose a discriminatory or unfair rate structure, as discussed in the *Surrey* case. Thus, BC Hydro submits that subsection 45(9) does not empower the Commission to condition the Aberfeldie CPCN in a manner that limits BC Hydro's ability to charge rates that allow it to earn its prescribed return on equity.

Conclusion

In light of the foregoing, BC Hydro is concerned that the Commission may well exceed its jurisdiction if it accedes to the request of the IPPBC and the BCOAPO, and conditions the Aberfeldie CPCN on some device that would limit BC Hydro's rights to later recover in rates prudently incurred expenditures. However, the Commission need not, and should not, make a ruling on this issue unless it believes that, despite BC Hydro's primary submissions, a cost control mechanism remains necessary or desirable.

All of which is respectfully submitted,

LAWSON LUNDELL LLP

Jeff Christian

JC/sal

cc. Project 3698447 Registered Intervenors

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[5] At Tab 5 of the Book of Authorities.

[6] At Tab 6 of the Book of Authorities.