Project No. 3698893

IN THE MATTER OF THE *UTILITIES COMMISSION ACT*, R.S.B.C. 1996, CHAPTER 473

and

STARGAS UTILITIES LTD.

APPLICATION TO VARY DELIVERY RATE, AMEND COST OF SERVICE FORMULA, AND APPROVE REPLACEMENT TERM FINANCING / REDEMPTION OF PREFERRED SHARES

February 3, 2017

WRITTEN ARGUMENT OF STARGAS UTILITIES LTD.

A. INTRODUCTION

1. On September 26th, 2016, Stargas Utilities Ltd. ("Stargas") filed an application (the application) with the British Columbia Utilities Commission ("BCUC" or the "Commission" for:

   (a) Interim and permanent approval of a $0.39 per gigajoule delivery rate decrease for all customers, effective November 1, 2016;

   (b) Approval to replace Stargas' existing term loan with a $300,000 term loan at an interest rate of prime plus 1.25% (the "Replacement Financing") and

   (c) Approval to redeem 1,000 Class G preferred shares having a par value of $100,000.

2. In the course of the proceeding, Stargas filed two updates to its Application amending its cost of service calculation. On December 8th, 2016 (Exhibit B-1-1), it contemplated a reduction of $0.45 and in response to questions from Commission staff. On January 9th, 2017 (Exhibit B-1-2), Stargas filed a further amendment to its estimate of application costs, projecting a reduction in delivery rate of $0.30 per gigajoule from $7.38 to $7.08 (as described in Exhibit B-13). Stargas notes that in responding to Commission IR 14.1

(Exhibit B-13), it overlooked the amendment required to the Commission's summary of the delivery rate decrease sought in this Application. For clarity, the approval sought by Stargas should be as follows:

> 1. Permanent delivery rate decrease of $0.30 per gigajoule from $7.38 per gigajoule to $7.08 per gigajoule for all customers, effective November 1, 2016. (Source: Exhibit B-1, Cover letter, p. 1; Amended by Exhibit B-1-1, Exhibit B-1-2; Exhibit B-13, Responses 13.1 and 14.1)

3. As amended, Stargas' delivery rate in its test year is as follows:

Notes			2017
	Operations & maintenance		$ 120,501
	Administration		
	Professional fees	$ 6,200	
	Insurance	13,130	
	Office & sundry	15,028	
	Management fees	78,173	
1	Rate application - legal	8,833	
1	Rate application - other	7,000	128,364
	Income tax		9,300
	Net, meters and lines		(170)
	Basic charges		(62,990)
	Sundry revenue		(4,102)
	Annual dividend		28,500
	Catch up dividend arrears		6,794
	Interest - operating line		4,190
2	Interest - shareholders		1,800
3	Interest - term debt		3,910
4	Amortization		54,804
	Cost of Service		$ 290,902
5	Forecast Deliveries (GJ's)		41,093.6
	Delivery rate		**$7.08**

Notes:

1. Application costs: As originally filed, Stargas estimated a cost of $9,954 to be included within the test year; as amended Stargas estimates a cost of $47,500 to be included 1/3 in the test year and with the balance in each of the two succeeding years.

2. Interest – shareholders: As originally filed, Stargas included interest at the rate of 6%; as amended Stargas contemplates interest at 1% over the rate charged on its operating line

3. Interest – term debt: As originally filed, Stargas did not include term debt interest in its test year; as amended, the test year includes interest on that portion of the Replacement term debt drawn to redeem preferred shares ($100,000).

4. Amortization: As originally filed, Stargas included debt service in lieu of amortization of its capital assets and, as amended restored amortization of its capital assets in the cost of service calculation (omitting debt service). Refer to Exhibit B-1-1 Note 4 on page 2.

5. Delivery volumes: Based on actual deliveries through its initial months of the test year, Stargas increased its estimate of delivery volumes.

4. On December 16th, 2016 (Order G-192-16), the Commission approved Stargas' refinancing request and the redemption of the 1,000 Class G preferred shares (the "Redemption").

5. The remaining issues to be determined are the approval of Stargas' delivery rate including Stargas' management costs and the calculation of Stargas' cost of service following from the approved refinancing and the Redemption.

6. The updated delivery rate proposed by Stargas is based on a thorough and complete analysis of current operating and administrative costs. Stargas is also entitled to receive a fair return on its prudently invested capital. As a result, and for the reasons set out below and in its Application materials, and filings in this proceeding, Stargas submits that the proposed updated rate structure be accepted by the Commission. In this argument, Stargas has attempted to focus on the matters that were the subject of most inquiry by the Commission and Intervenor; however, the failure to comment on a specific issues should not be taken to mean that Stargas concurs with any contrary position that may been advanced by the Intervenor.

7. In its intervention, the Silver Star Property Owners' Association ("SSPOA") compared the proposed Stargas rates to those of Fortis BC in an attempt to demonstrate Stargas' rates excessive. Stargas submits that the comparison is invalid as Fortis has an exponentially larger customer base to which its operating and earned return are applied. In this regard, Stargas notes that the SSPOA's submission (Exhibit C1-2, page 9) includes Fortis Vancouver Island's $6.265 delivery rate and Fortis Whistler's delivery rate of $7.763, each of which is comparable to the proposed Stargas rate.

8. Stargas also submits that several matters raised by the SSPOA are outside the scope of the proceedings before the Commission in this Application:

(a) Commodity rates: Stargas is not seeking any change to commodity rates in this Application. Stargas filed an application with respect to its commodity rate on September 26th, 2016, which was approved October 28th, 2016 (BCUC Order G-158-16). To be of assistance to SSPOA, Stargas responded to a wide variety of SSPOA interrogatories in this regard that were not relevant to the determination of delivery rate.

(b) Fortis Alternate Energy Inc. ("FAES Contract"): The FAES Contract was approved by the Commission as being in the public interest pursuant to Section 23 of the *Utilities Commission Act* in Order G-93-09 and costs thereunder approved for inclusion in cost of service. The Contract's term ends in 2019, prior to which, Stargas will re-negotiate a service agreement with FAES (or other service provider) and seek Commission approval for any new agreement. In inspecting the Contract, SSPOA pursued issues that are relevant to the customer only in any renewed service arrangement. Stargas also notes that installation costs passed on with the authorized 10% mark-up (BCUC Order G 118-05), about which there was some questioning, are those embedded in Schedules attaching to the existing approved FAES Contract.

B. RETURN OF AND ON INVESTMENT/CAPITAL STRUCTURE

9. Stargas is entitled to a fair return on its invested capital.

10. Stargas submits that in considering a fair return on and of invested capital for Stargas investors, the Commission must not compromise Stargas' legitimate cost of service by imposing a deemed capital structure when, in consideration of the past and current circumstance, the BCUC acknowledged and approved an "unconventional" rate structure requisite to provide a fair return to Stargas investors.

11. Section 60 (1) (b.1) of the *Utilities Commission Act* (the Act) provides the following with respect to the Commission's rate-setting powers:

> (b.1) the commission may use any mechanism, formula or other method of setting the rate that it considers advisable, and may order that the rate derived from such a mechanism, formula or other method is to remain in effect for a specified period.

12. Section 60 (1) (b.1) provides the Commission considerable latitude in determining appropriate rate setting mechanisms, including with respect to fair return.

13. In Orders G 80-02, the Commission authorized the issuance of preferred shares in the amount of $400,000 with their dividend set at 75 basis points over benchmark. In Order G 163-06, where the Commission order the payment of a dividend on the preferred shares, the Commission described the circumstances that led to Order G 80-02 and the issuance of the cumulative preferred shares as follows:

> Stargas' shareholders are not allowed to earn a return on "notional equity" but they are allowed to earn a return on preferred shares. On August 15th, 2002, the Company applied to the Commission for approval to issue cumulative preferred shares in order to absorb cumulative losses in excess of $615,000 and recognize the "time value" of the shareholders' investment. Commission Order G 80-02 approved the issues of $400,000 of cumulative preferred shares .... In order to provide a return to its shareholders, Stargas is directed to pay a dividend on its outstanding cumulative preferred shares at a rate of 9.55%.

At the time of the Order G 163-06 the benchmark return on equity was 8.80 percent.

14. In BCUC Order G 157-12, the Commission acknowledged the circular relationship between those amounts included in its cost of service and Stargas investors being afforded a reasonable opportunity to earn a fair return on their invested capital. In order that the utility generate the funds necessary to provide that fair return, it is necessary that the amount thereof be included in cost of service. In that proceeding the BCUC approved the inclusion in cost of service, over twenty years, of preferred share dividends unpaid in Stargas' fiscal years 2002 through 2006.

15. In Order G 157-12, the Commission also determined that it was appropriate to include the cost of Stargas' return based on preferred share dividends in the utility's fiscal 2013 revenue requirement, as opposed to a conventional rate based mechanism. In making that determination, the Commission considered among other things, that Stargas intended to

rely on the preferred share dividend as a rate-setting mechanism in future applications and that the Commission had approved the issue of and dividend payable on the preferred shares in Order G 80-02.

16. During the course of the Streamlined Review Process ("SRP") when asked, Mr. Blumes agreed that the return a utility collects from its customers should also decrease as the rate base decreases. This Application (and its proposed delivery rate decrease) was initiated by Stargas in recognition, that while operating under a unique rate structure, as the utility matured, it should find equivalent reductions by replacing higher cost preferred shares with lower cost debt. As detailed in response to the second round of BCUC information requests (Exhibit B-13), Stargas' actual capital structure is 40% equity/60% debt on invested capital of $751,929. However, in the Application Stargas proposes to include in rates only the interest costs on the $100,000 of its long term debt used to fund the redemption of preferred shares, together with the dividend at 75 basis points over benchmark on the remaining $300,000 of preferred shares.

	Amount	Ratio	2017 Embedded Cost	WACC (note 1)	Cost of Debt Earned Return
	(A)	(B)	C	BxC=(D)	AxC=(E)
Operating line	$ 110,929	20.1%	3.95%	0.79%	$ 4,382
Long term debt	100,000	18.1%	3.95%	0.72%	3,910
Shareholder loans	40,000	7.2%	4.25%	0.31%	1,700
Preferred shares	300,000	54.4%	9.50%	5.16%	28,500
Common shares	1,000	0.2%	0.00%	0.00%	-
	$ 551,929	100.0%		6.98%	$ 38,492

17. Stargas' return on long term debt and equity $32,410 ($28,500 and $3,910) is not materially different than a calculated return using a more conventional mechanism of a deemed debt and equity return on rate base. At a 42.5% equity/ 57.5% debt ratio, on rate base of $502,928 (Exhibit B-9), the equivalent return is $31,729 ($213,744 @ 9.5% plus $289,184 @ 3.95%). Stargas will continue to monitor the relationship between its return on equity (that based on its preferred share dividend) and that calculated using a more conventional mechanism.

18. Stargas submits that its proposal, while unconventional, is in accordance with the Commissions' prior orders G 80-02 and G 163-06, reflects a reduction in delivery rate

equivalent to conventional methods, and continues to afford Stargas investors a reasonable return on their invested capital.

C. SHAREHOLDER ADVANCES

19. Stargas has also proposed to include the interest costs on shareholder advances of $40,000 in rates. CMI Holdings (1998) Inc. provides cash advances and corporate guarantees as required to backstop credit facilities provided by its banker, and in lieu of further preferred share investment. As the amounts advanced are subordinated to the bank's interest, Stargas submits that a return of 1% greater than that charged on its operating line is warranted, and that the amount thereof is properly included in cost of service.

D. MANAGEMENT FEES

20. Stargas has applied for a management fee of $78,173 payable to Okanagan Funding Ltd. ("OKF") within its test year cost of service; the amount is consistent with actual fees charged in the two prior fiscal years ($81,800 in fiscal 2016 and $79,915 in fiscal 2015) (Exhibit B-15, Stargas response to SSPOA IR #2 Question 3A). Included in the estimate for the test year are cost of living increases of 4.9%. Hourly rates for OKF personnel have remained unchanged since 2012, and the 4.9% increase is based on BC CPI over that period (Exhibit B-1, page 12).

21. Stargas submits that ratepayers receive full and fair value for the management services provided by OKF and the experience of the personnel involved. As described in Stargas' response to BCUC IR#1 Q10.3 (Exhibit B-2):

> Okanagan Funding consultants are well suited for the tasks they perform; Mr. M. Iles, a successful entrepreneur in his own right, handles administrative duties, Mr. M. Blumes, a CGA, has capably handled all of the accounting tasks of our enterprise at one time or another (currently limited due to primary employment and family responsibilities) and, the author of this response, a CPA, who in the past the CFO and small stakeholder in Silver Star Mountain Resort, the CFO and founding partner of Mark's Workwearhouse (and, for it the author of several best in Canada annual reports) and as a volunteer in his profession, three years on the

Canadian Institute of Chartered Accountants' Accounting Standards Board and nine years on its Emerging Issues Committee.

22. Stargas further submits that were it to source the services provided by OKF from a third party, that the rates involved would be higher than those accepted by OKF.

23. Executive Hourly Rate: The rate for Mr. Blumes' executive services was BCUC G115-05 set at $120 hours by BCUC Order G 115-05. Increases based on CPI have been approved in intervening years and is the basis upon which the rate sought in the current Application. Order G 115-5 stated that the rate should be at a "rate for a KPMG manager". Exhibit B-8 Q6.1 notes that a "Senior Manager / Manager" is currently charged at the rate of $215 to $275 per hour. If the position taken in G115-05 were to be advanced in the Stargas current Application, Stargas would be justified to include an increase for executive time within that range. Stargas submits that the hourly rates charged by OKF for executive time are demonstrably below market rates.

24. Accounting Hourly Rate: Exhibit B-8 Q6.1 also indicates that were KPMG to provide accounting services (as are provided by Mike Blumes) that the rate would range from $90 to $180. The applied for rate for these services, at $69.24 is 77% of the low end of the range of accounting services, if supplied by KPMG.

25. Administrative services hourly rate: Stargas has responded to the appropriateness of the proposed administrative hourly rate in response to BCUC IR#2 Question 16.1 (Exhibit B-13). Stargas notes that, as the first responder to Stargas customer enquiries, Mr. Iles duties involve considered answers to array of varied issues involving his making both timely and effective decisions and includes discussion of proposed solutions with Mr. Blumes where he considers executive input additive. Stargas submits that the rate sought is appropriate.

26. Both the Commission and Interveners questioned the quantum of hours and nature of tasks for various management activities included in Stargas' forecast.

27. Okanagan Funding notes that the responsibilities involved in Stargas management are tiered and that the functions involved range from administrative in nature, through

prudent financial management, operating in a sophisticated commodity market, to highly complex regulatory requirements. The hours required within each tier require timely responses to customer/supplier inquiries as well as attendance to scheduled tasks (example, approval of monthly draft billings). Administrative, accounting and executive tasks require differing skill sets and Stargas is, it submits, well served by the services provided by OKF.

28. As noted in response to SSPOA IR #2, Question 1A (Exhibit B-15), time is recorded according to the nature of the task (executive, accounting and/or administrative). For instance, Mr. Blumes if undertaking accounting tasks, records that time at the accounting rate and in dealing with issues out of the ordinary notes the causative circumstances. While unable to recover prior documentation, Stargas records for November and December 2016 support, as a reliable estimate, the $78,173 management fee estimate included in the test year as follows: Exhibit B-10 catalogued that months management cost at $6,711 (excluding executive time on the Application); and Exhibit B-13 (page 14) detailed 50 administrative hours in December 2016 and Exhibit B-10 detailed 49 administrative hours in November 2016. Stargas submits that the November actual time representative; twelve like months would result in a management fee of $80,400.

29. Stargas executive time within the current budget aggregates 171 hours as follows:

Monthly routines – 12 hours
Marketing and relationships – 55 hours
Annual credit review – 10 hours
Resource interface – 16 hours
Gas contracting – 35 hours
Annual report – 43 hours

30. The hours included for the above activities have been approved by Stargas based on what has been required historically, in consideration of continuing priorities (relationship with customers and suppliers), and includes (within marketing and relationships) additional hours based on perceived opportunities for Stargas with respect to strategic initiatives identified by and in coordination with Resort management. Stargas notes that the management fee management necessarily requires reconciling competing constraints;

satisfying the needs of customers and suppliers is, and must be, balanced against the cost incurred in providing services on a cost effective basis.

31. In Exhibit B-10, Stargas has also provided detailed information regarding the management services provided by OKF, including a detailed description of executive management activities, and the routines involved in providing service (Routine A – Cash Receipts Routines; Routine – Bank reconciliation routines; Routine C – Billing Cycle routines; and Routine D – Statutory Reports). Stargas provided a management budget breakdown by activity for the $78,173 in Exhibit B-13 at page 13. Stargas has also provided additional information in its filed materials, substantiating the forecast amounts and describing the activities undertaken in providing service, including: (a) administrative time for Contacts with Customers (Ex. B-13, response to IR 16.2); (b) executive time for Marketing and Relationships (Ex. B-13, response to IR 17.1); (c) executive time for Gas Contracting / Commodity rates (Ex. B-13, response to IR 18.1; Ex. B-15, response to Q 1A); (d) administrative activities required (Ex. B-2, response to IR 10.3).

32. Stargas submits that its forecast for management fees is reasonable and should be approved as filed.

E. RATE APPLICATION COSTS

33. Stargas acknowledges that its initial assessment of the process for this Application, as well as the time and fees required, was materially underestimated. Stargas submits that regulatory and legal costs related to the Application are properly related to the provision of service and are, therefore, recoverable through Stargas rates. The costs of Stargas' management and associated legal fees related to the Application are an integral and legitimate cost of Stargas' provision of utility service.

34. SSPOA counsel (Exhibit C1-8) suggests that were Stargas to "true up" its costs, the SSPOA would not oppose Stargas doing so if the costs were subject to a future process. Stargas submits that its estimate for the time required for Mr. Blumes related to this Applications, and that for legal counsel are reasonable and not excessive, nor are they an

inefficient use of resources. In this regard, Stargas notes that the fees proposed to be included in Stargas rates for legal counsel are in compliance with the Commission's Participant Assistance/Cost Award ("PACA") guidelines. Rather than incur additional costs (both legal and management) in a further process, Stargas would, if so ordered, accept in lieu of a "true up" of its costs, the risk for any cost beyond its current estimate. Based on time and costs incurred to date, those costs will likely exceed the $37,500 included in Stargas' current forecast.

35. Stargas refutes SSPOA suggestions (in Exhibit C1-8) that updates to "virtually" real time "harmful" to ratepayers. It is not unusual in the course of regulatory proceedings to update forecasts as new information becomes available. Stargas could not reasonably have been expected to have prepared its initial forecast of rate application costs in the expectation that the SSPOA would require a range of answers to questions many of which are not relevant to setting of the Stargas delivery rate. Further some of the updates provided have the effect of reducing the contemplated delivery rate. Stargas likewise disagrees that its filings have been duplicative. While minor errors have been corrected, such correction time is negligible. Correction of minor calculation errors is also not an unusual occurrence in rate proceedings. If the SSPOA is to make a PACA claim, Stargas likewise submits that should Stargas be required to reimburse the SSPOA for those costs, that any such amount is properly recoverable in its rates.

F. SILVER STAR COMMUNITY CONSIDERATIONS

36. Stargas has supplied extensive responses to questions raised by both Commission staff and the SSPOA, and its senior executive, to the best of his ability, answered questions posed at the SRP. While Stargas had in prior applications satisfactorily dealt with regulatory requirements, the current proceedings have, in their complexity, lead Stargas to introduce independent legal counsel.

37. As noted above, the SSPOA pursued matters not relevant to the issues in this proceeding. Stargas submits there is a mixed message in the submissions of the SSPOA; the association appears to seek more on-site visits and greater Stargas presence, but suggests that such increased involvement should come at a lesser cost. Stargas remains proud of

bringing natural gas to the resort, and in the continued value brought to the resort in its supply of lower cost and safer natural gas as an alternative to propane.

G. CONCLUSION

38. Stargas asks that its proposed rate of $7.08 be approved as permanent with effect from November 1, 2016.

ALL OF WHICH is respectfully submitted this 3rd day of February, 2017:

STARGAS UTILITIES LTD.