British Columbia Utilities Commission

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VIA EFILE
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November 2, 2016

STARGAS DELIVERY RATE
EXHIBIT A-3

Mr. M. A. Blumes
President
Stargas Utilities Ltd.
1960 K.L.O. Road
Unit 17
Kelowna, BC V1W 5L2

Dear Mr. Blumes:

Re: Stargas Utilities Ltd.
Application to Vary Delivery Rate, Amend Cost of Service Formula and
Approve Replacement Term Financing/Redemption of Preferred Shares

Further to Commission Order G-155-16, which established a regulatory timetable with respect to the above noted proceeding, enclosed please find Commission Information Request No. 1.

In accordance with the regulatory timetable, please file your responses electronically with the Commission by Monday, November 14, 2016.

Yours truly,

Original signed by:

Laurel Ross

BG/cms
Enclosure

STARGAS UTILITIES
Application to Vary Delivery Rate, Amend Cost of Service Formula and Approve Replacement Term Financing/Redemption of Preferred Shares

TABLE OF CONTENTS **PAGE NO.**

A. COVER LETTER

1.0 Reference: COVER LETTER
Exhibit B-1, Application
Anticipated volumes

On page 1 of the cover letter, Stargas states that its proposed variation in the delivery rate charge to customers "is based on anticipated volumes of 40,683.7 gigajoules in the test year (fiscal 2017)."

1.1 Please explain how the forecast F2017 40,683.7 gigajoules (GJs) was determined and why Stargas anticipates F2017 volumes to be 2.38% higher compared to F2016 actual volumes of 39,738.60 (GJs) in F2016, as seen on page 17 of the Application.

B. SHAREHOLDER ADVANCES

2.0 Reference: AMENDMENTS TO COST OF SERVICE
Exhibit B-1, p. 2; Stargas Utilities Ltd. Annual Report for the Fiscal Year Ended May 31, 2016 (2016 Annual Report), Financial Statements for the Year Ended May 31, 2016 (2016 Financial Statements); Order G-163-06, Appendix A, Section 4.3, pp. 5-6; Stargas 2006 Application for Approval to Alter Rates (2006 Application), Sections III, VI, pp. 2, 6
Shareholder advances

On page 2 of the Application Stargas states:

> Stargas seeks BCUC approval to include interest of shareholder advances in the determination of its cost of service. CMI Holdings (1998) Inc. (Stargas parent company) and its shareholders' provide cash advances and personal guarantees as "backstops" to its banks requirements with respect to the operating facility utilized to cover seasonal cash flows and to finance receivables.

2.1 Please confirm that Stargas is NOT seeking approval in this Application for loan guarantees for financing from the personal guarantees of shareholders and companies controlled by those shareholders, as denied in Appendix A to Order G-163-06 (Section 4.3).

2.2 Please show the calculation of the interest on shareholder advances, personal guarantees and "backstops" that Stargas proposes to include in the F2017 cost of service.

As stated on page 6 of Appendix A to Order G-163-06, "the Commission accepts a 6 percent interest rate applied to shareholder loans and current loans from affiliated companies." In Section VI of the 2006 Application, Stargas states the prime interest rate is 5.5 percent; in section III of the 2006 Application, Stargas submits that the interest rate on its TD Bank Loans is 7.07 percent and 7.00 percent, respectively.

Stargas states on page 4 of the Application, "As of September 12th, 2016 the bank has indicated that the rate fixed for 1, 2, or 3 years would be 3.61%, 3.83% or 3.95% respectively; if Stargas opts to float with prime, the current rate would be 3.95%. The attached projections assume a rate of 3.95% throughout."

2.3 Please comment whether the interest rate applied to shareholder loans and current loans from affiliated companies should be reduced given that interest rates on bank debt have fallen since 2006 from 7% to approximately 4%.

2.4 In accordance with Directive 12 of Order G-163-06, please "separately identify shareholder loans and the amounts due to affiliated companies in the Company's capital structure."

C. TERM BANK LOAN

3.0 Reference: TERM BANK LOAN
Exhibit B-1, p. 4, Balance Sheet as at May 31, 2017, Income Statement for the Test Year Ending May 31, 2017; 2016 Annual Report, 2016 Financial Statements, Note 4; Order G-148-10
Existing term loan

By Order G-148-10 dated September 30, 2010, the Commission approved the consolidation of "two term loans aggregating $462,861 at August 31, 2010 into a single 10-year loan with an annual interest rate of prime plus 1.5 percent."

On page 4 of the Application Stargas states, "As at May 31, 2016 the utility's [existing] committed reducing term bank loan had been reduced to $208,388 and, absent the proposed loan, would be further reduced to $163,259 by the end of the test year."

3.1 Please confirm, or otherwise explain, that Stargas' existing committed reducing term loan referred to in this Application is the single 10-year loan approved by Order G-148-10.

The table below has been prepared by Commission staff on the basis of information included in the balance sheet and income statement as at and for the test year ending May 31, 2017:

Existing Term Loan Repayment Schedule

Month	Total Payment	Principal	Interest	Loan Balance
31-May-16				208,388
30-Jun-16	4,348	3,706	642	204,682
31-Jul-16	4,347	3,653	694	201,029
31-Aug-16	4,348	3,749	599	197,280
30-Sep-16	4,026	3,377	649	193,903
31-Oct-16	4,026	3,388	638	190,515
30-Nov-16	4,026	3,399	627	187,116

3.2 Please confirm, or correct, the Existing Term Loan Repayment Schedule for the period May 31, 2016 to November 30, 2016 prepared by Commission staff.

3.2.1 In the same format as above, please extend the loan payment schedule to include the monthly loan balance, principal payment, and interest payment on the existing term loan from the initial drawdown of the loan through to the maturity date of the loan.

4.0 Reference: TERM BANK LOAN
Exhibit B-1, pp. 4-5
Redemption of preferred shares/replacement term loan

On page 4 of the Application Stargas states, "The Utility's banker has authorized a replacement committed reducing term loan of $300,000; its proceeds will be used to retire existing term debt and to redeem 1,000 Class G preferred shares of Stargas having a par value of $100,000. The replacement loan is conditioned upon BCUC approval of the refinancing/change in the calculation of 'cost of service'."

4.1 Please confirm that Stargas is seeking Commission approval to redeem 1,000 Class G preferred shares having a par value of $100,000 pursuant to section 50(30)(b) of the *Utilities Commission Act*.

4.2 Please discuss and provide the transaction costs, if any, associated with the redemption of the 1,000 Class G preferred shares of Stargas. Please also explain how Stargas proposes to recover these transaction costs (i.e. expense, defer, or amortize and for which period).

4.3 Please confirm the table below prepared by Commission staff is accurate and provide additional information explaining how the remaining $12,884 from the $300,000 replacement term loan will be used. If no plans exist, please confirm whether the full amount of the $300,000 will be drawn down or only the amount which will be sufficient to retire existing term debt and redeem 1,000 preferred shares at the time of the transaction.

	Reference	Balance
Retire existing term loan	Page 5 - forecast Nov 30, 2016	$ 187,116
Redeem 1,000 Class G preferred shares		100,000
?		12,884
Proceeds of replacement term loan		$ 300,000

4.4 Please discuss and provide the transaction costs, if any, pertaining to Stargas' refinancing plans, including debt retirement penalties and borrowing charges. Please also explain how Stargas proposes to recover these transaction costs (i.e. expense, defer, or amortize and for which period).

On page 5 of the Application Stargas states, "Replacing preferred share investment with term debt will benefit customers – lower cost bank financing will allow for a meaningful reduction in delivery rates. Stargas can proceed to do so, however, only if amendments to its cost of service formula establish a basis from which revenues can be generated in amounts necessary to cover both principal and interest payments on its term debt."

4.5 Please elaborate on the reasons why Stargas' refinancing plans are contingent upon the Commission's approval of a change in the cost of service formula.

4.6 If the Commission were to deny Stargas' request for either: a) changes in the calculation of cost of service; or b) the redemption of $100,000 in Class G preferred shares, would Stargas still proceed with refinancing? If not, why not? Please discuss both scenarios.

On page 4 of the Application Stargas states:

> At the company's option, interest [on the replacement term loan] is to float 1.25% over prime or be fixed for whatever period selected by Stargas… As of September 12th, 2016

the bank has indicated that the rate fixed for 1, 2, or 3 years would be 3.61%, 3.83% or 3.95% respectively; if Stargas opts to float with prime, the current rate would be 3.95%. The attached projections assume a rate of 3.95% throughout.

4.7 Please discuss the reasons why Stargas prepared its projections assuming the higher floating rate of 3.95%. Does Stargas intend to select the option to float with prime for the replacement term loan?

On page 4 of the Application Stargas states, "If the current refinancing is approved, at May 31, 2017 bank debt would approximate $277,000…"

4.8 Please clarify whether the estimated bank debt at May 31, 2017 of $277,000 includes any amounts drawn on Stargas' operating line. If yes, how much?

Stargas notes on page 5 of the Application, "the additional term loan will be drawn at the later of December 1st, 2016 and the date of approval for the application… however, for rate setting purposes, we've assumed the additional financing and preferred share redemption to have taken effect on June 1st, 2016."

4.9 In the same format as is provided on page 17 of the Application, please provide a revised projected delivery rate schedule under the proposed cost of service methodology which is consistent with Stargas' plan to drawdown the replacement term loan on December 1, 2016 and to redeem $100,000 of Class G preferred shares at that time.

4.10 Please confirm Stargas seeks approval for a variable delivery rate of $6.93 per gigajoule, which will be less than the delivery rate associated with the drawdown of the replacement term loan and redemption of preferred shares on December 1, 2016.

The table below has been prepared by Commission staff on the basis of information included in the balance sheet and income statement for the forecast test year ending May 31, 2017:

Replacement Term Loan Repayment Schedule

Month	Total Payment	Principal	Interest	Loan Balance
01-Dec-16				300,000
31-Dec-16	4,687	4,358	329	295,642
31-Jan-17	4,686	3,713	973	291,929
28-Feb-17	4,687	3,726	961	288,203
31-Mar-17	4,687	3,738	949	284,465
30-Apr-17	4,686	3,750	936	280,715
31-May-17	4,687	3,763	924	276,952

4.11 Please confirm, or correct, the Replacement Term Loan Repayment Schedule prepared by Commission staff.

4.11.1 Please extend the loan repayment schedule above through to the expected maturity date of the replacement term loan, and show the final projected lump sum payment on November 30, 2021.

On page 4 of the Application Stargas states, "Based on the company's history and its forecasts, the covenant of CMI and its shareholders, management obtained the commitment for the replacement term loan…" (Emphasis added).

4.12 Please explain what is meant by "the covenant of CMI and its shareholders." Is this in reference to page 3 of the TD Bank Commitment letter which states, "So long as any amounts remain outstanding and unpaid under this Agreement or so long as any commitment under this Agreement remains in effect, the Borrower will and will ensure that its subsidiaries and each of the Guarantors will observe the Standard Positive Covenants set out in Schedule "A"…"? Please clarify whether CMI and the shareholders of CMI are the guarantors?

4.12.1 Please provide, as a confidential response, Schedule "A" of the TD Bank Commitment letter.

D. FINANCIAL SCHEDULES

5.0 Reference: TEST YEAR FORECAST (INCLUDING PROPOSED REFINANCING)
Exhibit B-1, pp. 6-7
Balance sheet and income statement as at and for the test year ending May 31, 2017

Stargas forecasts net income for the test year ending May 31, 2017 of $33,019, and a deficit of $(239,598) as at May 31, 2017 compared to an opening deficit of $(232,573). The calculated change in Stargas' deficit is $(7,025).

5.1 Please reconcile the difference between the forecast change in Stargas' deficit to its forecast net income for the test year ending May 31, 2017. Please provide revised forecast test year balance sheets and income statements, as necessary.

6.0 Reference: AMORTIZATION
Exhibit B-1, p. 3
Property & equipment and deferred charges

6.1 Please extend the property and equipment and deferred charges continuity schedule on page 3 of the Application until fully amortized. Please include annual amortization and accumulated amortization for each year, and ensure that the net book value of all amounts is $0 at the end of the amortization period.

7.0 Reference: DELIVERY COMPONENT OF OUR RATES – COST OF SERVICE
Exhibit B-1, pp. 10, 17; Order G-129-16
Preferred share dividend

On page 10 of the Application, Stargas presents the following three tables:

		As proposed		As proposed	
As Presently Constituted	**Test Year**	Without Refinancing	**Test Year**	With refinancing	**Test Year**
	2017		2017		2017
Operations & maintenance	$119,882	Operations & maintenance	$ 119,882	Operations & maintenance	$ 119,882
Administration	122,426	Administration	122,426	Administration	122,426
Income tax	9,000	Income tax	9,000	Income tax	9,000
Net, meters and lines	(170)	Net, meters and lines	(170)	Net, meters and lines	(170)
Basic charges	(62,990)	Basic charges	(62,990)	Basic charges	(62,990)
Sundry revenue	(4,073)	Sundry revenue	(4,073)	Sundry revenue	(4,073)
Annual dividend	41,000	Annual dividend	41,000	Annual dividend	28,500
Catch up dividend arrears	6,794	Catch up dividend arrears	6,794	Catch up dividend arrears	6,794
Interest - operating line	4,129	Interest - operating line	4,129	Interest - operating line	4,129
Amortization	54,804	Interest - shareholders	2,400	Interest - shareholders	2,400
		Payments - term debt	52,173	Payments - term debt	56,241
Cost of Service	$290,801	Cost of Service	$ 290,570	Cost of Service	$ 282,138

By Order G-80-02, the dividend on the Stargas' preferred shares is to be calculated using the Commission's benchmark return on equity plus 75 basis points. As stated in Order G-129-16, the Commission's benchmark return on equity is 8.75 percent, effective January 1, 2016.

7.1 Please confirm whether the annual dividend in the first and second table should be $38,000, rather than $41,000. If yes, please provide revised tables with the correct preferred share dividend amount. If no, please explain why not.

7.1.1 In the schedule on page 17 of the Application, please clarify whether the forecast 2017 preferred share dividend should be $28,500 under the proposed cost of service methodology and whether the forecast F2017 to F2024 preferred share dividend should be $38,000 under the current cost of service methodology. If yes, please provide revised schedules for page 17 of the Application. If no, please explain why not.

7.2 Please provide the calculation of the annual preferred share dividends included in Stargas' cost of service and rates from F2011-F2016.

7.3 Please explain the difference in the third table between "Payments – term debt" of $56,241 and "Term debt – principal & interest" of $53,242 in the schedule on page 17 of the Application (projected cost of service, proposed methodology). For clarity, please provide the correct payment amount (including principal and interest) and revise either table three on page 10 or page 17 of the Application, as needed.

7.4 In the same format as the three tables presented on page 10 of the Application, please provide two additional tables using the current cost of service methodology for the following scenarios:

- The cost of service calculated with proposed refinancing and redemption of preferred shares; and
- The cost of service calculated with refinancing sufficient to retire existing term debt only (i.e. draw down of replacement term loan will be used to retire existing term debt only and there will be no amounts drawn to redeem 1,000 Class G preferred shares).

E. COST OF SERVICE

8.0 Reference: AMENDMENTS TO COST OF SERVICE
Exhibit B-1, p. 1
Amortization

On page 1 of the Application Stargas states:

> Stargas is proposing to replace amortization in the cost of service calculation with debt service and has, in negotiating the terms of its proposed replacement term loan structured the terms of repayment so as to reflect meaningful reductions in the amount that would otherwise be included in that determination.

8.1 Please confirm, or otherwise explain, that Stargas is proposing to forgo and never recover the amortization which has been replaced by debt service charges.

9.0 Reference: DELIVERY COMPONENT OF OUR RATES - ADMINISTRATIVE COSTS
Exhibit B-1, p. 12
Administrative costs

9.1 Please provide a breakdown of historical actual administrative costs for F2014, F2015, and F2016 by completing the table below.

	Actual 2014	Actual 2015	Actual 2016
Professional fees			
Office and sundry			
Insurance			
Management fees			
Total Administrative Costs	117,798	114,999	120,656

10.0 Reference: DELIVERY COMPONENT OF OUR RATES - ADMINISTRATIVE COSTS
Exhibit B-1, pp. 8, 10, 13; Stargas Utilities Ltd. August 17, 2012 Application to Alter Rates (2012 Rates Application), Exhibit B-1, Attachment B-5, p. 2
Management budget submitted by Okanagan Funding Ltd.

On page 10 of the Application Stargas states, "Fortis BC Alternate Energy Services Inc. [FAES] provides all of the physical aspects of the operation of the utility as well as certain of its administrative functions… the contracted services include emergency standby and response, system maintenance, leak survey and remedial action, meter servicing and replacement, as well as general oversight and operating responsibility." (Emphasis added).

On page 13 of the Application, Stargas presents the management budget submitted by Okanagan Funding Ltd. for the test year ending May 31, 2017.

10.1 Please elaborate on the nature of the administrative functions provided by FAES and explain how these functions differ from the administrative services provided by Okanagan Funding Ltd.

10.2 Please explain the 20 administrative hours which has been budgeted by Okanagan Funding Ltd. for the test year ending May 31, 2017 relating to "Incidents". What is the nature of these hours and how do these differ from FAES hours spent on "emergency standby and response"?

10.3 Please provide a description of each of the following activities, a high level explanation of the number of budgeted hours, and an explanation of how each activity is necessary for and provides benefits to Stargas' customers:

1. Enter read report/follow-up
2. Check message line/follow-up
3. Contacts with Customers
4. Liaison with Fortis
5. Oversight
6. Marketing and relationships
7. Interface with Resort

On page 8 of the Application Stargas states:

> Natural gas is supplied to the resort at a significantly lower cost than other heating alternatives… The average customer would pay $966 plus our fixed monthly charge of $15 and carbon tax of $119 or a total of $1,265 for a full year's supply of natural gas. At an average of 65 cents per liter with two deliveries and applicable carbon tax, propane customers' would pay $2,234 for their consumption of that alternative. Customers using electricity would pay $2,147 for the equivalent volumes of natural gas (at an average of .089423 cents per KwH).

10.4 Given Stargas' opinion that the cost of natural gas is significantly lower than other heating alternatives, should marketing costs be reduced? Please explain why, or why not.

10.4.1 Please provide the annual marketing and relationships costs per customer for F2014-F2016.

10.5 Please explain why "Financial Statement preparation" is classified as executive time, whereas, "Work papers for KPMG" is classified as accounting time.

10.6 In the same format as is provided on page 13 of the Application, please provide budget and actual accounting, administrative, and executive hours for Okanagan Funding Ltd. for F2012 to F2016, and F2017 year-to-date.

On page 13 of the Application, Stargas includes a contingency rate of 4% on budgeted accounting, administrative, and executive hours in the calculation of total estimated management fees for the year ended May 21, 2017.

On page 2 of Attachment B-5 in the 2012 Rates Application, Stargas includes a contingency rate of 2% on budgeted accounting, administrative, and executive hours in the calculation of total estimated management fees for the year ended May 21, 2010.

10.7 Please explain the increase in the contingency rate on accounting, administrative, and executive hours from 2% in the 2012 Rates Application to 4% in the current Application. In addition, please explain why a contingency is necessary.

On pages 1 and 2 of Attachment B-5 in the 2012 Rates Application, Stargas presents the management budget submitted by Okanagan Funding Ltd. for the test year ending May 31, 2013.

10.8 Please explain the following increases in management budget hours between test year 2013 and test year 2017:

Activity	Test Year 2013 (hours)	Test Year 2017 (hours)	Increase (hours)
Collection/follow up	44	57	13
Billing enquiries, file changes	48	62	14
Contacts with customers	61	69	8
Liason with Fortis	52	56	4
Gas Contracting/commodity rates	29	35	6
Financial statement preparation	8	10	2
Rate application - commodity	11	25	14

In the footnote on page 13 of the Application Stargas states, "The above [management budget] doesn't include the $6,000 (rounded) estimate of accounting and executive time contemplated for the full rate case."

10.9 Please provide a breakdown of the $6,000 estimate into accounting and executive time by hours and dollars.

10.10 Please provide the rate impact of deferring and amortizing the rate case cost over two years.

10.11 Please provide actual management fee hours and dollars used by Okanagan Funding Ltd. to prepare the 2012 Rates Application.

F. PROJECTED DELIVERY RATES

11.0 Reference: PROJECTED DELIVERY RATES
Exhibit B-1, p. 17; Order G-80-02; Order G-129-16; Order G-155-16
Projected delivery rates

11.1 Given the forecast decrease in the cost of service under both the proposed and current cost of service methodologies shown on page 17 of the Application, does Stargas plan to file applications for delivery rate decreases from F2018 to F2024?

In the schedule on page 17 of the Application, Stargas shows forecast F2017 net installation/service revenue of $170.

11.2 Please explain how the forecast $170 F2017 net installation/service revenue was determined. Why is net installation/service revenue forecasted to decrease by $2,290 compared to F2016?

On page 17 of the Application, Stargas presents the forecast cost of service and delivery rate to customers for F2017 to F2024 under the current cost of service methodology by adding and subtracting certain items/amounts from the proposed cost of service methodology.

11.3 Please recast the forecast F2017 to F2024 cost of service and delivery rate under the current cost of service methodology without comparing to the proposed cost of service methodology (i.e. please show the total forecast amount for all relevant line items in the current cost of service methodology.)

11.3.1 Please explain/reconcile the difference in F2017 cost of service of $293,201 on page 17 of the Application under the current cost of service methodology and the $290,801 in the first table on page 10 of the Application. Is the difference due to Stargas' application for approval of $2,400 in interest on shareholder advances in the determination of cost of service? If not, please explain.

On page 17 of the Application, Stargas shows forecast F2017 "Term debt – principal & interest" of $53,242.

11.4 Please show the calculation of the $53,242 term debt (principal & interest) payment.

Directive 3 of Order G-155-16, dated October 6, 2016, directed Stargas to file the interim tariff pages with the Commission within 10 business days of the issuance of the order. Furthermore, Stargas has not filed tariff pages with the Commission to reflect gas cost and return on equity changes since 2012.

11.5 Please explain why, as of November 2, 2016, Stargas has not complied with Directive 3 of Order G-155-16. Please also explain why Stargas has not filed tariff pages with the Commission to reflect gas cost and return on equity changes since 2012.

G. RETURN OF INVESTMENT/ CAPITAL STRUCTURE

12.0 Reference: REPLACEMENT TERM LOAN
Exhibit B-1, p. 4; Exhibit A2-1, p. 2
Return of investment

On page 1 of the Application Stargas states:

> Stargas is proposing to replace amortization in the cost of service calculation with debt service… The inclusion of the current level of amortization in cost of service/delivery rate generates revenue in an amount that approximates the funds required to service the term loan… A similar equivalence will repeat in each of the test (fiscal 2017) and two following fiscal years but thereafter, having full amortized deferred amounts the utility will record reduced amortization expense. While amortization currently serves as a <u>surrogate</u> for debt service, it will not thereafter.

Furthermore, on page 4 of the Application Stargas states:

> While CMI, its shareholders, currently enjoy the current level of return on their investment, under the current regulatory model there is no prospect of a return of their investment given that amortization as a surrogate for debt service will, after a further three years at its current level, reduce to $16.076 [sic] (an amount that would generate revenue in an equivalent amount sufficient to service only the current term debt).

Page 2 of Exhibit A2-1 states:

> Depreciation rates are established to afford a regulated enterprise the opportunity to recover its capital investment (i.e. return of capital).

12.1 Given that amortization/depreciation provides a "regulated enterprise the opportunity to recover its capital investment" please explain Stargas' statement that "under the current regulatory model there is no prospect of a return of their investment given that amortization as a surrogate for debt service."

12.2 Please explain why Stargas considers amortization to be a surrogate for debt service.

12.2.1 Please explain why Stargas is not requesting both the recovery of amortization *and* of debt service in cost of service.

12.3 Please provide Stargas' annual amortization expense for F2014-F2016.

12.4 Please provide Stargas' actual capital structure for F2014-F2016 and forecast F2017.