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## Electronic Filing

British Columbia Utilities Commission  
Suite 410, 900 Howe Street  
Vancouver, BC V6Z 2N3

**Attention: Ms. Marija Tresoglavic, Acting Commission Secretary**

Dear Sirs/Mesdames:

**Re: FortisBC Alternative Energy Services Inc. – Application for Approval of the Fiscal 2020/2021 Annual Cost of Service and Cost of Service Rate for the Thermal Energy Service to Delta School District No.37 – Project No. 1599106**

We enclose for filing in the above noted proceeding the Reply Submissions of FAES.

Yours truly,

**FASKEN MARTINEAU DuMOULIN LLP**

*[Original signed by]*

Matthew Ghikas  
Personal Law Corporation

MTG/lh



**BRITISH COLUMBIA UTILITIES COMMISSION**

**IN THE MATTER OF**

**THE *UTILITIES COMMISSION ACT*  
RSBC 1996, CHAPTER 473**

**and**

**FORTISBC ALTERNATIVE ENERGY SERVICES INC.**

**FISCAL 2020/21 APPLICATION FOR COST OF SERVICE RATE FOR THE THERMAL  
ENERGY SERVICE**

**TO DELTA SCHOOL DISTRICT NUMBER 37**

**REPLY SUBMISSIONS OF FORTISBC ALTERNATIVE ENERGY SERVICES INC.**

**August 11, 2020**

FASKEN MARTINEAU DuMOULIN LLP  
Matthew Ghikas

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## A. INTRODUCTION

1. The Delta School District (“DSD”) takes the position that the deemed debt rate should be based on credit spreads between 10-year debt for BBB-rated distribution utilities (such as AltaGas Ltd. and Emera Inc.). This proposal represents a departure from the parties’ agreement to use a 20-year rate. It differs from how the BCUC-approved rates were determined for the past seven years. Maintaining the current treatment is appropriate, not because the BCUC is legally precluded from changing it (the BCUC always has that power), but because the current treatment is just and reasonable. The DSD’s arguments to the contrary, addressed below<sup>1</sup>, are without merit.

## B. THE 2012 COMPLIANCE FILING DID ADDRESS THE 20-YEAR TERM

2. The DSD focuses in paragraph 5 on the fact that the Rate Design Agreement and the Service agreements are silent regarding the term of debt to use. However, the Compliance Filing to Order G-31-12 included specific details about the 20-year rate and interpolation. The Compliance Filing forms part of the contractual matrix, and the BCUC should uphold it barring a compelling reason to depart from it.

3. The DSD is a sophisticated commercial party.<sup>2</sup> It not only signed the Compliance Filing, but also accepted FAES’s use of the methodology in applications over the next seven years.

4. In paragraph 8, the DSD minimizes its endorsement of the Compliance Filing to Order G-31-12 by characterizing the Compliance Filing as “only submitted for the purpose of determining an initial deemed debt rate, which was expressly subject to further BCUC review and approval on an annual basis, pursuant to BCUC Order G-71-12.” DSD goes on to assert in paragraph 9: “While the BCUC approved a deemed debt rate on the basis of the 20-Year Debt Rate proposed by FAES in Order G-71-12 and its accompanying Reasons for Decision, in doing so, it did not expressly direct FAES to use a 20-Year Debt Rate.” In fact:

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<sup>1</sup> FAES has focussed on the DSD’s main arguments, such that FAES’s silence should not be interpreted as agreement.

<sup>2</sup> 2012 Decision, page 70.

- The Compliance Filing included an agreed debt rate setting methodology for the entire 20-year initial term, not just “for the purpose of determining an initial debt rate”. The methodology explicitly referenced interpolated 20-year debt rates.<sup>3</sup> The adjustments to the agreed methodology directed by the BCUC at that time related to updating the interest rate forecasts and the choice of proxy companies. The BCUC did not vary the debt term, leaving the agreement intact.
- The BCUC’s direction to use, in the absence of an Interest AAM, “the same methodology as directed in this Order and accompanying Reasons for Decision” was unequivocal. It referred to the same methodology that FAES has been using, without objection by the DSD, for the past seven years.

5. As the DSD observes in paragraph 8, the BCUC is always able to revisit its directions. However, the fact that the BCUC *can* make changes to the methodology is not itself a reason to make changes. We explain next why the DSD’s two related justifications - the Generic Cost of Capital (“GCOC”) Stage 2 Decision and the use of a 10-year debt rate for other thermal energy projects - are not compelling.

#### **C. THE DSD IS RELYING ON INAPPLICABLE PASSAGES OF THE GCOC STAGE 2 DECISION**

6. The DSD’s primary rationale for changing the methodology is the BCUC’s GCOC Stage 2 Decision. In paragraph 12, the DSD quotes from the BCUC’s GCOC Stage 2 Decision that the “...default debt component of the capital structure is set to track a benchmark credit spread that reflects BBB or BBB (low) rated debt relative to the 10 year Government of Canada bond yield.”<sup>4</sup> However, a complete reading of section 3.4 of the GCOC Stage 2 Decision makes it clear that this quote is inapplicable to the DSD project.

7. The BCUC was explicit in the GCOC Stage 2 Decision that it only applied to the multi-customer Stream B district energy utilities specifically listed in the Decision. The BCUC stated in part<sup>5</sup>:

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<sup>3</sup> BCUC IR1 2.2 (See calculation table in the quote from the Compliance Filing).

<sup>4</sup> GCOC Stage 2 Decision (dated March 25, 2014), p. 123.

<sup>5</sup> GCOC Stage 2 Decision, p. 116.

In accordance to the TES Regulatory Framework, the Stream B utilities that require a deemed capital structure and a risk premium above the Benchmark ROE are:

- FAES Kelowna DES;
- Dockside green Energy;
- Corix UniverCity;
- Central Heat;
- River District Energy.

The relevant conclusions from the Contextual Issues discussions are as follows:

- As a result of the TES Regulatory Framework, the determinations from this Stage 2 proceeding will only apply to the utilities identified above as Stream B utilities. (Section 2.3.2) [Emphasis added.]

8. The considerations outlined in the GCOC Stage 1 Decision thus remained applicable to the DSD. To recap, the BCUC had stated in the Stage 1 Decision:

The Commission Panel has already found that the cost of deemed long-term debt (rate and term) for each utility should be addressed separately on a case by case basis. Based on this, the Panel recommends that on a go-forward basis the FBCU's Option 1 be used as a guideline for setting the deemed debt rate.<sup>6</sup>

FAES's response to BCUC IR1 2.4, discussed in FAES's Final Submissions, provides its analysis using "FBCU's Option 1". The analysis suggests a debt term *longer* than 20 years, not shorter.

**D. THE DSD IS MAKING INAPT COMPARISONS TO OTHER UTILITIES, AND SELECTIVELY APPLYING THE DECISIONS**

9. The DSD cites three thermal energy projects. It maintains in paragraph 16 that there is "no material distinction between the thermal energy projects in the above-noted BCUC decisions and the one at issue in this proceeding that would warrant a departure from the methodology approved by the BCUC in respect of these other projects." There are three answers to this argument, discussed below.

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<sup>6</sup> GCOC Stage 1 Decision, p. 110.

[https://www.bcuc.com/Documents/Decisions/2013/DOC\\_34706\\_05-10-2013-BCUC-GCOC-Stage1DecisionWEB.pdf](https://www.bcuc.com/Documents/Decisions/2013/DOC_34706_05-10-2013-BCUC-GCOC-Stage1DecisionWEB.pdf).

**(a) Multi-Customer District Energy Systems Give Rise to Different Regulatory Considerations**

10. There is a material distinction between this case and the three other utilities cited by the DSD for which the BCUC had approved a 10-year debt term.

11. All three of the DSD's examples are Stream B multi-customer district energy utilities that, unlike the DSD's system, were the subject of the GCOC Stage 2 Decision.

12. A multi-customer district energy system provides service to various end users under a more traditional tariff structure. The DSD, by contrast, is a sophisticated commercial party that has negotiated and agreed to terms in the context of a competitive environment for thermal energy services. The agreed terms of service are still subject to BCUC review, but the BCUC recognizes that negotiated outcomes are a relevant consideration.

13. The BCUC addressed this difference specifically in the BCUC Proposed TES Regulatory Framework and Guidelines Decision:

An on-site TES system is less likely to restrict a customer's choice than is a district energy system - which has the potential to cover substantial areas, thus limiting choice appreciably - provided there are sufficient on-site TES providers.<sup>7</sup>

14. The BCUC, in its 2012 DSD Decision, had noted the DSD's sophistication:

The Panel agrees with Delta SD that regulatory oversight can provide protective benefits. However, the Panel cautions Delta SD that in providing regulatory oversight of this Project and the ensuing rates, the BCUC must make a determination of what it considers to be just and reasonable. The Panel will consider the fact that the rates proposed have been agreed to by two sophisticated commercial parties, fully capable of representing themselves, that the agreements signed are a result of arms-length negotiations, represented by competent legal counsel; and that the DSD has its own accountability mechanisms in place such as elected trustees to ensure that its interests are protected.<sup>8</sup>

In the present context, the fact that the parties have agreed to use 20-year debt terms should be persuasive.

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<sup>7</sup> BCUC Proposed TES Regulatory Framework and Guidelines Decision, p. 26.

<sup>8</sup> 2012 Decision, page 70.

**(b) There is No Evidence to Suggest the Cited Utilities Are Comparable**

15. The DSD has not sought to adduce any evidence to demonstrate the comparability of FAES's cost of capital for this project with the other utilities on a risk-adjusted basis.

**(c) The DSD is Applying the GCOC Stage 2 Principles Selectively**

16. The DSD is also being selective in its desire to adopt the GCOC Stage 2 principles applicable to the listed Stream B district energy systems. A utility's cost of capital is determined by the combination of (i) the debt/equity ratio, (ii) return on equity ("ROE") and (iii) the debt return. The GCOC Stage 2 Decision addressed all three elements. While the DSD likes how the Stage 2 Decision determined the debt cost for the listed district energy systems, the DSD is silent on the debt-equity ratio and the allowed ROE. The district energy systems cited by the DSD are allowed more equity in their capital structures, and their allowed ROE is higher than FAES's allowed ROE. The logical result of the DSD's statement that there is "no material distinction..." would be a higher equity ratio and a higher ROE than FAES currently uses. In fact, FAES's overall weighted average cost of capital (WACC) is marginally lower under the current method than it would be if the principles established for district energy utilities were non-selectively applied to the DSD. The calculations showing this result are presented below.

FINANCING		DSD Approved G-88-12	Minimum Default Stream B <sup>1</sup>	Difference
Debt%	D	60.0%	57.5%	-2.5%
Equity%	E	40.0%	42.5%	2.5%
Cost of Debt%	%D	4.55%	3.96%	-0.59%
Cost of Equity%	%E	9.25%	9.50%	0.25%
Corporate Tax Rate %	%T	27%	27%	0%
WACC %	((D x %D) x (1- %T)) + (E x %E)	5.69%	5.70%	0.01%

**Note:**

<sup>1</sup> GCOC Phase 2 Decision:

- Page 123:
  - In reference to the Stage 1 Decision, the Panel confirms that the default debt component of the capital structure is set to track a benchmark credit spread that reflects BBB or BBB(low) rated debt relative to the 10 year Government of Canada bond yield.
- Page 124:
  - The Commission Panel finds that a minimum default capital structure consisting of 57.5 percent debt and 42.5 percent common equity represents a reasonable balance.
  - After considering the past TES project decisions and the evidence put forward by the experts, the Panel accepts the default equity risk premium of 75 basis points recommended by FAES and its expert, Ms. McShane.

**E. CONCLUSION**

17. FAES's proposed rates reflect the reasonable forecast COS, determined in accordance with the agreement between the Parties, past BCUC directions and sound regulatory policy. They are just and reasonable. The BCUC should approve them as sought.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

Dated: August 11, 2020



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Matthew Ghikas

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