OWEN·BIRD
LAW CORPORATION

PO Box 49130
Three Bentall Centre
2900-595 Burrard Street
Vancouver, BC
Canada V7X 1J5

Telephone 604 688-0401
Fax 604 688-2827
Website www.owenbird.com

Direct Line: 604 691-7557
Direct Fax: 604 632-4482
E-mail: cweafer@owenbird.com
Our File: 38106/0000

October 23, 2020

VIA ELECTRONIC MAIL

British Columbia Utilities Commission
6th Floor, 900 Howe Street
Vancouver, B.C. V6Z 2N3

Attention: Marija Tresoglavic, Acting Commission Secretary

Dear Sirs/Mesdames:

Re: Shannon Estates Utility Ltd. - Levelized Rate Application for the Shannon Estates Thermal Energy System ~ Project No. 1599113

We are counsel to EPS-5056 Hudson & Adera Strata (the "**Strata**"). Attached please find the Strata's Final Argument with respect to the above-noted matter.

If you have any questions regarding the foregoing, please do not hesitate to contact the undersigned.

Yours truly,

OWEN BIRD LAW CORPORATION

Christopher P. Weafer

CPW/jj
cc: Strata
cc: Shannon Estates Utility Ltd.
cc: Registered Interveners

EPS-5056 Hudson & Adera Strata

FINAL SUBMISSIONS

Shannon Estates Utility Ltd. - Levelized Rate Application for the Shannon Estates Thermal Energy System
Project No. 1599113

October 23, 2020

EPS-5056 Hudson & Adera Strata

Shannon Estates Utility Ltd. - Levelized Rate Application for the Shannon Estates Thermal Energy System

Project No. 1599113

Table of Contents

EPS-5056 Hudson & Adera Strata ("EPS-5056")

FINAL SUBMISSIONS

Shannon Estates Utility Ltd. ("SEUL" or the "Applicant")- Levelized Rate Application for the Shannon Estates Thermal Energy System (the "Application") Project No. 1599113

I. INTRODUCTION

1. This proceeding represents the culmination of a lengthy and complicated process whereby SEUL seeks to meet its legislative obligation in satisfying the Commission that it has created a rate structure for its thermal energy system which balances the shareholders of SEUL's right to earn a fair and reasonable rate of return on their investment while balancing the legal protection of ratepayers to not be subjected to rates which are unfair, unjust or unreasonable as per the requirements set out in the *Utilities Commission Act,* RSBC 1996 c 473 ("**UCA**") at sections 59-60. SEUL started on this path in 2016 which resulted in the Commission's Order G-190-17 ("**Order G-190-17**"), wherein the Commission Panel essentially found that SEUL had not met the threshold of convincing the Commission that it had applied for fair, just and reasonable rates.

2. Order G-190-17 correctly highlighted that the onus is on the Applicant to bear the burden of proof in demonstrating there is sufficient evidence to enable the Commission to make a determination that there is both a need for, and the reasonableness of, the costs that are the basis for the applied-for rates and the appropriateness of the rate structure upon which those rates are charged.

3. EPS-5056 (or the "**Intervenor**"), as a strata representing owners of units served by SEUL, was tangentially involved in the proceedings which led to Order G-190-17. In this proceeding, EPS-5056 has taken on a role of ensuring the Commission has direct input from ratepayers of SEUL. It should not be a surprise to the Commission that as a relatively small community responding to a regulatory process such as this, there has been a steep learning curve, as there has been for SEUL, and EPS-5056 wishes to acknowledge the time and effort of Commission staff and the Commission in the attention put forward to review this Application and the previous applications of SEUL with a view to ensuring the public interest objectives of the UCA are upheld. As will be set out below, it is the position of the Intervener that for a number of components of the Application SEUL has not discharged their obligation of providing persuasive evidence that costs and charges set out in the Application will result in rates which are fair, just, and reasonable. The detail of these items will be discussed below, and the Intervener has a few contextual comments to make in support of their position.

4. Utility rates are regulated by the British Columbia Utilities Commission ("**BCUC**") because utilities are natural monopolies. As noted, utility rates are intended to be cost-based, with a fair rate of return provided to the utility. The oversight of the BCUC is intended to protect customers and ensure that utilities do not earn more or less than a fair rate of return. While there has been a trend towards performance-based ratemaking for established utilities to lessen the regulatory burden and avoid rate frequent rate hearings, in this case the proposal is to avoid a rate hearing for a decade. The decision of the Commission will in effect

preclude ratepayers from challenging rates based on the determinations made in this process for ten years.

5. Typically in performance-based rate making the longer term is justified on the basis of there being a strict formula approach and with many years of actual cost and sales to examine and establish an appropriate baseline. What SEUL has proposed in this Application is not performance-based ratemaking; SEUL has no requirements to meet certain performance criteria, yet it would allow SEUL to keep any savings associated with reducing its costs over time.

6. SEUL has proposed a rate that is levelized over 10 years, using a forecast of costs and sales that are very uncertain given the recent completion of the project. At the same time, SEUL is proposing certain deferral accounts to protect itself, but does not intend to track or maintain a deferral account for actual versus forecast financial results. This does not follow the general approach to regulated ratemaking, and does not protect either the customers or SEUL from the uncertainty inherent in a 10-year forecast. SEUL's proposal is more like that of a utility in a competitive market, where it has the potential to keep any profit earned from the difference between its revenues and its costs in real time, the rates for SEUL are not set on a competitive basis. Further, the Application is structured such that there is an incentive to underestimate sales and overestimate costs when establishing the 10-year rates proposed.

7. EPS-5056 submits the Commission should not allow SEUL to have it both ways. SEUL can either consider itself a competitive entity, set rates on a competitive basis, and keep all of the risks and rewards, or it can be a regulated utility that is

allowed to earn a fair return based on cost-based rates, with an obligation to report its actual earnings and a requirement to adjust rates, if necessary, to avoid earning excess profits.

8. Intervenors in SEUL proceedings have repeatedly stated that the utility should be able to recover its costs to remain financially viable, but that rates for customers must be fair and equitable. SEUL's proposal has failed to meet these goals and does not provide an appropriate approach to ratemaking for a regulated utility. While many of the elements are there, and the Application is an improvement over prior efforts, this filing continues to fail the major construct to set rates that cover its costs and deliver a fair rate of return, no more and no less.

9. In summary, both the overall approach to rate setting and the resulting rates proposed by SEUL are inappropriate and unreasonable and should not be approved as filed.

II. PRICES ARE TOO HIGH IN COMPARISON TO OTHER UTILITIES

10. One important comparison in assessing the reasonableness of SEUL rates is their competitiveness to other utilities. In Strata 26.1.1[1], SEUL provided a comparison to BC Hydro rates for various cases, which shows bills under SEUL rates range from 134% to 169% when compared to BC Hydro bills for the same consumption level. SEUL failed to provide the bills under current rates, which was part of that request, and EPS submits the lack of response is not consistent

[1] Exhibit C5-3, page 3

with meeting the regulatory onus of proving their case. In BCUC 20.1[2], SEUL did provide one example of the bill increase for one scenario, which resulted in a bill that is 175% of the bill at current rates of BC Hydro.

11. The comparison would be even starker if compared to a scenario where the customer used natural gas for space or water heating, as costs for natural gas are even lower than for BC Hydro.

12. While competitiveness alone is not a reason to change the rates proposed by SEUL, EPS-5056 submits it raises a serious doubt as to whether SEUL has included reasonable costs and made reasonable assumptions when developing its rates — a repeat of concerns which arose in the proceeding leading to Order G-190-17.

Summary of Results in Strata IR 26.1.1

		Annual Electric Bill			
Sq. Ft.	kWh/month	SEUL	BC Hydro	Difference	SEUL/BCH Cost
600	400	$1,136	$732	$404	155%
600	700	$1,602	$1,198	$404	134%
600	1000	$2,068	$1,407	$661	147%
775	600	$1,447	$1,058	$388	137%
775	1297	$2,530	$1,614	$916	157%
775	1500	$2,845	$1,755	$1,090	162%
1200	600	$1,447	$1,058	$388	137%
1200	1000	$2,068	$1,407	$661	147%
1200	1500	$2,845	$1,755	$1,090	162%

[2] Exhibit A-3, Page 15

1500	800	$1,757	$1,268	$490	139%
1500	1200	$2,379	$1,546	$833	154%
1500	1800	$3,311	$1,964	$1,347	169%

[3]

13. In fact, the rates proposed by SEUL are significantly higher than what they first proposed in 2016, when the proposed variable rate was $0.1036 per kWh (Project 3698882 Exhibit B-1, page 6)[4] compared to the current proposed variable rate of $0.1295 per kWh. The proposed rate is 25 percent higher than the original proposal. Given that the original proposal was not accepted as appropriate by the BCUC, EPS-5056 submits it would be inappropriate to now approve rates that are significantly higher.

14. With proposed rates that are 75% higher than current Commission-approved rates. SEUL is implementing rate shock to its ratepayers. Typically, rates that are higher than 10% are considered to induce rate shock. That is a factor that should be considered when the BCUC makes a decision on the proposed rates as on the face of it the applied for increase is unreasonable.

III. SEUL COSTS ARE TOO HIGH AND ARE UNREASONABLE

15. In looking at the costs included in rates, SEUL has not met its burden of proof to show that costs are reasonable:

[3] Exhibit C5-3, page 3

[4] Exhibit B-1 of Project 3698882 - Shannon Estates Thermal Energy Systems Rates Application dated May 24, 2016, page 6

- SEUL has had no incentive to negotiate lower cost contracts with its suppliers for year 1 as those costs are automatically passed on to ratepayers;

- Escalation rates of 4% for Werner Smith are high, given that $57,000 of the $85,000 in annual costs are for mechanical operation and maintenance, which is escalated at 2.5% per the contract (Strata 24.1)[5];

- Going forward, if SEUL reduces its costs it will benefit the SEUL shareholder with no benefit to ratepayers (Strata 24.1.3)[6];

- SEUL has included an increase in tax rates, with no clear and persuasive evidence in support. That should be removed. As SEUL stands to benefit if its other costs are lower than projected in the financial model, it should also take the risk if tax rates increase. EPS-5056 notes that SEUL has proposed its willingness to accept a deferral account for taxes at page 11 of its Final Submissions and in response to BCUC IR37.1, and EPS-5056 supports the creation of that deferral account;

- The overhead allocation of $3,500 per month, or $42,000 per year, is based on an allocation of staff expenses which equate to 2-4 hours per week of staff time. EPS-5056 submits this is an excessive amount of time on a long-term basis. Given that actual operations, maintenance and billing are all outsourced, the management of the utility should be relatively minimal (Strata 33.2.2)[7];

---

[5] Exhibit C5-3, page 2

[6] Exhibit C5-3, page 2

[7] Exhibit C5-3, page 6

- While it was unclear to the Intervener through the Application itself, in Strata 28.1.5[8], SEUL makes it clear that it will not be recording differences in actual costs from forecast costs in the Revenue Deficiency/Surplus Deferral Account. That means that if SEUL has overestimated expenses in its financial model used to set rates for the 10 year term, the SEUL shareholder will get to keep any surplus as additional profit beyond its approved rate of return. EPS-5056 submits that is not fair, just or reasonable given the rate shock being proposed for year one of the term of the Application.

16. Given the paucity of evidence to support many of the Applicant's costs, the high increases assumed for Werner Smith and tax rates, and the ability to keep any profits associated with overestimating its costs in the financial model, the rates proposed by SEUL are too high. EPS-5056 submits this could be corrected through lower year 1 rates or alternatively by requiring that SEUL report its actual costs to the Commission and its customers and maintain any differences from the forecast in the Revenue Deficiency/Surplus Deferral Account.

IV. RATE OF RETURN

17. SEUL has provided no persuasive evidence to support the cost of debt used in its financial model. It is using a cost of debt of 4.64% compared to 3.6% for Corix, 4.55% for FAES, 4.10% for PNG and 3.9% for FBC (Strata 35).[9] In the response to Strata IR 35, SEUL asserts its risks are higher than the other referenced utilities for 3 reasons:

[8] Exhibit C5-3, page 4

[9] Exhibit C5-3, page 7

- The number of customers is fixed. EPS-5056 submits this is less risky as there is less uncertainty facing the utility;

- Low occupancy rates. EPS-5056 submits the evidence demonstrates this is already built into the load forecast and rates. SEUL does not face any risk because of this unless it changes rates to reflect a higher occupancy rate; and

- It has efficient technology to achieve a low carbon footprint. EPS-5056 submits while true, this has nothing to do with risk – other utilities face more risk if they have to comply with requirements to reduce their carbon footprint.

18. SEUL asserts that the appropriate interest rate is what it could get from conventional lenders if it were a “stand alone” entity is Prime +2%. However, the SEUL model does not treat this deemed interest like real interest because it does not treat it as an expense and thus does not claim it as a deduction from income for tax purposes. The result of this approach is that the effective rate of this deemed interest is the P+2% plus the tax rate applicable to the forgone deduction. When a bank charges P+2%, they receive this as business income and must pay tax thereon. Using the Model assumptions of 4.45% interest, and tax rates of 27% and escalating to 33%, the net yield to the bank is 3.25% at a tax rate of 27%, or 2.98% at a tax rate of 33%. If the rate of interest charged by the banks is to be used as the appropriate rate, then the tax adjustment should be made to the rates so as to make the actual results the same. Under the model, the lender (SEUL Shareholder) receives the full 4.45% without any further

tax (by way of a dividend) without any tax thereon because the taxes have been paid by the ratepayers through the increased fees.

19. The SEUL model does not treat the deemed interest as an expense and results in the ratepayers paying the SEUL shareholder's taxes thereon. EPS-5056 submits that the appropriate way for the Commission to deal with this issue would be to treat the deemed interest expense as if it were a tax deductible item for purposes of the SEUL model. The best way to incorporate the impact of this shift in taxes is to allow a lower cost of debt for SEUL when setting rates. Based on both the cost of debt filed by other utilities and the impact of the shift in taxes, the allowed cost of debt should be in the range of 2.75 to 3.25 percent.

V. SEUL SALES FORECAST IS TOO LOW

20. SEUL uses sales and revenue figures in its financial model and rate development that reflect occupancy rates between 70% and 80%. This is not consistent with what Strata owners have observed on site (Strata 30.1).[10] In BCUC 34.1.1[11], SEUL provided financial models reflecting a case where energy sales are 10% and 20% higher than included in the financial model, presumably reflecting corresponding increases in the occupancy rates. The financial model provided in that response uses the same starting rates but use a lower increase in rates over the 10-year period. The following table compares the rates by year 10 under those two scenarios.

[10] Exhibit C5-3, page 5

[11] Exhibit A-4, page 4

Year 10 Rates

	Base Case	10% Higher Sales	% Difference	20% Higher Sales	% Difference
Variable Rate	$0.1609	$0.1455	-10%	$0.1295	-20%
Capacity Levy	$0.0687	$0.0621	-10%	$0.0553	-20%

21. By SEUL using such a low occupancy rate in developing rates, it artificially raises rates to customers. If actual occupancy rates are higher than what SEUL assumed, or increase over time, SEUL will collect more revenues than projected in the financial forecast. Because SEUL is not planning on tracking differences between actual and forecast sales and/or profit levels, SEUL will get to keep those higher revenues. Given the proposed method for setting rates, EPS-5056 submits SEUL has an economic incentive to underestimate sales which is not reasonable or consistent with appropriate fair and just ten-year rate term parameters.

22. EPS-5056 submits SEUL should be using sales that are at least 10% higher than included in the forecast. In adjusting rates for this change, the starting rates should be appropriately lowered to mitigate the rate shock as proposed, rather than decreasing the annual escalation in rates. EPS-5056 highlights that the Commission's Thermal Energy Systems Regulatory Framework Guidelines provide that rate shock is inappropriate and unreasonable.[12]

[12] Thermal Energy Systems Regulatory Framework Guidelines, Section 2.4.3

VI. SEUL RATES SHOULD BE LEVELIZED OVER 20 YEARS, NOT 10 YEARS

23. SEUL originally filed a model showing full revenues and costs over the first 10 years, but included only the costs for years 11 through 30. In Strata IR 20[13], SEUL responded to a request to include revenues for years 11 through 30. In the first case, with rates set at the level for year 10 for all future years, the results showed that the Revenue Surplus/Deficiency balance would be $1.8 million to the benefit of SEUL by the end of year 20. This results in revenues that are 7% higher than needed over the 20-year period. In the second case EPS-5056 requested revenues that escalate by 2% per year for years 11 through 30. By the end of year 20, the Revenues Surplus/Deficiency balance would by $3 million in favor of SEUL. This results in revenues that are 10% higher than needed over the 20-year period.

24. With the rates SEUL has proposed for years 1 through 10, the evidence in this proceeding is that rates would need to decrease in years 11 through 20 to achieve a zero balance by the end of year 20.

25. Rather than have rates that increase over time, and then decrease after year 10, it would be more appropriate to levelize costs over a 20-year period. EPS-5056 submits this time frame better matches the life-cycle of the facilities. This approach would also provide more fair, just and reasonable rate stability for customers and avoid intergenerational inequity for ratepayers.

[13] Exhibit C5-2, page 4

26. EPS-5056 is also concerned that once SEUL rates are at the level proposed for year 10, SEUL will ensure its costs equal or exceed the revenues.

27. EPS-5056 recognizes that costs are more speculative the further out in time you go; this is already an issue with the proposed 10-year time period. EPS-5056 submits that risk over time is better dealt with through deferral accounts and rate riders, or by re-adjusting rates periodically based on actual results, rather than just using a 10-year levelized cost.

VII. REGULATORY DEFERRAL ACCOUNT

28. SEUL has proposed a Regulatory Deferral Account ("RDA") to recover costs of $313,685 that were spent in its first application. In SEUL's first application, SEUL filed a proposal that did not follow the guidelines for a thermal energy system and was poorly executed such that the proposal was rejected in favor of using rates for a similar utility system. The current Application from SEUL does follow the guidelines and is much better organized and executed.

29. EPS-5056 submits that the first application was a waste of both money and effort on behalf of SEUL, its ratepayers and the Commission. The costs were imprudently incurred. EPS-5056 submits the Commission should reject SEUL's proposal to recover this expense through the RDA.

VIII. REVENUE DEFICIENCY/SURPLUS DEFERRAL ACCOUNT AND REPORTING

30. As discussed previously, in Strata 28.1.5[14], SEUL makes it clear that it will not be recording differences in actual costs from forecast costs in the Revenue Deficiency/Surplus Deferral Account. That means that if SEUL has overestimated expenses in its financial model used to set rates for 10 years, it will get to keep any surplus profit. Similarly, it has the potential to lose money.

31. Regulated rates are set to ensure that ratepayers pay cost-based rates plus ensure that utilities earn a fair return. EPS-5056 is not looking to pay more or less than the cost of service and are not asking for SEUL to take on all the risks and rewards associated with the utility. As it stands, EPS-5056 submits that SEUL has overestimated costs and underestimated revenues, leaving it with a better than even opportunity of exceeding its allowed/fair rate of return.

32. As SEUL is not proposing to track or report the difference between actual and forecast results, neither ratepayers nor the Commission will have any way of knowing if SEUL is earning excess profits beyond a fair rate of return. Ratepayers will be at risk, having commenced the term of the levelized rate period with introduction of rate shock, of paying rates which are not cost-based, and exceed fair, just and reasonable levels.

33. Given the track record of the utility in its short existence, EPS-5056 submits that SEUL should be required to track actuals revenues and costs as well as its

[14] Exhibit C5-3, page 4

earning and report the results to both the BCUC and its ratepayers on an annual basis.

34. The Intervener acknowledges that the Commission's Thermal Energy Systems Regulatory Framework Guidelines have as a principal use of the least deferral mechanisms possible, however the absence of a deferral mechanism should not result in windfall profit to SEUL which the Intervener submits would likely be the case.

IX. SEUL NEEDS A PROPER SPLIT BETWEEN FIXED AND VARIABLE RATES

35. SEUL stated in its Application that the fixed capacity levy should recover the fixed costs of the utility:

> "The monthly capacity levy is intended to recover SEUL's fixed costs, which includes all costs except for SEUL's electricity and natural gas costs. It is particularly important that SEUL have a fixed rate component, providing a high degree of certainty SEUL will be able to recover its fixed costs…"[15]

36. SEUL further stated it was removing the metering charge and it would be included in the capacity levy:

> "SEUL proposes that effective January 1, 2021, the metering charge be cancelled and instead incorporated into SEUL's cost of service and

[15] Exhibit B-1, page 33

recovered by the capacity levy. This change will simplify customers' invoices and avoid the confusion created by having two fixed charges, rather than just one, on each invoice."[16]

37. EPS-5056 submits these two claims both appear to be in error.

38. In the Application, SEUL erroneously reported that its fixed costs were in the range of 30 percent (BCUC 20.4)[17], which tracks relatively well with its proposed used of a fixed rate that is 40 percent of total revenues. The reported split did not appear to match what was in the SEUL financial model, and in Strata 22[18], SEUL corrected its mistake to report that 70 percent to 75 percent of its costs are fixed. This results in a serious mismatch between fixed costs and fixed revenues.

39. SEUL has stated that its capacity levy was set by starting with the current level and increasing by 2% per year (Strata 22.1.3).[19] With the small increase in the capacity levy, the resulting increase in the variable rate moves from $0.053111 per kWh to $0.12950 per kWh (BCUC 20.1).[20] The proposed energy rate is nearly 2.5 times the current energy rate. This increase is excessive when compared to the capacity levy increase.

[16] Exhibit B-1, page 15

[17] Exhibit A-3, page 16

[18] Exhibit C5-3, page 1

[19] Exhibit C5-3, page 1

[20] Exhibit A-3, page 15

40. There are several issues with respect to this mismatch:

- It results in unoccupied units not paying their fair share of costs. If the occupancy rates are as low as SEUL claims, and some of that is related to absentee owners as opposed to days when owners are away on vacation, those residents occupying their units are subsidizing those units that are not occupied;

- It creates a greater potential for excess profits for SEUL, particularly if SEUL has underestimated loads; and

- It sends the wrong price signal to customers in terms of energy usage versus variable costs, particularly when compared to current rate levels.

41. SEUL has also proposed eliminating the monthly fixed meter charge included in current rates. Based on the way that SEUL has set the capacity levy (current rates plus 2% per year), EPS-5056 submits the proper conclusion is that the fixed metering cost ends up as part of the variable energy charge in the proposed rate design. This means that the rate design is moving even further away from the actual split between fixed and variable costs.

42. With the metering charge included in the variable charge, the rental units benefit at the expense of individual ratepayers due to their lower energy use. This results in an unfair and unreasonable shifting of these costs to those units with a larger square footage. These costs are known, and do not vary based on size of unit nor on any variation in consumption, and the 3rd party provider charges and is paid the same for each unit.

43. The reasoning that SEUL provides is that it makes the invoicing less confusing to the ratepayers, which is completely unsupported in the evidence as SEUL has not provided any details/evidence of complaints from the ratepayers about the alleged confusion caused. EPS-5056, as a ratepayer representative, submits that to the contrary of all the items appearing on the invoice, this line item is the most transparent and understandable. Since the only impact of this change is to shift the cost from the smaller units to the larger units, with no impact to the overall operating results for SEUL, it appears that this proposed change is without any merit and shifts costs to the condominium owners (which are typically larger units) from the owners of the smaller rental units. This would indicate that the resulting benefits flow to Wall Financial Corporation at the expense of the condo owners.

44. While EPS-5056 recognizes that high fixed charges result in lower conservation signals, in this case EPS-5056 submits that the fixed rate should be adjusted to move closer to the actual fixed costs of over 70 percent. We recommend that the metering charge be retained, and that the fixed capacity levy be increased to better match the fixed costs to the utility, as was SEUL's original intent.

X. CONCLUSION

45. This proceeding represents the culmination of a lengthy and complicated process whereby SEUL seeks to meet its legislative obligation in satisfying the Commission that it has created a rate structure for its thermal energy system which balances the shareholders of SEUL's right to earn a fair and reasonable

rate of return on their investment while balancing the legal protection of ratepayers to not be subjected to rates which are unfair, unjust or unreasonable as per the requirements set out in the UCA, RSBC 1996 c 473 at sections 59-60.

46. SEUL started on this path in 2016 which resulted in the Commission's Order G-190-17, wherein the Commission Panel essentially found that SEUL had not met the threshold of convincing the Commission that it had applied for fair, just and reasonable rates.

47. As set out above, the Intervener submits that SEUL has again failed to fully discharge its obligation to propose rates that are fair, just and reasonable.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

Gail Tabone

Gail Tabone, EES Consulting, Consultant for
EPS-5056 Hudson & Adera Strata

Christopher P. Weafer, Counsel for
EPS-5056 Hudson & Adera Strata