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ORDER NUMBER
G-226-20

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

BEFORE:
W. M. Everett, QC, Panel Chair
A. K. Fung, QC, Commissioner
E. B. Lockhart, Commissioner

September 1, 2020

ORDER

WHEREAS:

A. On June 9, 2020, pursuant to sections 59 to 61 and 89 of the *Utilities Commission Act* (UCA), FortisBC Alternative Energy Services Inc. (FAES) applied to the British Columbia Utilities Commission (BCUC) for approval of:

   i. The fiscal 2020/21 cost of service (COS) rate (COS Rate) of $0.184 per kWh, effective July 1, 2020, based on FAES' forecast annual COS for thermal energy service provided by FAES to the Delta School District No. 37 (DSD); and

   ii. The application of any payments received from DSD during fiscal 2020/21, over and above the payments of the COS Rate, against the balance in the District Deferral Account, with the impacts of the payment(s) to be reflected in the fiscal 2022/23 COS Rate (Application);

B. By Order G-155-20 dated June 17, 2020, the BCUC established a regulatory timetable for the review of the Application, which included one round of information requests (IR) and further process to be determined. The order also approved the COS Rate of $0.184 per kWh, effective July 1, 2020, on an interim and refundable or recoverable basis, pending completion of the BCUC's review of the Application;

C. By Order G-194-20 dated July 20, 2020, the BCUC established a further regulatory timetable for the review of the Application, which included final and reply arguments; and

D. The BCUC has reviewed the Application, the evidence and arguments in the proceeding and considers approval is warranted.

NOW THEREFORE pursuant to sections 58 to 61 of the UCA and for the reasons attached as Appendix A to this order, the BCUC orders as follows:

1. FAES is approved to establish a COS Rate of $0.184 per kWh, on a permanent basis, effective July 1, 2020, for the fiscal and contract year from July 1, 2020 to June 30, 2021.

2. FAES must apply any payments received from DSD during fiscal 2020/21, over and above the payments of the COS Rate, to reduce the balance in the District Deferral Account, with the impacts of the payment(s) to be reflected in the 2022/23 COS Rate.

3. FAES is directed to file tariff pages for endorsement with the BCUC reflecting the permanent fiscal 2020/21 COS Rate effective July 1, 2020 within 10 days of the date of this order.

DATED at the City of Vancouver, in the Province of British Columbia, this 1st day of September 2020.

BY ORDER

Original signed by:

W. M. Everett, QC
Commissioner

Attachment

FortisBC Alternative Energy Services Inc.
Fiscal 2020/21 Application for Cost of Service Rate for the Thermal Energy Service
to the Delta School District Number 37

REASONS FOR DECISION

1.0 Introduction and Regulatory Process

On June 9, 2020, FortisBC Alternative Energy Services Inc. (FAES) applied to the British Columbia Utilities Commission (BCUC) for approval, on an interim and permanent basis, of its fiscal 2020/21 cost of service (COS) rate (COS Rate) of $0.184 per kWh, effective July 1, 2020 (Application) based on FAES' forecast annual COS of $1.099 million for thermal energy service provided by FAES to the Delta School District No. 37 (DSD).[1]

On June 17, 2020, the BCUC approved the fiscal 2020/21 COS Rate of $0.184 per kWh on an interim and refundable basis, effective July 1, 2020.[2] The BCUC also established a regulatory timetable which provided for one round of information requests (IR) and further process to be determined. On July 20, 2020, the BCUC established a further regulatory timetable which provided for final and reply arguments.[3]

The sole issue in dispute in this proceeding is the calculation of the deemed debt rate, which is discussed in these reasons for decision.

2.0 The Deemed Debt Rate

To calculate the deemed debt rate, FAES uses a 20-year term debt rate based on a simple average of the 10-year and 30-year rates for corporate proxies and the Government of Canada bond yields in accordance with the BCUC's Generic Cost of Capital (GCOC) Stage 1 Decision.[4] FAES has used the same approach to calculate the deemed debt rate since the BCUC's approval of the inception of thermal energy service to DSD in 2012. Based on this methodology, FAES has calculated a deemed debt rate of 4.55 percent for fiscal 2020/21.[5] As part of its annual revenue requirement calculations, FAES updates the deemed debt rate each year as required by the BCUC.[6]

FAES submits that the continued use of an interpolated 20-year debt rate is appropriate because it reflects the long-term nature of the assets, the contractual terms, and the available debt terms. FAES submits there will be significant amount of rate base remaining at the end of the initial 20-year term of the agreement between FAES and DSD to provide thermal energy service to DSD. FAES explains that some of the assets will be in service for up to 40 years or more while other assets will be replaced.[7]

In 2012, both FAES and DSD signed the Compliance Filing to Order G-31-12 that included the methodology of using a 20-year rate derived by linear interpolation between the 10-year and 30-year rates to calculate the cost

[1] Exhibit B-1, p. 1.
[2] Exhibit A-2, Order G-155-20.
[3] Exhibit A-4, Order G-194-20.
[4] FAES Revisions to Rates Design for Thermal Energy Service to DSD, Final Order G-71-12 dated June 5, 2012.
[5] Exhibit B-1, pp. 16–17.
[6] Ibid. pp. 14–15; Order G-71-12, Directive 1(d).
[7] Exhibit B-2, BCUC IR 2.4.

of debt for the entire initial term of the agreement.[8] The agreement included an initial term of 20 years and a further renewal term of 10 years. FAES notes it does not have the option to terminate the agreement at the end of the initial 20-year term and it is obligated to provide service to DSD in perpetuity unless DSD defaults or terminates the contract. FAES submits that a 30-year debt term would be more appropriate to use in perpetuity compared to the current 20-year debt term.[9]

The use of a 10-year debt term to calculate the deemed debt rate would result in a $22,000 reduction to the fiscal 2020/21 COS. Conversely, the use of a 30-year debt term would result in a $21,000 increase to the fiscal 2020/21 COS.[10] FAES submits that neither a 10-year nor a 30-year debt term would be consistent with the agreement between FAES and DSD and previous BCUC orders. Furthermore, the use of a 10-year debt term would imply that the debt term should be decreased each year as the initial term decreases, which would be inconsistent with the BCUC's GCOC Stage 1 Decision, which stated that the debt term should reflect the long-term nature of the utility assets, contractual terms and available debt terms.[11]

DSD's Position

DSD does not agree with the deemed debt rate used by FAES and submits that a 10-year debt term is more appropriate.[12]

DSD confirms that it had agreed to the use of a 20-year debt rate in 2012 as set out in the Compliance Filing to Order G-31-12 and it had not opposed the use of a 20-year debt rate in subsequent annual rate approval proceedings. DSD also confirms that it does not take issue with the deemed debt rate approved by the BCUC in prior years.[13] However, DSD submits that any prior agreement does not preclude it from objecting to the proposed deemed debt rate in this proceeding or in future proceedings. DSD submits that the signed Compliance Filing for Order G-31-12 "was 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." Order G-71-12 and its accompanying reasons for decision did not expressly direct the use of a 20-year debt rate, but did expressly contemplate the adoption of an alternative methodology to determine the deemed debt rate in future years.[14] Furthermore, reviewing the reasonableness of using a 20-year debt rate is consistent with the BCUC's directive of requiring the deemed debt rate be subject to annual BCUC review and approval.[15]

DSD submits that in the GCOC Stage 2 Decision, the BCUC had confirmed a default 10-year debt rate.[16] The BCUC had also ordered a 10-year deemed debt rate for the following thermal energy system (TES) projects that DSD submits have "no material distinction" compared to the DSD TES project:[17]

- Corix Multi-Utility Services Inc.'s Burnaby Mountain District Energy Utility thermal energy project;[18]

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[8] Exhibit B-2, BCUC IR 2.2; Compliance Filing to Order G-31-12, Attachment 4.
[9] Exhibit B-2, BCUC IR 2.4.
[10] Ibid.
[11] Ibid.
[12] DSD Final Argument, p. 2.
[13] Ibid., p. 3.
[14] Ibid.
[15] DSD Final Argument, p. 4; Order G-71-12, Directive 1(d)(ii).
[16] DSD Final Argument, p. 6; GCOC Stage 2 Decision, p. 123: https://www.bcuc.com/Documents/Proceedings/2014/DOC_41123_03-25-2014-BCUC-GCOC-Stage-2-Decision-WEB.pdf.
[17] DSD Final Argument, pp. 4–5.
[18] Approved by BCUC Order C-5-17 dated September 15, 2017.

- Corix Multi-Utility Services Inc.'s University of British Columbia Neighbourhood District Energy System thermal energy project;[19] and
- River District Energy's District Energy Utility.[20]

DSD submits that FAES has not adduced evidence to justify a departure from the "default" use of a 10-year debt rate referred to in the GCOC Stage 2 Decision and it has not established why the continued use of a 20-year debt rate should be adopted.[21]

FAES' Reply

FAES submits that the Compliance Filing for Order G-31-12 "forms part of the contractual matrix." FAES notes that DSD is a sophisticated party, which signed the Compliance Filing and accepted the methodology for seven years.[22] The Compliance Filing included an agreed debt rate setting methodology for the entire 20-year initial term and "explicitly referenced interpolated 20-year debt rates." While the BCUC at that time directed adjustments to the methodology, it did not vary the debt term.[23] In FAES' view, the BCUC's direction to use, in the absence of an interest automatic adjustment mechanism, "the same methodology as directed in [Order G-71-12] and accompanying Reasons for Decision" is unequivocal.[24]

FAES submits that the default debt term stated in the BCUC's GCOC Stage 2 Decision is not applicable to the DSD TES project because that Decision applies only to multi-customer Stream B district energy utilities specifically listed in the Decision.[25] The three utilities cited by DSD as not having a material distinction from the DSD TES project were, unlike the DSD, Stream B multi-customer district energy utilities that were the subject of the GCOC Stage 2 Decision.[26] FAES submits that a multi-customer district energy system provides service to various end users and operates under a more traditional tariff structure. Whereas, in the case of the DSD TES project, DSD "has negotiated and agreed to terms in the context of a competitive environment for thermal energy services." FAES notes that in the BCUC's 2012 Decision that approved the contracts and rate for FAES to provide thermal energy service to DSD, the BCUC stated that when determining what it considers "just and reasonable", it would take into consideration the fact that FAES and DSD are two sophisticated commercial parties capable of ensuring their own interests are protected and that the agreements were the result of arms-length negotiations.[27]

In FAES' view, there is no evidence to support that the three utilities cited by DSD are comparable to FAES' cost of capital for the DSD TES project on a risk-adjusted basis. FAES submits that a utility's cost of capital consists of three elements: the debt-to-equity ratio, the return on equity (ROE) and the debt return, which were all addressed in the BCUC's GCOC Stage 2 Decision. FAES submits that the utilities cited by DSD are allowed more equity in their capital structures and their allowed ROE is higher than FAES'.[28]

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[19] Approved by BCUC Order G-84-15 dated May 25, 2015.
[20] Approved by BCUC Order C-14-11 dated December 19, 2011.
[21] DSD Final Argument, p. 7.
[22] FAES Final Argument, p. 1.
[23] Ibid., p. 2.
[24] FAES Reply Argument, p. 2.
[25] FAES Reply Argument, pp. 2–3; GCOC Stage 2 Decision, pp. 115–116.
[26] FAES Reply Argument, p. 4.
[27] Ibid.; FEI Application for Certificate of Public Convenience and Necessity for Approval of Contracts and Rate for Public Utility Service to Provide TES to DSD, Decision dated March 9, 2012, p. 70.
[28] FAES Reply Argument, p. 5.

FAES acknowledges that the BCUC is not legally precluded from changing the methodology for deriving the deemed debt rate. However, it submits that the continuation of the current methodology is appropriate and "just and reasonable."[29]

BCUC Determination

The Panel acknowledges that FAES and DSD are sophisticated commercial parties which entered into an arms-length agreement for thermal energy services and signed a Compliance Filing that included the methodology of using a 20-year debt term to calculate the cost of debt for the initial term of the agreement. However, the Panel agrees that the signed Compliance Filing to Order G-31-12 does not preclude the deemed debt rate from further BCUC review as conceded by FAES. Considering that DSD now receives thermal energy service from FAES under a COS Rate, which is reviewed by the BCUC annually, DSD has the right to object to the calculations of the COS Rate, such as the proposed deemed debt rate, in this proceeding and in future proceedings.

Nonetheless, the Panel is not persuaded that the BCUC's GCOC Stage 2 Decision is applicable to the DSD TES project. The Panel accepts that the GCOC Stage 2 Decision is only applicable to TES projects under the Stream B Regulatory Model as provided in that Decision and the DSD TES project was not one of those projects.

Notwithstanding this, the deemed debt rate should not be reviewed in isolation from the other elements of a utility's cost of capital. Differences in risk between utilities are a significant consideration when determining a utility's cost of capital and DSD has not provided sufficient evidence to demonstrate that these three utilities have "no material distinction" to the DSD TES project with respect to risk. Therefore, based on the evidence at hand, the Panel is not persuaded that a 10-year debt term would be appropriate for the DSD TES project and the Panel is also not persuaded that an adjustment to the debt term would be appropriate without reviewing FAES' debt-to-equity ratio and return on equity for the project.

For the above reasons, the Panel finds FAES' methodology for determining the deemed debt rate reasonable and therefore approves the fiscal 2020/21 COS Rate of $0.184 per kWh, on a permanent basis.

In addition, the Panel acknowledges the calculations included on page 5 of FAES' Reply Argument were not previously presented and thus, DSD did not have the opportunity to address them in argument. As such, the Panel clarifies that this information has not been accepted as evidence in this proceeding and the Panel has not considered this information in its determination.

[29] FAES Reply Argument, p. 1.