Stargas Utilities Ltd.
2475 Dobbin Road, Unit 3
PO Box 26039, West Kelowna
British Columbia, V4T 2G3

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

December 9th, 2016

Subject: A-6 Panel questions with respect to Replacement Financing (timing issues)

Dear Ms. Hamilton:

We appreciate the opportunity to, in advance of the SRP on December 14th, dialogue on issues that could assist in our meeting the deadline reflected in our bank's commitment letter. We think it important to note that issues raised in A-6 were, in part, addressed by our amended application, filed with the Commission and posted as B-1-1 on December 8th, 2016. Commission interrogatories presented persuasive descriptions of the role that amortization/depreciation is to play in the "return of capital investment" to a regulated enterprise; cited in A2-1 – point 6 Bonright, Principles of Public Utility Rates – "capital cost amortization ..... to afford an adequate opportunity to recoup from ratepayers its investment in fixed assets" and lead to our recognizing that we ought not propose changes to our cost of service calculation that would defeat the clearly stated intent of its inclusion in the determination of a regulated utilities revenue requirement for that specific purpose.

Question: "How much of the initial $400,000 preferred share investment has already been recovered through Stargas' annual amortization charges that have been included in rates"?

Response: The $400,000 investment has remained at its initial level from funding in 2002 to today. Stargas, whether through funds generated by amortization included in rates or other source has not returned one dollar of the initial $400,000 investment. Stargas has, indeed, generated funds from the inclusion of amortization in rates, but the amount required to service principal and interest on term financing has exceeded that source as follows:

Year	Principal	Interest	Debt Service	Amortization
2012	$ 42,328	$ 21,734	$ 64,062	$ 54,804
2013	$ 42,328	$ 19,046	$ 61,374	$ 54,804
2014	$ 33,229	$ 16,284	$ 49,513	$ 54,800
2015	$ 38,334	$ 14,423	$ 52,757	$ 54,800
2016	$ 45,758	$ 10,076	$ 55,834	$ 54,800
			$ 283,540	$ 274,008

The following extract from BCUC Order G157-12 is, we submit, relevant to the current discussion:

"On August 15, 2002, Stargas applied to the Commission for approval to issue cumulative preferred shares in order to absorb losses in excess of $615,000 and recognize the "time value" of the shareholders' investment. Commission Order G-80-02 approved the issuance of $400,000 of cumulative preferred shares with a dividend rate equal to the Commission's annual benchmark return on equity plus 75 basis points. From fiscal 2002 through fiscal 2006, accumulated unpaid dividends amounted to $135,887 and no return on equity was included in the revenue requirement. In order to provide a return to Stargas' shareholders, Commission Order G-163-06 directed the Company to pay a dividend on its outstanding preferred shares. Stargas has declared and paid dividends annually in accordance with G-163-06 between fiscal 2007 and fiscal 2012. The Application includes $41,000 for forecast preferred share dividends in the fiscal 2013 revenue requirement, based on the principal preferred share balance of $400,000 multiplied by the Commission's annual benchmark return of 9.5 per cent plus 75 basis points. Stargas has not included any additional return on equity, nor have they included a long-term debt return, in the fiscal 2013 revenue requirement." (emphasis added)

It acknowledged in that order that Stargas investors had committed $400,000 to establish and maintain the supply of natural gas to Silver Star Mountain Resort, that 2002 to 2006 they'd not earned any return on their investment and that in accordance with BCUC Order-163-06 that they'd paid dividends between fiscal 2007 and 2012 and that in 2013 (and by implication) thereafter Stargas was authorized to include within cost of service and pay dividends on the $400,000 investment. Order 163-06 made the following statement – "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 percent (the 2006 benchmark return on equity of 8.80 percent plus 75 basis points) in F2007". We assert that the phrase "to provide a return to its shareholders" a pivotal determination in the adoption and retention of the allowed inclusion of annual dividends on the $400,000 investment, and further that that return "equitable" as a variant from conventional rate making.

We note the following "The Commission is responsible for ensuring that customers receive safe, reliable and non-discriminatory energy services at fair rates from the utilities it regulates, that shareholders of these utilities are afforded a reasonable opportunity to earn a fair return on their invested capital, and that the competitive interests of B.C. businesses are not frustrated". We posit, that the current inclusion of annual dividends on the $400,000 investment consistent with the "fair return" contemplated within the BCUC's organizational profile. Our motivation to propose replacement of higher cost preferred shares with bank debt ought to have been postured within our initial application as it now is within the amendment – we simply want to replace $100,000 of the shareholder's otherwise permanent $400,000 investment that has an current annual approved cost to ratepayers of $9,500 with interest at, 3.91% (if the two year fixed rate selected) of $3,910. Note also, that through our history we have not included any amount with respect to coverage of our term debt in cost of service to, thereby generate a term-debt return. We proposed in our recent amendment, an allowance for interest on term debt mitigating the savings generated by reduced dividends on preferred shares and have, in considering rates past 2019, contemplated further inclusions.

A-6 suggests two options:

Option 1

Stargas would generate the funds to service the Replacement Loan by increasing its annual amortization expense to an amount equal to the principal portion of the Replacement Loan. Rate base would be reduced annually by the amount of the principle repayment of the loan for the term of the loan. Stargas'

earned return would be limited to only the interest on the Replacement Loan, notwithstanding other outstanding debt.

Response: Having come to understand and agree with the underlying basis for the inclusion of amortization in cost of service and revenue, we'd not want to adjust amortization as contemplated within Option 1.

Option 2

A deemed capital structure of 57.5% debt and 42.5% equity would apply to Stargas.[3] The earned return would be calculated using mid-year rate base x benchmark return in British Columbia of 8.75%[4] plus the equity risk premium of 75 basis points. Furthermore, the amortization of Stargas' rate base would be calculated on a straight line basis, consistent with current practice, and recoverable in the annual revenue requirements.

Response: Were our rates to include earned returns based on a forecast mid-year rate base of $502,928 and the indicated capital structure we'd include $14,949 in lieu of the $32,410 contemplated in our December 8th amended filing.

	Amount (A)	Ratio (B)	Average Embedded Cost C	Cost Component (B)x(C)=(D)	Earned Return (A)x(D)=(E)
Long term debt	$289,184	57.5%	3.8%	2.19%	$ 6,319
Common Equity	213,745	42.5%	9.5%	4.04%	8,630
Total	$502,928	100.0%		6.22%	$ 14,949

Our inference (if not that implied by the Commission in its presentation of the two options) is that we are being asked to abandon the expectation of equitable returns on our $300,000 preferred share investment (that assuming we've had approval to a $100,000 redemption. Surely the "opportunity to earn a fair return on their invested capital" embedded in the several affirming prior orders from the Commission trumps conversion of the long-standing claim to full and fair returns on our equity investment to a conventional rate setting model that, as demonstrated, returns less than 50% of an equitable return on investor funds. I trust that having confirmed that the full amount of the original $400,000 remains, without reduction on the Stargas ledger (as evidenced herein) that the position presented at the SRP, or in advance of that (if the narrow window of opportunity allows) is altered in recognition that we have a significant continuing investment on which a fair return is our due

Respectfully submitted

M.A. Blumes,
President, Stargas Utilities Ltd.