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Via E-file

BCUC File 62371
Batch 61390

December 5, 2019

B.C. Utilities Commission
Suite 410, 900 Howe Street
Vancouver, BC V6Z 2N3

File No.: 4.2(2019)

Attention: Patrick Wruck
Commission Secretary and Manager, Regulatory Services

Dear Mr. Wruck:

Re: Pacific Northern Gas Ltd.
Certificate of Public Convenience and Necessity for Kitimat Regulating Station LDS#2
Establishment of Depreciation Rate
Letter of Comment

On August 23, 2019, Pacific Northern Gas Ltd. (PNG) filed an application to seek approval of a Certificate of Public Convenience and Necessity (CPCN), pursuant to sections 45 and 46 of the *Utilities Commission Act* (UCA), for capital expenditures of approximately $1.77 million to design and construct a new let-down station #2 (LDS#2) dedicated to providing natural gas service to JGC Fluor BC LNG Joint Venture (JFJV) as engineering, procurement and construction contractor for the development of the LNG Canada liquefied natural gas (LNG) export facility in Kitimat, British Columbia (LNGC Project) (Application). In the Application PNG also sought approval under section 39 of the UCA to enter into a gas sales agreement (GSA) with JFJV dated August 22, 2019, to provide natural gas service to JFJV for an initial period of 4.5 years.

By Order C-3-19 dated September 25, 2019, the BCUC granted a CPCN to PNG authorizing the construction and operation of LDS#2 and approved the GSA.

In Order C-3-19, the BCUC observed that Section 56(2) of the UCA states that "[t]he commission must determine and, by order after a hearing, set proper and adequate rates of depreciation." In this regard, the BCUC established a written public hearing process and regulatory timetable to review the appropriate depreciation rate of the LDS#2 assets. The regulatory timetable included provision for parties to submit letters of comment on this matter of depreciation rates.

As PNG did not specifically address the matter of what might be appropriate depreciation rates for the LDS#2 assets in its Application, PNG is taking the opportunity to provide this letter of comment. The discussion that follows summarizes PNG's views on several matters that have been given consideration in this review.

Illustrative Depreciation Rates

As noted in PNG's Application, a net present value (NPV) analysis was presented, for illustrative purposes only, whereby the LDS#2 assets were depreciated evenly over the primary term of the GSA (i.e. depreciate capital cost over 5 years at a flat rate of 20% per year). PNG reiterates that this scenario was presented solely for illustrative purposes, to show that under the contractual arrangements, the capital cost of LDS#2 would be fully recovered and that incremental margin would also be generated to the benefit of ratepayers over the primary term of the GSA.

PNG was not proposing to depreciate the assets over the contract term.

Existing Regulatory and Accounting Practices

In its Application, PNG had anticipated depreciating the LDS#2 assets in accordance with its established regulatory and accounting practice of depreciating assets over their estimated useful lives. If an instance were to arise before the end of the assets estimated useful life where the assets were determined to no longer be used or useful, or to be impaired in value, PNG would be required to record a write-down in the value of the asset in a manner consistent with established regulatory and accounting practices.

Estimated Useful Life

Similar to many other utilities, the useful life estimates for PNG's assets are supported by periodic depreciation studies undertaken by independent depreciation consultants. Depreciation studies give consideration to estimated lives for asset groups, including a peer review and consultation with utility staff to identify company-specific factors that may impact service lives. The last depreciation study for PNG was completed in August 2017 with the resultant depreciation rates being implemented effective January 1, 2018. The 2017 Depreciation Study and the rates proposed therein were subject to BCUC review and approved as part of PNG's 2018-2019 Revenue Requirements Application.

As LDS#2 is a distribution regulating station and primarily comprised of assets classified to BCUC 477 – Regulating, PNG anticipated depreciating the assets over an estimated useful life of 35 years, equivalent to a rate of 2.857%, as per the recommendations of the 2017 Depreciation Study. As noted, the estimated useful life of the LDS#2 assets of 35 years exceeds the GSA contract terms of 4.5 to 10 years by a material amount.

Further, PNG has noted that, with minor modifications, the packaged station could be reused for future needs at alternate locations. With potential industrial and large commercial developments in the PNG service territory, PNG is confident that the station could be repurposed and reused for the remainder of its useful life.

Asset Impairment

As indicated in the Application and as noted in response to Information Requests, PNG believes there to be a likely occurrence that the LDS#2 assets will be repurposed following their use for the LNGC Project. Consequently, the LDS#2 assets are expected to generate cash flows, either directly or indirectly, after the primary and any renewal contract terms expire as the assets can be repurposed for various other cash generating uses.

In the unforeseen event that the LDS#2 assets are determined to be no longer used and useful, or assessed as being impaired in value at any time during their estimated useful life, PNG would propose to retire or write-down the asset and defer the amount of the undepreciated plant balance or write-down in the Ordinary Plant Gains and Loss deferral account to be amortized over five years. This would be consistent with PNG's current BCUC-approved treatment for asset retirements and gains and losses realized in the normal course of business.

US GAAP Differences

Lastly, as noted in response to Information Requests, PNG believes there would be a difference in the accounting treatment for regulatory purposes and financial reporting under US GAAP if PNG were directed to use a depreciation rate based on the primary term of the GSA contract. The use of a depreciation rate based on the primary term would result in accelerated depreciation of assets and recognition of amortization expenses that would be materially different than what is permitted under US GAAP.

While the incremental cost to PNG would not be significant, if PNG were directed to use a depreciation rate based on the primary term, it would result in PNG keeping two sets of accounting records – one for financial reporting under US GAAP and one for regulatory purposes – to track differences in asset value and amortization expenses, thus doubling the administrative time and effort required to account for the LDS#2 assets.

Please direct any questions regarding this letter to my attention.

Yours truly,

Verlon G. Otto