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Via E-file

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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 Watson Island Customer Tie-in  
Establishment of Depreciation Rate  
Letter of Comment**

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On September 25, 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 net capital expenditures of approximately \$2.55 million to design and construct new natural gas service infrastructure, including a pipeline, a regulating station and meter site assets (collectively, the Watson Island Customer Tie-In [WICT] Project). The WICT Project is necessary to provide natural gas service to Pembina Pipeline Corporation (Pembina) for their proposed liquified petroleum gas export terminal to be constructed on Watson Island in Prince Rupert, British Columbia (Application). In the Application PNG also sought approval under section 39 of the UCA to enter into a gas sales agreement (GSA) with Pembina dated September 4, 2019, to provide natural gas service to Pembina for an initial period of 20 years.

By Order C-4-19 dated October 9, 2019, the BCUC granted a CPCN to PNG authorizing the construction and operation of the WICT Project and approved the GSA.

On October 31, 2019, the BCUC issued Order G-266-19 to amend the regulatory timetable to make provision for a review of the appropriate depreciation rate for the WICT Project assets, observing 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.” The amended 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 WICT Project 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 WICT Project assets were depreciated evenly over the primary term of the GSA (i.e. depreciate capital cost over 20 years at a flat rate of 5% per year). PNG reiterates that this scenario was presented solely for illustrative purposes, to show that under the contractual arrangements, the capital cost of the WICT Project 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 WICT Project 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 the WICT Project assets are primarily distribution pipeline and regulating assets, they are comprised of assets classified to BCUC 475 – Distribution Mains and BCUC 477 – Regulating. BCUC 475 assets are depreciated over the estimated useful life of 65 years for assets in this class at a rate of 1.538%. BCUC 477 assets are depreciated over the estimated useful life of 35 years for assets in this class at a rate of 2.857%, as per the recommendations of the 2017 Depreciation Study. As noted, the estimated useful life of the WICT assets of 35-65 years exceeds the GSA contract term of 20 years by a considerable amount.

Further, PNG has noted that a significant secondary benefit from construction of the WICT Project is that PNG will have an asset in place that has the potential to be used as a platform to serve other new customers in the Watson Island development. PNG has detailed that competition for land and other resources, which have viable access to tidewater, is currently very high and that a number of project developers giving consideration to Watson Island as a potential project site have spoken to PNG over the past year. Further, PNG has communicated that the City of Prince Rupert is actively marketing this site for industrial development and that PNG expects most of these projects would require natural gas.

#### 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 WICT Project assets will be used and useful, to some extent, beyond the 20-year GSA term. Consequently, the WICT Project assets are expected to generate cash flows, either directly or indirectly, after the primary and any renewal contract terms expire.

In the unforeseen event that the WICT Project 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 WICT Project assets.

Please direct any questions regarding this letter to my attention.

Yours truly,

A handwritten signature in black ink, appearing to read "Verlon Otto". The signature is written in a cursive style with a large initial "V" and a stylized "O".

Verlon G. Otto