LAWSON LUNDELL LLP

Suite 1600 Cathedral Place
925 West Georgia Street
Vancouver, BC
Canada V6C 3L2
T: 604.685.3456

October 2, 2020

Ian Webb
D: 604.631.9117
F: 604.694.2932
iwebb@lawsonlundell.com

Via E-filing

British Columbia Utilities Commission
Suite 410, 900 Howe Street
Vancouver, BC V6Z 2N3

Attention: Marija Tresoglavic
Acting Commission Secretary

Dear Ms. Tresoglavic:

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

On behalf of Shannon Estates Utility Ltd. (**SEUL**), and in accordance with the regulatory timetable established by BCUC Order No. G-186-20, we enclose for submission to the BCUC SEUL's response to the BC Old Age Pensioners' Organization, Active Support Against Poverty, Council of Senior Citizens' Organization of BC, Disability Alliance BC, and Tenant Resource and Advisory Centre's Information Request No. 2.

Yours very truly,

LAWSON LUNDELL LLP

Ian Webb

Ian Webb

IDW/ns1
Enclosures
cc. Michelle Casey, Lawson Lundell
Joanne Liu, Wall Financial Corporation

SHANNON ESTATES UTILITY LTD.
RESPONSE TO BCOAPO INFORMATION REQUEST NO. 2

12.0 Reference: Exhibit B-4, BCOAPO IR 1.1.2

12.1 Does SEUL concede that to the extent that cost forecasts are on the high side, other things equal, the risk of the utility under-earning with respect to its allowed RoE is diminished due to the increased "headroom"? If not, please explain fully.

RESPONSE:

SEUL agrees that to the extent that rates are set on the basis of a cost forecast and actual costs end up being lower than the cost forecast, the risk of SEUL under-earning with respect to its allowed RoE is lower than if actual costs are equal to or higher than the forecast (all other things being equal). SEUL believes, however, that the cost forecast and related deferral account proposals in the Application are a reasonable basis for setting rates on a levelized basis for ten years.

13.0 Reference: Exhibit B-4, BCOAPO IR 1.7.2

13.1 Can SEUL confirm that a more concise response to the premise in the referenced IR is "Yes"? If not, please explain.

RESPONSE:

No. The phrase "effectively as a boost to ROE" as used in the original information request is not sufficiently clear to support a "yes" response. In particular, it is not clear how reasonably compensating the shareholder for its investment in the utility could be viewed "effectively as a boost to ROE". It is not appropriate to confirm, without qualification, a statement that is not fully understood and could be subject to different interpretations.

14.0 Reference: Exhibit B-4, BCOAPO IR 1.7.4

14.1 Does SEUL agree that if the affiliate were charged more than stand-alone cost (i.e., the cost of self-provision), the affiliate would be better off providing the service on its own? If not, please explain fully.

RESPONSE:

SEUL does not fully understand this question. We assume that in the posited scenario, an affiliate is proposing to charge "the affiliate" more than the cost of self-provision, but the question does not indicate the circumstances. As a general statement, a utility requiring a service should make reasonable efforts to procure the service cost-effectively considering matters such as availability, quality, risk, period of time the service is required, and price.

14.2 Does SEUL agree that if the affiliate were charged exactly stand-alone cost (i.e., the cost of self-provision), the affiliate would be no better off than if the affiliate providing the service on its own? If not, please explain fully.

RESPONSE:

Please refer to the response to BCOAPO IR 14.1.

14.3 Does SEUL still maintain that stand-alone cost is not a maximum with respect to the appropriate charge to an affiliate for a service provided to the affiliate?

RESPONSE:

SEUL may have misunderstood the intent of BCOAPO IR 7.4. Given the scope of the Application and the preamble reference of the question, SEUL understood the information request to be asking about the use of deemed capital structure, allowed ROE and a deemed debt interest rate for setting regulated rates. Please refer to the response to BCOAPO IR 14.1.

15.0 Reference: Exhibit B-4, BCOAPO IR 1.7.6

15.1 Please confirm that the response provided indicates that SEUL is 100% debt financed: if unable to so confirm, please explain.

RESPONSE:

Confirmed.

15.2 If SEUL is 100% debt financed, please comment on how the risks and rewards are different for SEUL and its owner than it would be if it were actually financed as indicated by its deemed capital structure.

RESPONSE:

There would be no impact to the risks and rewards to SEUL's owner, Wall Financial Corporation ("WFC"), as WFC has invested in this utility with the goal of earning a Commission-approved rate of return on its investment. There are, however, significant benefits and cost savings to SEUL and therefore to its customers due to WFC providing 100% financing on an interest free basis. These benefits include the following:

- **Avoidance of the setup fees, standby fees, interest payments, and annual review fees that SEUL would have incurred if it received financing from a traditional lending institution. Normally, these expenditures would be included in computing the utility's cost of service, which would in turn be factored into setting the utility's rates; and**
- **No annual reviews and financial or operating covenants that SEUL must maintain. Instead, SEUL has the freedom to run its business as needed in a regulated environment without seeking and obtaining lender approval or dealing with the various restrictions lenders typically impose.**

It should be noted that had SEUL not received this loan from WFC, SEUL would have been required to incur significant costs (as noted above) and may not have been able to obtain sufficient financing on reasonable terms due to the tighter lending restrictions in today's pandemic environment. For example, SEUL does not own the type of traditional assets favoured by lenders (such as land) that SEUL could pledge as security and does not have a proven track record of profitability, both of which are factors considered by the banks and lenders in assessing the credit and terms they are willing to extend.

15.3 Does SEUL agree that financiers usually consider firms that are 100% debt financed to be risky and therefore usually are required to pay a higher cost for their debt?

RESPONSE:

SEUL is not itself an expert in financing and does not have particular expertise on or insight into the question asked in this information request. However, SEUL understands in general that the assessment of a firm's risk depends on many factors. SEUL expects that were SEUL to seek and obtain financing from a bank, the bank

would consider a variety of factors in assessing the risk of the utility which would in turn influence the rate the bank would charge to the utility. SEUL expects that these factors would include, among many others, the stability of the business, the value of the business' assets, and the security the bank would receive for the loan.

15.4 Are any of the assets of SEUL pledged as collateral to WFC in order to secure the debt financing? If so, please explain fully.

RESPONSE:

No.

15.5 Is there any possibility that SEUL could default on its loan obligations to WFC or is the interest free aspect of the loans a feature to ensure that in the event of financial hardship of SEUL, the carrying costs of the debt would be zero?

RESPONSE:

The carrying cost of the debt to SEUL is currently zero.

15.6 Please discuss fully the financial advantages and disadvantages, including the ramifications with respect to taxes paid, for SEUL and for WFC of the current actual capital structure and debt terms of SEUL.

RESPONSE:

Generally speaking, interest paid by an entity is tax deductible while interest earned by another entity is taxable. By not paying interest on the intercompany loan, SEUL does not get the benefit of the tax write-off associated with the interest that would have been payable on the loan (i.e. equal to 27% of the interest amount). However, the interest expense is not included as an expense in the Financial Model for purposes of setting the rates. This means that SEUL's customers are better off by an amount equal to the difference between the expense and the tax benefit (or 74% of the interest amount in this instance).

16.0 Reference: Exhibit B-4, BCOAPO IR 1.7.8 Attachment, WFC 2020 AR

16.1 Please confirm that per the AR, the only mentions in respect of regulatory affairs or regulatory issues are (i) "municipal regulatory requirements" (p. 7), (ii) "environmental regulatory authorities" (p. 7), and (iii) "additional regulatory scrutiny" in the event of cyber-attacks (p. 8). If unable to so confirm, please explain.

RESPONSE:

In addition to the references cited in the question above, the Wall Financial Corporation 2020 Annual Report includes the following references to regulatory matters:

- **Reference to "adverse government and environmental regulations" under the heading "Forward-Looking Statements" (p. 4);**
- **Reference to "government policies, regulations and taxation" under the heading "General risks" (p. 6);**
- **Reference to "government and environmental regulations" under the heading "Industry risks" (p. 6);**
- **Statement that "Various government bodies (including the Canadian federal government, the British Columbia provincial government and the Vancouver municipal government) are exploring or enacting legislation and regulations that are intended to have an impact on the real estate industry" under the heading "Concentration of assets risk" (p. 6);**
- **Reference to "changes in regulations and taxes" under the heading "Properties under development" (p. 7); and**
- **Reference to "increased government regulation" under the heading "Disease outbreak" (p. 7).**

17.0 Reference: Exhibit B-3, BCUC IR 1.3.1

17.1 Does SEUL agree that if all of its fixed costs are recovered by fixed charges, the risk of under-recovering fixed costs due to demand variations is reduced to almost zero? If not, please fully explain why not.

RESPONSE:

SEUL agrees that if the Capacity Levy is set on the basis of fully recovering all forecast fixed costs, there will be little risk that variances in customer energy consumption will cause under- or over-recovery of fixed costs. Please refer to section 7 of the Application. SEUL notes, however, such a Capacity Levy will create a risk of under-recovery of fixed costs – for example, if actual fixed costs are higher than forecast fixed costs. Please also note that in the Application SEUL used the term "fixed costs" in reference to all costs except for SEUL's electricity and natural gas costs.