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Nelson Hydro

Reconsideration and Variance of Order G-196-22

Decision
and Order G-311-23

November 15, 2023

Before:
C. M. Brewer, Panel Chair

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Executive Summary

The British Columbia Utilities Commission (BCUC) issued its decision on Nelson Hydro's Cost of Service Analysis (COSA) and Rate Design application on July 19, 2022 (COSA Decision)[1]. Pursuant to section 99 of the *Utilities Commission Act*, Nelson Hydro filed an application on December 2, 2022, requesting that the BCUC reconsider and vary two aspects of the COSA Decision based on alleged errors of fact and law; namely 1) the directives related to the allocations of generation and power purchases in Nelson Hydro's COSA, and 2) the directives for the utility to utilize a debt-to-equity ratio of 50 percent/50 percent in calculating the rate base of its Rural operations (Reconsideration Application). In the alternative, if the BCUC upholds the COSA Decision, Nelson Hydro seeks two alternative requests as follows: a) that the BCUC adjust the allocation of the power purchases at the FortisBC (FBC) Coffee Creek Substation (Coffee Creek) based on an additional error of fact, and b) that the BCUC also direct the capital reserve transfer to be contributed to by both Rural and Urban customers to achieve a fair outcome amongst these ratepayers groups.

In the Reconsideration Application, Nelson Hydro submits that the BCUC made a key error of fact when assuming that the generation assets were located in the Rural area, which, it argues, has a material bearing on the COSA Decision. In Nelson Hydro's view, this factual error leaves the COSA Decision reasoning to allocate 100 percent of the generation assets to the Common[2] assets and costs category unsupported.

Having reviewed the COSA Decision and the submissions received in the Reconsideration Application proceeding, the Panel finds that the BCUC determination to assign the generation assets and costs 100 percent to Common was not contingent on the location of the generation assets. As stated in the COSA Decision, the primary reason for the BCUC's determination that the generation assets and costs should be assigned to Common is that Nelson Hydro's generation assets are used by both Urban and Rural customers. The BCUC expressly stated that this reason alone could justify assigning the generation assets and costs to Common. Therefore, the Panel denies Nelson Hydro's request to vary the COSA Decision for the generation assets and costs to be assigned 100 percent to the Urban customers in the COSA. For the same reason, the Panel also denies Nelson Hydro's request to vary the COSA Decision by assigning the power purchases 33.5 percent to Urban and 66.5 percent to Rural.

The Panel then turned its attention to Nelson Hydro's two alternative requests concerning the Coffee Creek power purchases and the capital reserve transfer. On the first alternative request, the fact that Nelson Hydro can simultaneously export power to FBC at Bonnington and import power from FBC at Coffee Creek, resulting in net exports to FBC, again highlights that power purchases are used by both Urban and Rural customers with no clear separation within one integrated system. Thus, the Panel denies Nelson Hydro's request to vary the COSA Decision by adjusting the allocation of power purchases costs from Coffee Creek to 100 percent to the Rural service area.

On the second alternative request, the Panel is not persuaded that Nelson Hydro's request to have Rural ratepayers contribute to the capital reserve fund while also paying an allowed return in their rates is grounded

[1] BCUC Decision and Order G-196-22 dated July 19, 2022.

[2] Assets and costs that cannot be allocated 100 percent to the Urban or Rural service areas are considered Common and are broken out to all customers based on usage.

in standard regulatory practices for public utilities. A key aspect of Nelson Hydro's justification for its request is that the COSA Decision cannot lead to a fair outcome nor one that permits the operation of a safe, reliable, and appropriately sustained utility for Rural ratepayers. In the Panel's view, whether Nelson Hydro generates sufficient funds to operate and sustain the utility is an issue more appropriately addressed in a revenue requirement proceeding, which looks at the level of revenue generated through rates to recover the costs to provide safe and reliable service. Therefore, the Panel denies Nelson Hydro's reconsideration request to assign the capital reserve transfer 100 percent to Common.

As for the reconsideration pertaining to the capital structure as established in the COSA Decision, the Panel confirms Nelson Hydro's return on equity (ROE) at 9.25 percent on a deemed equity component of 50 percent. The Panel considers that so long as the return is commensurate to the risks faced by Nelson Hydro as compared to the Benchmark Utility, Nelson Hydro's Rural rate should be sufficient to yield a fair and reasonable compensation. Differences between the achieved and allowed ROE typically relate to whether the utility is forecasting its revenue requirements appropriately, rather than whether there is a need to alter the capital structure or allowed ROE so that the shareholder is fairly compensated. A utility must be given <u>an opportunity</u> to earn a fair and reasonable return, but this does <u>not guarantee that it will actually earn such return</u>. Rural ratepayers should not bear the burden of the City of Nelson's borrowing restrictions by way of an increase to the equity component beyond what is already fairly compensated via the risk assessment.

The Panel therefore denies Nelson Hydro's request to set the debt-to-equity ratio to reflect Nelson Hydro's actual debt-to-equity for the estimated rate base of Nelson Hydro's Rural operations and to increase Nelson Hydro's debt in advance of any future COSA filing.

1.0 Introduction

On December 2, 2022, Nelson Hydro filed an application for reconsideration and variance of Decision and Order G-196-22 dated July 19, 2022 (COSA Decision)[1] pursuant to section 99 of the *Utilities Commission Act* (UCA) with the British Columbia Utilities Commission (BCUC) and in accordance with Part V of the BCUC's Rules of Practice and Procedure (Reconsideration Application).

Nelson Hydro is in part, excluded from the definition of a public utility under the UCA. By the definition in section 1(1) of the UCA, a public utility does not include "a municipality or regional district in respect of services provided by the municipality or regional district within its own boundaries." Nelson Hydro is owned and operated by the City of Nelson (the City) and serves Urban customers within the City's boundaries, as well as Rural customers outside the City's boundaries. The BCUC's review of the Reconsideration Application pertains solely to Nelson Hydro's Rural ratepayers, as the BCUC only has jurisdiction to regulate Nelson Hydro's public utility operations outside the City's boundaries.

In the Reconsideration Application, Nelson Hydro seeks an order to reconsider and vary several directives of Order G-196-22. The particulars of those directives are set out in Section 1.1 below.

1.1 Background

On July 19, 2022, the BCUC issued Order G-196-22 and accompanying reasons for decision regarding Nelson Hydro's Cost of Service Analysis (COSA) and Rate Design application (COSA Decision). The BCUC ordered, among other things, the following:

i. Nelson Hydro to recalculate its COSA with generation assets and costs assigned 100 percent to Common assets and costs, which are assets and costs that cannot be allocated 100 percent to the Urban or Rural service areas and are broken out to all customers based on usage (Common);

ii. Nelson Hydro to recalculate its COSA with power purchase costs assigned 100 percent to Common costs; and

iii. Nelson Hydro's return on equity is set at a 50-basis point premium above the benchmark as established by Order G-75-13 on a deemed equity component of 50 percent.

1.2 COSA Decision Findings and Directives

Generation Assets and Costs

In Section 2.3.1 of the COSA Decision, the BCUC determined that Nelson Hydro's generation assets and costs should be assigned 100 percent to Common assets and costs for the following three reasons.

1) Nelson Hydro's generation assets are used by both Urban and Rural customers.

   In the original COSA model submitted by Nelson Hydro, Urban customers use 88.9 percent of the power generated by Nelson Hydro that is not sold to FortisBC Inc. (FBC) or British Columbia Hydro

[1] Nelson Hydro Cost of Service Analysis and Rate Design Application dated November 27, 2020 proceeding.

and Power Authority (BC Hydro) while Rural customers use the remaining 11.1 percent. This reason alone could justify assigning the generation assets and costs to Common. Also, there is no physical separation of the power flows between Urban and Rural customers, as all the power from Nelson Hydro's generating facilities is delivered by its one integrated transmission system into its one integrated distribution system to service both Urban and Rural customers. Nelson Hydro's Urban and Rural customers draw their power from one common pool.[2]

2) There is no sound regulatory reason for assigning the generation assets and costs 100 percent to Urban customers.

   Nelson Hydro submitted that Rural ratepayers had not contributed equitably to the investment in these assets or their operation. However, Nelson Hydro acknowledged that in previous years the City's accounting practices were not sophisticated enough to properly identify that it was operating to the detriment of Urban ratepayers, so it is difficult to see how it could be determined with any reasonable certainty that Rural ratepayers had not contributed equitably towards the assets that were used to generate their power.[3]

   The BCUC made no determination on this point but found that it was not relevant for the purposes of setting rates for Rural ratepayers of Nelson Hydro. The BCUC sets rates on a prospective basis. This is a well-established regulatory practice and a widely accepted principle of ratemaking. The BCUC did not consider the original motivations for Nelson Hydro's investments or whether Rural ratepayers have historically contributed equitably to such investments in the past to be relevant at the time of the decision in a prospective examination of Rural rates.

   Furthermore, the BCUC disagreed that assigning generation assets and costs to Common would in effect constitute "reallocating ownership of the generation assets to all customers of the utility." Assets assignments in a COSA are to determine the customers from whom the related costs should be recovered and do not change the ownership of the underlying assets.

   What was relevant is that the generation assets used to provide electricity service to both Rural and Urban ratepayers are today owned by Nelson Hydro, a BCUC-regulated public utility in respect of the Rural service, and have been within the scope of the BCUC's regulation since at least September 11, 1980, when Nelson Hydro's authorization under the UCA was deemed to be granted. This authorization further means that, under section 121 of the UCA, Nelson Hydro's management authority over the use of its generation assets does not supersede or impair the BCUC's rate-setting role for Nelson Hydro's Rural ratepayers, including the BCUC's powers to determine the appropriate allocation of generation assets and costs.[4]

3) Nelson Hydro is not obligated by the *Community Charter* to assign 100 percent of its generating assets and costs to Urban customers.

   The BCUC disagreed with Nelson Hydro that the *Community Charter* obligates Nelson Hydro to assign all of the generation assets and costs to Urban. The BCUC acknowledged that section 7(b) of the

[2] COSA Decision, pp. 26–27.
[3] Ibid., p. 27.
[4] COSA Decision, pp. 27–28.

Community Charter says that one purpose of a municipality is "providing for services, laws and other matters for community benefit." The BCUC further acknowledged that the principles of statutory interpretation require both the *Community Charter* and the UCA to be considered as part of the overarching legislative scheme under which Nelson Hydro operates, and that the words of both statutes must be read together "in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act[s], the object of the Act[s], and the intention of Parliament."

Sections 59 and 60 of the UCA expressly provide the power to the BCUC to determine a rate for Nelson Hydro to charge its Rural ratepayers that is not unjust, unreasonable, unduly discriminatory or unduly preferential. As explained above, section 121 of the UCA expressly provides that nothing done under the *Community Charter* supersedes or impairs a power conferred on the BCUC or an authorization granted to a public utility. Therefore, even if a rate approved by the BCUC for Rural ratepayers did not provide "community benefit" in the meaning of section 7(b) of the *Community Charter*, the UCA has paramountcy over the *Community Charter* and the rate stands. This interpretation is also consistent with section 8(10) of the *Community Charter*, which states that powers provided to municipalities under section 8 are "subject to any specific conditions and restrictions established under this or another Act," the other Act in this case being the UCA.

Further, pursuant to section 60 (1) (b.1) of the UCA, the BCUC "may use any mechanism, formula or other method of setting the rate that it considers advisable," and this includes determining that Nelson Hydro's generation costs should be assigned to Common and thereafter allocated on a sound regulatory basis between Urban and Rural customers.[5]

Power Purchases

In Section 2.3.2 of the COSA Decision, the BCUC found Nelson Hydro's power purchases are used by both Urban and Rural customers with no clear separation, and that power purchase costs should be allocated 100 percent to Common and thereafter allocated on a sound regulatory basis.[6]

The BCUC disagreed with Nelson Hydro's premise that Rural ratepayers should pay for proportionately more of the power purchase costs than the Urban ratepayers. Nelson Hydro submitted that it would not purchase "nearly the same amount of power from FBC but for the fact that it services the Rural service area", but the same could have been said of the Urban service area. Further, Nelson Hydro acknowledged that the need to purchase additional power was only added as demand grew "in the Urban and Rural areas", undermining the notion that Rural ratepayers are proportionately more responsible for power purchase costs than Urban ratepayers.[7]

Capital Structure and Earned Return

In Section 3.5 of the COSA Decision, the BCUC found that Nelson Hydro faces greater risk than the Benchmark Utility. The BCUC set a return on equity (ROE) for Nelson Hydro's Rural operations at 50-basis-point premium

[5] COSA Decision, p. 29.
[6] Ibid., pp. 30–31.
[7] Ibid., p. 31.

above the Benchmark Utility rate at the time of the COSA Decision, which is 9.25 percent. The BCUC also set a deemed debt-to-equity ratio of 50 percent/50 percent based on its risk assessment of Nelson Hydro as well as the City's ability to raise debt.[8] The BCUC denied Nelson Hydro's request to phase-in the allowed ROE over three years and directed Nelson Hydro to set rates based on the approved ROE and deemed capital structure.[9]

In the COSA Decision, the BCUC acknowledged the Nelson Hydro 2017 Rate Application decision that it is more fair and reasonable to rely on an actual debt-to-equity ratio when a deemed capital structure cannot be achieved. However, the BCUC in the COSA Decision found that Nelson Hydro can theoretically achieve higher debt levels and cited section 75 of the UCA that the BCUC is not bound by previous decisions.[10]

Other

The BCUC made no determination on the capital reserve transfer, as it was 100 percent assigned to Urban customers.[11]

2.0 Reconsideration Application

Nelson Hydro requests that the BCUC reconsider and vary the COSA Decision on the grounds that the BCUC made material errors of law and fact. In particular, Nelson Hydro requests the BCUC vary the COSA Decision as follows:

i. Nelson Hydro be directed to assign its generation assets and costs 100 percent to its Urban customers in the COSA;

ii. Nelson Hydro be directed to assign power purchases 33.5 percent to Urban and 66.5 percent to Rural; and

iii. A debt-to-equity ratio reflecting the utility's actual debt-to-equity be used for the estimated rate base of Nelson Hydro's Rural operations and Nelson Hydro be directed to increase its debt in advance of any future COSA filing.[12]

2.1 Review Process

The BCUC established a regulatory timetable for the review of the Reconsideration Application (Reconsideration proceeding), providing for public notice, intervener registration, one round of Information Requests (IRs), submissions on further process, and final arguments.[13]

The following interveners participated in the Reconsideration proceeding :

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[8] COSA Decision, pp. 75–77.
[9] Ibid., p. 78.
[10] Ibid., p. 77.
[11] Nelson Hydro COSA and Rate Design proceeding (COSA proceeding), Exhibit B-1, Appendix 8-1LCost of Service Analysis (November 2020), p. 21.
[12] Exhibit B-1, p. 4.
[13] Order G-392-22, Order G-73-23, and Order G-175-23.

- Residential Consumer Intervener Association (RCIA);
- Mr. Randy Evanchuk (Mr. Evanchuk); and
- Mr. Daniel Gatto (Mr. Gatto).

The BCUC received 11 letters of comment from the public which focused on the unfairness of cost allocation if the COSA Decision is varied and the lack of Rural ratepayer representation in Nelson Hydro's governance.[14]

2.2 Legislative and Regulatory Framework

The definition of "public utility" in section 1 of the UCA reads in part:

> **"public utility"** means a person, or the person's lessee, trustee, receiver or liquidator, who owns or operates in British Columbia, equipment or facilities for
>
> (a) the production, generation, storage, transmission, sale, delivery or provision of electricity, natural gas, steam or any other agent for the production of light, heat, cold or power to or for the public or a corporation for compensation, or […]
>
> but does not include
>
> (c) a municipality or regional district in respect of services provided by the municipality or regional district within its own boundaries, […]

For the remainder of this decision, the portion of the definition of "public utility" in section 1 of the UCA presented in part above, will be referred to as Municipal Exclusion.

Sections 59 to 61 of the UCA require the BCUC to set rates that are not unjust, unreasonable, or unduly discriminatory in respect of services provided by regulated utilities.

Pursuant to section 99 of the UCA, the BCUC has a broad express statutory power to reconsider the COSA Decision, and the procedure to do so is set out in Rule 26 of the BCUC Rules of Practice and Procedure (BCUC Rules). Section 99 states that "[t]he commission, on application or on its own motion, may reconsider a decision, an order, a rule or a regulation of the commission and may confirm, vary or rescind the decision, order, rule or regulation."

Rule 26.04 (c) of the BCUC Rules provides that an application for reconsideration must be filed in accordance with the rules pertaining to document filing and must describe the impact of the decision and how it is material.

Rule 26.05 of the BCUC Rules provides that an application for reconsideration must contain a concise statement of the grounds for reconsideration and include one or more of the following grounds:

(a) The BCUC has made an error of fact, law, or jurisdiction which has a material bearing on the decision;

[14] Exhibit E-1, Lengsfeld Letter of Comment; Exhibit E-4, Murphy Letter of Comment; Exhibit E-10, Munroe Letter of Comment.

(b) Facts material to the decision that existed prior to the issuance of the decision were not placed in evidence in the original proceeding and could not have been discovered by reasonable diligence at the time of the original proceeding;

(c) New fact(s) have arisen since the issuance of the decision which have material bearing on the decision;

(d) A change in circumstances material to the decision has occurred since the issuance of the decision; or

(e) Where there is otherwise just cause.

Section 121 of the UCA describes the relationship with the *Local Government Act* and reads in part:

> 121 (1) Nothing in or done under the *Community Charter* or the *Local Government Act*
>
> (a) supersedes or impairs a power conferred on the commission or an authorization granted to a public utility, or relieves a person of an obligation imposed under this Act or the *Gas Utility Act*.

3.0 Reconsideration Decision

In this section, the Panel addresses whether the BCUC erred in fact or law, and, if so, whether to vary the COSA Decision as follows:

1. Assign Nelson Hydro's generation assets and costs from 100 percent Common to 100 percent to Urban customers in the COSA;
2. Assign power purchases from 100 percent Common to 33.5 percent Urban and 66.5 percent to Rural;
    - If the COSA Decision is upheld in respect of the above two reconsideration items, the Panel will also address two new elements introduced by Nelson Hydro in the Reconsideration Application with respect to the assignment of the (i) power purchases at the Coffee Creek Substation (Coffee Creek) and (ii) capital reserve transfer; and
3. Use Nelson Hydro's actual debt-to-equity ratio for the estimated rate base of Nelson Hydro's Rural operations and direct Nelson Hydro to increase its debt in advance of any future COSA filing.

3.1 Allocation of Generation and Power Purchases

In the Nelson Hydro COSA and Rate Design proceeding (COSA proceeding), Nelson Hydro proposed to allocate 100 percent of the generation assets and costs to its Urban customers and value any surplus generation supplied to Rural customers at the FBC wholesale energy rate.[15] Nelson Hydro also assigned power purchases 33.5 percent to Urban customers and 66.5 percent to Rural customers.[16] In the COSA Decision, the BCUC rejected Nelson Hydro's proposed assignment of generation assets and costs, and directed Nelson Hydro to recalculate the COSA with generation assets and costs assigned 100 percent to Common assets and costs, citing the following three reasons:

[15] COSA proceeding, Exhibit B-1, p.58.

[16] Ibid., Exhibit B-4, BCUC IR 12.6.

(a) Nelson Hydro's generation assets and costs are used by both Urban and Rural customers;

(b) There is no sound regulatory reason for assigning 100 percent of the generation assets and costs to Urban customers; and

(c) Nelson Hydro is not obligated by the Community Charter to assign 100 percent of its generating assets and costs to Urban customers.[17]

Relying on the same reasoning, the BCUC also rejected Nelson Hydro's proposed allocation of power purchases and directed that they be treated as Common costs in the COSA.[18]

Nelson Hydro submits that the COSA Decision was unreasonable, as the BCUC made a key error of fact, which has a material bearing on the COSA Decision. Nelson Hydro states that the COSA Decision consistently highlighted the importance of the location of assets in allocating their associated assets and costs. However, the BCUC made an error of fact when it found that Nelson Hydro's generation assets "reside in the Rural area" when, in fact, they have been in the City of Nelson (i.e. the Urban area) since a 2003 boundary expansion.[19]

Nelson Hydro acknowledges that the location of the generation assets was "not determinative" in the COSA Decision but remains convinced that the factual error served as the foundation for the BCUC's finding that the assets' location "did not support an allocation of 100 percent of the assets and costs to the Urban customers." Nelson Hydro submits that this factual error has a material bearing on the BCUC Decision, something the BCUC itself recognized when stating that "the assignment of generation and power purchase costs are likely to have a material effect on the ultimate allocation of costs between the Rural and Urban customer classes, and consequently on Rural customers' rates".[20]

Nelson Hydro states that the COSA Decision is to be reviewed on a standard of reasonableness as described in paragraph 85 of *Canada (Minister of Citizenship and Immigration) v. Alexander Vavilov (Vavilov)*.[21] A reasonable decision is one based on an internally coherent and rational chain of analysis, and one which is justified in relation to the facts and law that constrain the decision maker. A decision cannot be upheld if the BCUC reached an outcome based on flawed logic; both the outcome of the COSA Decision and the process by which it was reached are to be considered. Furthermore, as stated in *Vavilov*, at paragraph 86, even if the ultimate outcome was reasonable and falls within the range of possible, accepted outcomes, an otherwise reasonable outcome cannot stand if it was reached on an improper basis. Nelson Hydro submits that the factual error led to the COSA Decision being reached on an improper basis and had a material effect on the ultimate allocation of costs.[22]

In Nelson Hydro's view, the factual error regarding the location of the generation assets leaves the BCUC's reasoning unsupported on all three counts. Regarding the first reason, Nelson Hydro explains that the BCUC cited the location when noting that "there is no clear separation of the generation assets". Nelson Hydro is able to show that this is an error of fact, since the boundaries were changed to include the generation assets, and it

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[17] COSA Decision, pp. 26–29.

[18] Ibid.

[19] Exhibit B-1, pp. 8–9.

[20] Ibid., p. 9.

[21] Supreme Court Judgments, Canada (Minister of Citizenship and Immigration) v. Alexander Vavilov, 2019 SCC 65.

[22] Exhibit B-1, p. 9.

further submits that the BCUC relied on this error to conclude that there is no sound regulatory reason for assigning the generation assets and costs 100 percent to Urban customers. Nelson Hydro asserts that location of the assets in the City supports a clear separation of the generation assets. Furthermore, Nelson Hydro points out that, while the BCUC also cites other reasons to support its finding, the location of the generation assets is the first reason presented, which it argues, indicates that the BCUC's belief that the generation assets were in the Rural area was a significant factor in the BCUC's finding that there is no clear separation of the generation assets.[23]

With respect to the second reason, Nelson Hydro submits that the BCUC also relied on the mistaken assumption that the generation assets were in the Rural area and the fact that they are in the City actually provides a "sound regulatory reason for assigning the generation assets and costs 100 percent to Urban customers" because City taxpayers have historically funded these assets. As such, Nelson Hydro states that City Council is entitled to exert control over an asset that it has not only owned and maintained for over 100 years, but is located in the City and primarily used to provide a service within its own boundaries, a service area that is not subject to BCUC regulation.[24]

Regarding the third reason, Nelson Hydro asserts once more that the BCUC's mistaken assumption played a significant role in its determination and that the location of the generation assets in the City changes the analysis of the City's obligations under the *Community Charter*. Nelson Hydro submits that the *Community Charter* gives municipal councils the ability to control a municipality's assets for community benefit and it is not the BCUC's role to second guess and overrule a decision made by succeeding municipal councils that its longstanding investment in hydro generation should benefit City residents. The urban location strengthens Nelson Hydro's argument that the assets should be controlled by City Council and used for "community benefit" under the *Community Charter*.[25]

Therefore, when recognizing that the generation assets are in the Urban area, Nelson Hydro argues on the one hand that the BCUC's reasoning in rejecting its proposed allocations is left unsupported and on the other hand, Nelson Hydro's reasoning in support of its proposals can no longer be rejected.[26]

In the COSA proceeding, Nelson Hydro submitted that the Municipal Exclusion in the UCA prevents the BCUC from "reallocating ownership of the generation assets to all customers of the utility" and that any such reallocation would be an "extension of the BCUC's authority to the municipal portion of the utility, and contrary to the lawful scope of the BCUC's regulatory oversight under the UCA". In essence, Nelson Hydro submits that the treatment of generation as an Urban asset properly reflects the scope of the BCUC's authority under the UCA, while recognizing the City's authority and obligations under the *Community Charter*. Nelson Hydro also asserts that any reallocation of the City's generation assets to the Rural ratepayers would be an extension of the BCUC's authority to the municipal portion of Nelson Hydro, and contrary to the lawful scope of the BCUC's regulatory oversight under the UCA.[27]

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[23] Exhibit B-4, BCUC IR 2.3; Nelson Hydro Final Argument, p. 12.
[24] Ibid.
[25] Exhibit B-4, BCUC IR 2.3; Nelson Hydro Final Argument, p. 13.
[26] Nelson Hydro Final Argument, p. 13.
[27] Ibid., p. 10.

Nelson Hydro submits that the Municipal Exclusion clearly places regulation of the Urban portion of Nelson Hydro outside the scope of the BCUC's regulatory authority, which includes, in Nelson Hydro's view, those assets physically located in the Urban area that are used to service Urban ratepayers.[28]
During this Reconsideration proceeding, Nelson Hydro provides a list of all assets located in the City and assigned to Common, as shown in Table 1.[29]

Table 1: Nelson Hydro's Common Assets Located in the City of Nelson

Asset ID	Description
SS-Mill12kV-T40	Power Transformer T40
SS-Mill12kV-Outdoor Metalclad	Switchgear Outdoor Metalclad
SS-Mill12kV-12VR40	Voltage Regulator 12VR40
SS-Mill12kV-Outdoor 60kV Fuse Structure	Outdoor 60kV Fuse Structure
SS-Mill12kV-Fence/Gate Assembly	Station Yard Fence/Gate Assembly
SS-Mill12kV-System Ground Grid	Station Yard System Ground Grid
SS-Mill12kV-Outdoor Bus	Station Yard Outdoor Bus
SS-Mill12kV-Arrestors	Lightning Arrestors Arrestors
SS-Mill25kV-T41	Power Transformer T41
SS-Mill25kV-T42	Power Transformer T42
SS-Mill25kV-60CB4	Circuit Breaker 60CB4
SS-Mill25kV-Outdoor Steel Structure	Structure Outdoor Steel Structure
SS-Mill25kV-Outdoor Disconnect Switches	Outdoor Disconnect Switches
SS-Mill25kV-25VR41	Voltage Regulator 25VR41
SS-Mill25kV-25VR42	Voltage Regulator 25VR42
SS-Mill25kV-25CR41	Recloser 25CR41
SS-Mill25kV-25CR42	Recloser 25CR42
SS-Mill25kV-E-House & P&C	Protection & Controls E-House & P&C
SS-Mill25kV-Fence/Gate Assembly	Station Yard Fence/Gate Assembly
SS-Mill25kV-System Ground Grid	Station Yard System Ground Grid
SS-Mill25kV-Outdoor Bus & Structures	Station Yard Outdoor Bus & Structures
SS-Mill25kV-High Voltage Cable	Station Yard High Voltage Cable
SS-Mill25kV-Outdoor Disconnect Switches	Outdoor Disconnect Switches
SS-Mill25kV-Arrestors	Lightning Arrestors
SS-Mill25kV-25MU40	Metering Unit 25MU40
SS-Mill25kV-Arrestors	Lightning Arrestors
SS-Mill25kV-25CR40	Recloser 25CR40
SS-Granite-Circuit Breaker	Circuit Breaker 60CB2
SS-Granite-Circuit Breaker	Circuit Breaker 60CB3
SS-Granite-Circuit Breaker	Circuit Breaker 60CB12
SS-Granite-Circuit Breaker	Circuit Breaker 60CB27
SS-Granite-Switchgear	Switchgear E-House P&C
SS-Granite-Structure	Structures Switches & Bus
SS-Granite-Fence	Station Yard Civil Fence/Gate Assembly
SS-Granite-Grnd Grid	Station Yard System Ground Grid

Positions of Parties

RCIA notes that Nelson Hydro goes to great lengths in its argument to assert the importance of the location of the generating assets, as well as the significance placed on the location by the BCUC. However, RCIA observes that, while the length of the panel determination portion of Section 2.3.1 of the COSA Decision is about four pages, the location of the generation assets is mentioned only once, in one sentence where the BCUC also explicitly states that "it does not consider this [the location] to be determinative", and then not referenced any

[28] Ibid., p. 13.
[29] Exhibit B-5, Evanchuk IR 3.1.

further. In RCIA's view, not only does this unambiguous statement make it clear that the BCUC does not consider the location of the assets to be material, it also does not lend itself to an interpretation according to which the said sentence is "significant", "crucial", or that the location of this sentence as the "first reason presented" is of any special importance.[30]

RCIA notes that Nelson Hydro also downplays the BCUC's statement that the location of the assets is not determinative when it submits that "[w]hile the location of the assets was deemed "not determinative", the assessment exceeds the materiality threshold required by the BCUC's Rules of Practice and Procedure." RCIA submits that the basis on which Nelson Hydro claims that something explicitly cited as "not determinative" could be considered "material" is unclear. In RCIA's view, it should be obvious from a plain reading of the COSA Decision that the BCUC did not consider the location of the generating station to be either determinative or material.[31]

RCIA also submits that Nelson Hydro's evidence regarding the location of the generation assets in the COSA proceeding is at best unclear and at worst has misidentified the location of the generating station as being in the Rural area.[32] In RCIA's view, the generation assets can even be considered to be de facto in the Rural area.[33]

In reply to RCIA, Nelson Hydro disagrees with RCIA questioning the basis for Nelson Hydro to claim something explicitly cited as not determinative could be considered material. Nelson Hydro stresses that the BCUC chose to focus on the location of the assets amidst a voluminous record even though such topic was not explored in the COSA proceeding, clearly indicating the significance of such factor.[34]

Nelson Hydro also submits that the materiality threshold regarding the BCUC error on the location of the assets has been met. Nelson Hydro submits that the location of the assets is, at law, determinative of which body has jurisdiction to determine the allocation of the cost and benefit of the generation assets. The determinative legislation is the UCA which precludes the BCUC from regulating the activities of a municipality within its municipal boundaries. Nelson Hydro stresses that the generation assets are within the municipal boundaries and the BCUC does not have the legal authority to determine the allocation of the costs or benefits of such assets. The City of Nelson possesses this jurisdiction and has exercised this jurisdiction through the adoption of its own policy decisions. Clearly, exclusion of such assets from the BCUC's review is material. Nelson Hydro notes that RCIA has provided no legal argument to overcome the specific exclusionary language of the UCA.[35]

In reply to RCIA's comment that the standard of review is set out in Part I of the BCUC Rules, Nelson Hydro submits that the standard of review is typically cited as the legal standard for judicial review while the BCUC Rules set out the procedure for a reconsideration application. Nelson Hydro states that while the BCUC Rules set out the procedural guidelines for reconsideration, the BCUC is also subject to the common law standard of review of reasonableness and correctness.[36]

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[30] RCIA Final Argument, pp. 9–10.
[31] RCIA Final Argument, p. 10.
[32] Ibid., p. 19.
[33] Ibid., pp. 19–20.
[34] Nelson Hydro Reply Argument, p. 7.
[35] Ibid.
[36] Nelson Hydro Reply Argument, p. 3.

Mr. Evanchuk submits that Nelson Hydro's argument, described at paragraphs 42 to 47 of the Reconsideration Application and according to which the BCUC's error on the location of assets had a material bearing on the COSA Decision, is invalid because a precedent has been set with the Common assets that are physically located in the City of Nelson as shown in Table 1.[37]

In its reply argument, Nelson Hydro notes Mr. Evanchuk's opposition to its Reconsideration Application but does not reply to Mr. Evanchuk on this issue.

Panel Determination

Section 99 of the UCA gives the BCUC broad statutory powers to reconsider the COSA Decision. The BCUC is not relying on the common law and therefore it is not constrained by any standard of review. As noted previously, Rule 26 of the BCUC Rules sets out the procedure and grounds for a reconsideration.

For the reasons set out below, the Panel finds that the BCUC determination to assign the generation assets and costs 100 percent to Common was not contingent on the location of the generation assets. As stated in the COSA Decision, the primary reason for the BCUC's determination that the generation assets and costs should be assigned to Common is that Nelson Hydro's generation assets are used by both Urban and Rural customers. The BCUC expressly stated that this reason alone could justify that determination. Therefore, the Panel denies Nelson Hydro's request to vary the COSA Decision for the generation assets and costs to be assigned 100 percent to the Urban customers in the COSA. For the same reason, the Panel also denies Nelson Hydro's request to vary the COSA Decision by assigning the power purchases 33.5 percent to Urban and 66.5 percent to Rural.

Generation Assets and Costs

The Panel acknowledges that there was a factual error regarding the location of generation assets in the COSA Decision but disagrees with Nelson Hydro that this error materially influenced or was determinative of the assignment of 100 percent of generation assets and costs to Common.

As stated in the COSA Decision's section headed "Nelson Hydro's generation assets are used by both Urban and Rural customers", the primary reason for the BCUC's determination that the generation assets and costs should be assigned to Common is, as indicated in the subheading, that Nelson Hydro's generation assets are used by both Urban and Rural customers.[38] As noted in the COSA Decision, the fact that there is no physical separation of the power flows between Urban and Rural customers, and that all the power from Nelson Hydro's generating facilities is delivered by its one integrated transmission system into its one integrated distribution system to service all customers supports the reasoning behind the BCUC determination to assign the generation assets and costs 100 percent to Common.

Thus, the Panel disagrees with Nelson Hydro's assertion that the location of the generation assets constituted the first reason presented in the COSA Decision. As RCIA observes, the location of the generation assets did not appear prominently in the BCUC reasons for allocating these assets and their related costs to Common and was not considered material. Indeed, the location was neither the first reason, nor a reason at all for that matter. The BCUC's first reason was as follows: "The COSA states that Urban customers use 88.9 percent of the power

[37] Evanchuk Final Argument, p. 5; Exhibit B-5, Evanchuk IR 3.1.
[38] COSA Decision, p. 26.

generated by Nelson Hydro that is not sold to FBC or BC Hydro, and that Rural customers use the remaining 11.1 percent. **For this reason alone, generation assets and costs could reasonably be assigned to Common**."[39] [*Emphasis added*]

The Panel notes that in its Reconsideration Application, Nelson Hydro does not dispute the fact that both Urban and Rural customers use its generation assets, and that there is no physical separation of the power flows between these two groups of customers. In the Panel's view, the BCUC's reasoning in the COSA Decision did not depend on the location of the generation assets. Therefore, the determination to assign the generation assets and costs 100 percent to Common related entirely to usage and was not dependent on the location of the assets.

The Panel appreciates that Nelson Hydro has corrected its evidence regarding the location of the generation assets in its Reconsideration Application,[40] but there is no dispute that Nelson Hydro's generation assets are used by both Urban and Rural customers with no physical separation of the power flows between them. BCUC's error as to the location of the generation assets is therefore inconsequential. The Panel agrees with the COSA Decision that the fact of common usage between both Urban and Rural customers alone justifies the assignment of 100 percent of the generation assets and costs to Common.

Furthermore, the Panel notes that the BCUC buttressed its determination to allocate the generation assets and costs 100 percent to Common by providing two additional compelling reasons, namely, that there is no sound regulatory reason for assigning the generation assets and costs 100 percent to Urban customers, and pointing out that the UCA authorizes the BCUC to use any mechanism, formula or other method of setting the rate that it considers advisable.

The BCUC rejected Nelson Hydro's argument that Rural ratepayers had not contributed equitably to the investment in the generation assets or their operation. This was difficult to ascertain due, as Nelson Hydro itself acknowledged, to Nelson Hydro's past accounting practices. However, the COSA Decision found that contributions toward the assets are not relevant for the purposes of setting rates for Rural ratepayers.

The Panel agrees with the COSA Decision in this regard. The BCUC sets rates on a prospective basis, which follows a well-established regulatory practice and a widely accepted principle of ratemaking. To this end, the primary factor that the BCUC considered, as noted above, was that the generation assets are used to provide electricity service to both Rural and Urban ratepayers, regardless of the assets' location.

The Panel disagrees with Nelson Hydro's submission that the location of the generation assets played a significant role in shaping the BCUC's rejection of Nelson Hydro's argument that the *Community Charter* obligates Nelson Hydro to assign all the generation assets to Urban. The BCUC's determination of which entity – the BCUC or the City – has jurisdiction over the allocation of assets for the purpose of determining a rate relied on sections 59 and 60 of the UCA. Those provisions give express power to the BCUC to determine a rate. Referencing section 60 (1) (b.1) of the UCA, the COSA Decision correctly states that the BCUC can use any mechanism, formula or other method of setting the rate that it considers advisable to set a Rural rate for Nelson Hydro.[41]

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[39] COSA Decision, p. 26.
[40] Exhibit B-4, BCUC IR 4.1, Appendix 4.1.
[41] COSA Decision, p. 29.

The Panel agrees that the powers conferred to the BCUC under sections 59 and 60 of the UCA include the power to determine that Nelson Hydro's generation assets and costs should be assigned to Common. Also, as stated above, in the Panel's view, the BCUC was able to reach this determination on the sole basis that these generation assets are used by both Rural and Urban customers, without regard to the assets' location.

In addition, the COSA Decision made clear that, with respect to Nelson Hydro as a public utility, the UCA has paramountcy over the *Community Charter* because section 121 of the UCA expressly states that nothing done under the *Community Charter* supersedes or impairs a power conferred on the BCUC or an authorization granted to a public utility. This means that Nelson Hydro has the authority to make management decisions regarding the use of its generation assets, but its decision must be consistent with the provisions of the UCA.

Furthermore, the Panel is not persuaded by Nelson Hydro's argument that the location of assets is, at law, determinative of which body has jurisdiction to determine the allocation of such assets' costs and benefits. The Panel notes that Nelson Hydro did not reference any statute or provide any legal authority that would support its assertion.

To be clear, the Panel does not disagree that the UCA definition of a public utility does not include a municipality in respect of services provided by the municipality within its own boundaries. In fact, the Panel notes that the COSA Decision made no determination on the provision of service by Nelson Hydro to its Urban customers nor on any other aspect of the Urban service that may affect Urban rates, such as the level of dividend and capital reserve transfer from the Urban ratepayers. However, the location of the generation assets in British Columbia does not determine regulation under the UCA. The Panel notes that none of the operative words in either the definition of public utility or the Municipal Exclusion relate to the location of assets, equipment or facilities used to provide utility service, whether public or municipal. Therefore, one cannot conclude from a plain reading of the Municipal Exclusion that the location of assets used to provide service is, on its own, determinative of which body has jurisdiction to determine the allocation of such assets' costs and benefits.

As a case in point, the Panel notes Mr. Evanchuk's submission, which highlights the fact that in its COSA, Nelson Hydro has allocated several assets located in the City to Common. This appears to contradict Nelson Hydro's position that location is determinative of the assets and cost allocation.

Having reviewed the COSA Decision, the Panel disagrees with Nelson Hydro that the factual error in respect of the location of the generation assets was foundational to the BCUC determination to assign the generation assets and costs 100 percent to Common. **The Panel finds that the BCUC determination to assign the generation assets and costs 100 percent to Common was not contingent on the location of the generation assets. It is therefore a reasonable decision based on an internally coherent and rational chain of analysis, which is justified on the relevant facts and law. Therefore, the Panel denies Nelson Hydro's request to vary the COSA Decision for the generation assets and costs to be assigned 100 percent to the Urban customers.**

Power Purchases Costs

The Panel is cognizant that the BCUC used a similar reasoning in the COSA Decision to allocate the power purchases 100 percent to Common as it did for the generation assets and costs. There, the BCUC determined that, like generation assets and costs, Nelson Hydro's power purchases are used by both Urban and Rural customers with no clear separation. As a result of the above Panel determination on the allocation of the generation assets and costs, **the Panel also denies Nelson Hydro's request to vary the COSA Decision by assigning the power purchases 33.5 percent to Urban and 66.5 percent to Rural.**

3.1.1 Coffee Creek Substation

Nelson Hydro submits that if the Panel upholds the COSA Decision to allocate 100 percent of the generation assets and power purchases to Common, it should nonetheless adjust the allocation of power purchases costs from Coffee Creek to 100 percent to Rural based on a factual error in the COSA Decision.[42]

Nelson Hydro notes that when determining the generation allocation, the BCUC stated:

> There is no physical separation of the power flows between Urban and Rural customers. All the power from Nelson Hydro's generating facilities is delivered by its one integrated transmission system into its one integrated distribution system to service both Urban and Rural customers. Nelson Hydro's Urban and Rural customers draw their power from one common pool.[43]

Nelson Hydro states the same common pool logic should then be applied equally to the costs of power purchases from FBC.[44] Nelson Hydro states that the factual error is that the power from Coffee Creek serves Rural customers only, as there is a physical separation of a portion of the utility's power flows. The area of the North Shore served by Coffee Creek is isolated from the remainder of the Nelson Hydro service area by a switch that under all conditions is open (i.e. disconnected). During system outage restoration or planned maintenance, the normally open switch location can change, however it is always on the North Shore (i.e. in the Rural service area). Even without this physical restriction, there is no scenario where power would be supplied to the Urban area from the North Shore, as it can already be supplied through substations at Mill Street and Rosemont which are supplied from Granite Terminal which is fed by the Bonnington Falls Generating Station and FBC. Accordingly, energy and demand billing from Coffee Creek should be allocated 100 percent to Rural.[45]

Nelson Hydro recognizes that there may have been some confusion regarding language used that described Nelson Hydro as having an "integrated" system and hydraulic generation that can serve both Urban and Rural service areas. Nelson Hydro acknowledges both statements are true such that both service areas are part of a single utility and most of the Rural area is connected to the Urban area. However, in the case of Coffee Creek, such connection is not possible, as the substation cannot serve Urban customers.[46]

In the COSA proceeding, Nelson Hydro stated Coffee Creek is wholly owned and operated by FBC and serves FBC customers as well as Nelson Hydro Northshore Rural customers.[47] Nelson Hydro has a metering unit within the station to reconcile billing.[48] Therefore, Coffee Creek and its associated costs are not included in Nelson Hydro's COSA model.[49]

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[42] Exhibit B-1, p. 11.
[43] COSA Decision, p. 27.
[44] Exhibit B-1, p. 10.
[45] Ibid., p. 11.
[46] Exhibit B-1, p. 11.
[47] COSA proceeding, Exhibit B-15, BCOAPO IR 58.1; Exhibit B-13, Faust IR 7.
[48] COSA proceeding, Exhibit B-15, BCOAPO IR 58.1.
[49] COSA proceeding, Exhibit B-19, BCOAPO IR 97.1.

Nelson Hydro explained that it could supply Northshore customers through the City's transmission lines in the event of loss of supply from FBC at Coffee Creek.[50] Nelson Hydro stated that anytime there is a loss of supply from FortisBC Coffee Creek point of interconnection, Nelson Hydro attempts, load permitting, to supply as many customers as possible, including the Northshore Rural customers, from the Mill Street Substation.[51] An example is when FBC has a failure within Coffee Creek as occurred in November 2022 as a result of a low voltage bushing failure on their Coffee Creek T3.[52]

Nelson Hydro explained that energy and demand purchases from FBC are measured at FBC delivery points.[53] Nelson Hydro noted Coffee Creek is one of three metering points located at the point of interconnections with FBC. The other two are located at the Bonnington and Rosemont Granite Substations.[54] Bonnington Substation is assigned to Common, as it is a generation asset, while Rosemont Granite is assigned to Common, as it is located centrally enough to be able to serve both Rural and Urban loads.[55] Both are supplied by FBC power purchases and Nelson Hydro generation.[56]

Nelson Hydro explained, there are times when Nelson Hydro exports to FBC at Bonnington because the South Shore, the City of Nelson, and lower North Shore load is below Nelson Hydro generation capacity. At the same time, Nelson Hydro imports power from FBC at Coffee Creek to supply Redfish to Coffee Creek. When this occurs, FBC calculates the net total. If the hourly net total indicates a generation surplus, then it is recorded as a sale to FBC.[57]

Positions of Parties

RCIA submits that Nelson Hydro has provided no technical studies or reports demonstrating Urban residential are unable to be served from Coffee Creek power purchases, nor has Nelson Hydro shown that the limitation could never be mitigated under potential future development scenarios.[58] RCIA also notes that Nelson Hydro has not explained why Rural customers served from the South Shore distribution system should be allocated any costs attributable to the Coffee Creek imports given Nelson Hydro's logic that Urban customers cannot be served via Coffee Creek. This highlights the fact that Coffee Creek is even less able to serve South Shore Rural customers, a fact that contradicts Nelson Hydro's argument to assign these costs to Rural. As the BCUC considered the system configuration and location of generating facilities in the COSA Decision and no plausible new facts have been introduced, RCIA submits that Nelson Hydro has failed to meet the requirements of Rule 26.05 of the BCUC Rules.[59]

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[50] COSA proceeding Exhibit B-1, p. 56.
[51] Exhibit B-7, RCIA IR 2.2, 2.2.1.
[52] Ibid., RCIA IR 2.2.1.
[53] COSA proceeding, Exhibit B-13, Faust IR 7.
[54] COSA proceeding, Exhibit B-12, BCUC IR 26.22.
[55] COSA proceeding , Exhibit B-1, Appendix 8-1, p. 8; Exhibit B-9 BCOAPO IR 16.4.
[56] COSA proceeding, Exhibit B-15, BCOAPO IR 58.4.
[57] COSA proceeding, Exhibit B-19, BCOAPO IR 98.1.
[58] Nelson Hydro Final Argument, p. 26.
[59] RCIA Final Argument, p. 24.

In reply, Nelson Hydro disagrees with RCIA and points to various IRs where Nelson Hydro has explained why it cannot serve the Urban area from Coffee Creek. The limitation on the FBC Coffee Creek transformer makes it physically impossible to serve the Urban area or even all the Northshore customers under any conditions. Thus, all power metered by FBC at its Coffee Creek substation serves Rural customers and, Nelson Hydro argues, should be so allocated.[60]

Nelson Hydro also points out that the COSA calculates costs for all regulated rural customers and allocates them fairly such that customers in the North and South service areas pay the same rates. There is no attempt by Nelson Hydro to charge the Northshore customers more because they are serviced by FBC. Nelson Hydro only wants all Rural costs to be correctly allocated based on the principles outlined in the COSA Decision, which indicated that the physical separation of power flows must be considered in allocating power purchases between Rural and Urban customers.[61]

Mr. Evanchuk submits that Nelson Hydro's statements about the power purchases at Coffee Creek affirm the BCUC's proper allocation of FBC purchases because if Coffee Creek is supplied 100 percent to Rural customers, everything else is Common.[62]

Nelson Hydro does not rebut Mr. Evanchuk's point directly in its reply argument.

Panel Determination

The Panel does not consider that the BCUC erred in concluding that power purchase be assigned 100 percent to Common even though the power from Coffee Creek serves Rural customers only. Generation was assigned 100 percent to Common, as it is used by both Rural and Urban customers. The power from Nelson Hydro's generating facilities is delivered by one integrated transmission system into its one integrated distribution system to service both Urban and Rural customers. In the event of power loss from FBC at Coffee Creek, power can flow through the City's transmission lines to the Northshore customers.

Power purchases are assigned 100 percent to Common because the power is used by both Urban and Rural customers with no clear separation. The BCUC disagreed with Nelson Hydro's premise that Rural ratepayers should pay for proportionately more of the power purchase costs than the Urban ratepayers, as Nelson Hydro acknowledged that the need to purchase additional power was only added as demand grew "in the Urban and Rural areas," undermining the notion that Rural ratepayers are proportionately more responsible for power purchase costs than Urban ratepayers.

Coffee Creek is wholly owned by FBC outside Nelson Hydro's integrated system and was not included in the COSA model. Coffee Creek is one of three delivery points where Nelson Hydro receives its purchased power from FBC. The other two delivery points supply Urban and Rural customers with generation and power purchases. Nelson Hydro explained in the COSA proceeding that in times of generation surplus from the City and the Rural Southshore, it will export power to FBC at Bonnington while at the same time still import power from FBC at Coffee Creek. When this occurs, FBC determines a net total based on the amount of generation exported at Bonington and imported at Coffee Creek. This flow and purchase of power at different delivery points again

[60] Nelson Hydro Reply Argument, p. 10.
[61] Ibid.
[62] Evanchuk Final Argument, p. 6.

highlights that power purchases are used by both Urban and Rural customers with no clear separation. In other words, the power is used within one integrated system.

Given that when purchased power enters any point in Nelson Hydro's system it becomes part of the Nelson Hydro's integrated system, **the Panel denies Nelson Hydro's request to vary the COSA Decision by adjusting the allocation of power purchases costs from the Coffee Creek substation to 100 percent to the Rural service area**.

As such, the Panel does not need to address RCIA's argument that the South Shore customers would also need to be excluded from the costs of Coffee Creek purchases if Nelson Hydro's assertions are correct.

3.1.2 Capital Reserve Transfer

In the Reconsideration Application, Nelson Hydro clarifies that its original COSA proposal to allocate capital reserve transfer 100 percent to Urban was based on its proposal to allocate generation 100 percent to Urban.[63] Nelson Hydro submits that if the BCUC upholds its COSA Decision to allocate 100 percent of generation to Common, it should direct Nelson Hydro to modify the COSA to also allocate the proportionate amount of capital reserve transfer to Common.[64]

Nelson Hydro argues that the benefits conferred by the utility's low-cost legacy hydro generation should be accompanied by the cost of investing in the utility's assets.[65] Thus, as the COSA Decision directed Nelson Hydro to allocate generation 100 percent to Common, it follows logically that transfers to the capital reserve also be allocated 100 percent to Common. In Nelson Hydro's view, it would be unfair to expect Urban ratepayers to fund all investment but share the benefits from those investments (i.e. low-cost generation) with Rural ratepayers.[66] Equally, it would be unfair and unreasonable for Rural customers to have the benefit of common cost allocation of the generation assets, while making no contribution to the capital reserves of Nelson Hydro, which support the generation assets.[67]

Nelson Hydro submits that the COSA Decision effectively creates a subsidy from Urban to Rural ratepayers, as the latter receive the benefit of low-cost generation while the former must increasingly rely on higher-cost power purchases from FBC, purchases it would not otherwise require so long as it can rely on its own hydro plant. This results from assigning a portion of Nelson Hydro's generation to Rural, which proportionally reduces the portion of higher-cost power purchases assigned to Rural. In addition, Nelson Hydro states that, under the model directed by the COSA Decision, the Urban customers will be those generating the funds to sustain the hydro plant, even though much of the generation will be allocated to service the Rural customers.[68]

Nelson Hydro submits that its position is supported by previous BCUC decisions.[69] In Decision and Order G-119-17, the BCUC approved the applied-for transfer to capital reserves and Nelson Hydro's practice of financing its capital expenditures primarily through the use and management of the fund.[70] In Decision and Order G-274-19, the BCUC found that making no allocation from Rural ratepayers to the capital reserve was unreasonable, and stated the following:

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[63] Nelson Hydro Final Argument, p. 15.
[64] Exhibit B-1, p. 7.
[65] Nelson Hydro Final Argument, p. 15.
[66] Ibid., p. 16.
[67] Exhibit B-1, p. 9.
[68] Exhibit B-4, BCUC IR 9.2.
[69] Nelson Hydro Final Argument, p. 16.
[70] Decision and Order G-119-17 dated August 8, 2017, p. 14.

> The panel considers that making no allocation to the Capital Reserve Fund by Rural ratepayers is unreasonable. The Capital Reserve Fund is set aside for future investments in the generating and distribution network for the benefit of all Nelson Hydro ratepayers and has been contributed to by both Rural and Urban ratepayers in the past. Further, the Capital Reserve Fund is used to hold any variance in net operating income and any surpluses, less any deficits, have been contributed by both Rural and Urban ratepayers. The Panel expects that the Capital Reserve will continue to provide these functions for Rural ratepayers, **<u>so for Rural ratepayers not to contribute to the Capital Reserve would contravene the provision of section 59(5)(b) of the UCA that requires rates to be sufficient to yield "a fair and reasonable compensation for the service provided by the utility," as Rural ratepayers would not be contributing to the fund that will be used in future years to maintain and enhance the system which they use.</u>** The Panel is not persuaded that it is reasonable for Nelson Hydro to arbitrarily assign the Capital Reserve transfer exclusively to Urban customers.[71] [*Emphasis added by Nelson Hydro*]

Thus, Nelson Hydro submits that not requiring Rural customers to also contribute to the capital reserve if they benefit from low-cost generation would reverse years of regulatory decisions by the BCUC without any sound regulatory reasons. Nelson Hydro submits that the impact would be to substantially undermine its ability to sustain the utility.[72]

In the COSA proceeding, InterGroup Consultants Ltd. (InterGroup) prepared a COSA study (the COSA Study),[73] which Nelson Hydro described as being consistent with standard utility practice.[74] InterGroup used a rate base/rate of return method for the purpose of the COSA Study for Rural customers. InterGroup explained that Nelson Hydro's previous general rate applications included a dividend and transfer to capital reserve as part of the costs to serve all customers, while the COSA Study was prepared using a rate base/rate of return method where the dividend and capital reserve transfer are replaced by ROE and amortization expense.[75] In the COSA Study, InterGroup allocated the capital reserve transfer to the Urban customer classes only considering the status of Nelson Hydro as a municipally-owned utility and the need to generate revenues to fund capital.[76] Nelson Hydro explained that in the COSA Study, capital reserves are funded by Urban rates, which is made possible by the City of Nelson having its own low-cost generation.[77]

However, during this Reconsideration proceeding, Nelson Hydro states that "a "return on equity (ROE) and amortization expense" cannot universally replace a transfer to capital reserves, nor can one model universally substitute for the other". Thus, while Nelson Hydro did not originally propose a capital reserve transfer from Rural ratepayers in the COSA Study because it favoured using an ROE/Return on Rate Base (ROE/RORB) model with hydro output priced at FBC rates for these customers, Nelson Hydro clarifies that the issue is not the form of return but rather determining a means to generate the funds needed to operate and sustain the utility. Nelson Hydro explains that, in the COSA and Rate Design Application dated November 27, 2020 (COSA Application), its proposed ROE/RORB model had the potential to support the Rural assets, and the hydro output pricing had the opportunity to support the hydro plant output. However, the COSA Decision severely curtailed Nelson Hydro's access to ROE funding for the Rural areas. Unlike an investor-owned utility, Nelson Hydro does not consider the ROE as a return to the shareholder as compensation for the investment; rather, the ROE is

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71 Decision and Order G-274-19, November 17, 2019, p. 9.

72 Nelson Hydro Final Argument, p. 17.

73 In the COSA Application, Intergroup provided a study on the COSA called the Cost of Service Analysis for 2019.

74 COSA proceeding, Exhibit B-1, p. 1.

75 COSA proceeding, Exhibit B-1, Appendix 8-1, p. 3 and Exhibit B-4, BCUC IR 4.2.1.

76 COSA proceeding, Exhibit B-1, Appendix 8-1, p. 4.

77 COSA proceeding, Exhibit B-12, BCUC IR 71.2.1.

merely a separate form of cash flow to support the utility, which acts as an alternative to capital reserves and is part of a package that also includes fully priced output of the hydro plant.[78]

Nelson Hydro explains that it provided the BCUC with two comprehensive models that can generate the needed cash to sustain the utility's service delivery to Rural ratepayers: 1) the first model uses capital reserves, and 2) the second model uses a return on "equity" where equity is the entire investment in the net book value, plus a value for hydro output that is equivalent to the FBC bulk power price. Nelson Hydro states that these two approaches are substitutes for each other. However, the COSA Decision mixes and matches elements of each as if Nelson Hydro was an investor-owned utility. Nelson Hydro explains that this approach will fail because it cannot raise capital by issuing shares, or raise debt at will, or issue non-amortizing debt, or use long-dated debt reflective of the life of utility assets.[79]

To illustrate its point, Nelson Hydro uses numerical examples and contrasts the ROE of $1.292 million requested in its original COSA Application[80] to the ROE of $0.918 million approved by the BCUC in the COSA Decision.[81] Nelson Hydro points out that the applied-for ROE would have been available to support capital reinvestment in a Rural asset base of $15.313 million, which did not include generation, whereas the approved ROE of $0.918 million (i.e. 29 percent less than the applied-for ROE) would be required to fund reinvestment on a Rural asset base of $19.151 million (i.e. 25 percent more than in Nelson Hydro's original COSA Application), inclusive of the Rural share of generation assets. Nelson Hydro concludes that the COSA Decision, while in theory keeping the ROE model intact, effectively halved the funds available to Nelson Hydro for reinvestment coming from the Rural service area. The COSA Decision also eliminated the opportunity to generate free cash flow from the hydro output delivered to Rural areas.[82]

Nelson Hydro also notes that Rural customers' amortization expenses on hydro assets are very low compared to reinvestment needs because of the long life of these assets, and very old and low original cost values. Nelson Hydro clarifies that amortization expenses do not "fund" new assets, rather they recover the costs of old assets. Thus, amortization expenses can generate cash to permit reinvestment if they are material, but Nelson Hydro points out that the total amortization expenses (Urban and Rural) on the hydro assets are $264,000 per year, which it states are extremely limited compared to the assets in question. Nelson Hydro gives the example of 2023, which does not represent a particularly large year for capital at the hydro plant but is one where a set of sustaining projects is expected to cost $425,000. Nelson Hydro submits that without other sources of capital, such as the capital reserves, it is extremely challenging to consider how Nelson Hydro could sufficiently fund even moderate-sized reinvestment projects if they are to be funded solely by depreciation on past assets and an extremely limited ROE.[83]

Considering the constraints imposed on Nelson Hydro's ability to generate cash in relation to the Rural asset base, Nelson Hydro submits that the ROE/RORB model is severely challenged to yield the funds needed for reinvestment in assets from which Rural customers receive service, which only leaves capital reserves as a form of cash for reinvestment.[84] Nelson Hydro submits that the approach adopted by the COSA Decision cannot lead to a fair outcome nor one that permits the operation of a safe, reliable, and appropriately sustained utility for

[78] Exhibit B-4, BCUC IR 6.2.
[79] Exhibit B-4, BCUC IR 6.2.
[80] The ROE was applied to the Rural rate base based on an actual debt-to-equity ratio, i.e., equity portion of rate base at $13.966 million at 9.25 percent rate of return.
[81] Nelson Hydro calculated this ROE on a rate base of $19.852 million, inclusive of the rural share of hydro generation assets, at 50 percent equity, at 9.25 percent rate of return.
[82] Exhibit B-4, BCUC IR 6.2.
[83] Exhibit B-4, BCUC IR 6.2.2.
[84] Ibid.

Rural ratepayers. The COSA Decision in effect de-coupled the low-cost generation from capital reserves and will have a significant impact on the sustainability of the utility as a whole.[85]

Positions of Parties

RCIA submits that Nelson Hydro's request to recover part of the capital reserve from Rural customers is inappropriate and should be denied because it would effectively seek to have Rural customers become equity holders in the generating plant and while urban customers can benefit from such ownership through the municipal tax framework, the same is not true for Rural residential customers. In RCIA's submission, making any adjustments for ownership benefits through municipal taxes would more clearly and appropriately delineate utility rates from the municipal ownership piece.[86]

In reply, Nelson Hydro states that RCIA's submission is untrue and ignores previous BCUC direction and precedent, stating that a Rural contribution to capital reserves is appropriate and does not create any ownership interest.[87] Also, Nelson Hydro remarks that none of the interveners have addressed the fact that the COSA Decision framework will not allow Nelson Hydro to operate sustainably.[88]

Panel Determination

Nelson Hydro has requested that, in the event that the COSA Decision is upheld such that 100 percent of generation assets and costs are allocated to Common, the Panel assign the capital reserve transfer 100 percent to Common. Nelson Hydro argues that approving this request would be logical, otherwise it would result in an unfair treatment of Urban customers vis-à-vis Rural customers.

Given the Panel's prior determination in this decision to deny Nelson Hydro's request to assign the generation assets and costs to Urban, the Panel is prepared to assess Nelson Hydro's new request on its merits. However, the Panel clarifies that this request is not related to any prior determination made by the BCUC in the COSA Decision. This is because, in the COSA, Nelson Hydro had clearly intended to allocate 100 percent of the capital reserve transfer to Urban, and as a result, the COSA Decision remained silent on this topic.

In the COSA proceeding, Nelson Hydro's goal was to apply standard utility regulatory practices for Rural customers, while continuing to follow the best practices of municipal utility finance for the Urban customers. The Panel understands this meant using an ROE/RORB model and amortization expense for Rural customers, which the COSA Decision delivered, while Nelson Hydro would continue using the dividend and capital reserve transfer for Urban customers. The Panel now understands that Nelson Hydro's primary goal is to generate enough cash from Rural ratepayers to reinvest in the Rural rate base. The result is that Nelson Hydro no longer wishes to strictly adhere to standard utility regulatory practices for Rural customers as it now proposes to use elements of both models. Indeed, allocating 100 percent of the capital reserve transfer to Common would see Rural ratepayers fund part of the capital reserve going forward in addition to being subject to the ROE/RORB model and amortization expense. The Panel is not persuaded that Nelson Hydro's request to have Rural ratepayers contribute to the capital reserve fund while also paying an allowed return in their rates is grounded in standard regulatory practices for public utilities.

[85] Exhibit B-4, BCUC IR 6.2.

[86] RCIA Final Argument, p. 22, 25–26.

[87] Nelson Hydro Reply Argument, p. 9.

[88] Ibid., pp. 11–12.

Due to the approved ROE, which Nelson Hydro views as insufficient to maintain a Rural asset base inclusive of the Rural share of generation, it is now requesting BCUC approval of an additional means to generate the funds needed to operate and sustain the Rural side of the utility: a contribution from Rural ratepayers to the capital reserve. In the Panel's view, Nelson Hydro seems to be confusing the ROE with a replacement for the capital reserves, whereas Intergroup explained in the COSA Study that the ROE replaces the dividend, and amortization expenses replace the capital reserve transfer.

A key aspect of Nelson Hydro's justification for its request is that the approach adopted by the COSA Decision, which decoupled low-cost generation from capital reserves, cannot lead to a fair outcome nor one that permits the operation of a safe, reliable, and appropriately sustained utility for Rural ratepayers. However, the Panel notes that the level of capital required to be reinvested in the utility to maintain a safe and reliable operation was not examined in either the Nelson Hydro COSA proceeding or in the Reconsideration proceeding. In the Panel's view, whether Nelson Hydro generates sufficient funds to operate and sustain the utility is an issue more appropriately addressed in a revenue requirement proceeding, which looks at the level of revenue generated through rates to recover the costs to provide safe and reliable service. Nelson Hydro may address any issues related to the costs of providing safe and reliable service in either its 2024 revenue requirement application (RRA) or a future one.

The Panel also disagrees with Nelson Hydro that denying its request to allocate the capital reserve transfer 100 percent to Common, while upholding the COSA Decision to allocate the generation assets 100 percent to Common, equates with a reversal of years of regulatory decisions by the BCUC without any sound regulatory reasons. The Panel notes that the two previous BCUC decisions quoted by Nelson Hydro[89] were issued before the COSA Decision, at a time when Nelson Hydro didn't have proper accounting means to separate the costs of Rural versus Urban ratepayers. In that context, the BCUC Decision and Order G-274-19 stated that "the Capital Reserve Fund is set aside for future investments in the generating and distribution network for the benefit of all Nelson Hydro ratepayers and has been contributed to by both Rural and Urban ratepayers in the past."[90]

The Panel considers that there should be a distinction between the capital reserve that was funded by all ratepayers prior to the COSA Decision and the capital reserve that is funded by Urban ratepayers on a go-forward basis. The balance of historical capital reserve, toward which all ratepayers contributed, should continue to be used for future investments in the utility assets for the benefit of all ratepayers. Following the COSA Decision, Urban ratepayers alone fund the capital reserve for the assets assigned to Urban, while the Rural ratepayers are under the ROE/RORB and amortization expense model. This means Rural ratepayers fund their allocation of Common assets through the inclusion of these assets in the Rural Rate Base which earns a return and is charged amortization expense.

Thus, the previous BCUC decisions were coherent with the pre-COSA model under which Nelson Hydro was operating at the time in which all ratepayers contributed to the capital reserve. The decisions made following the COSA Decision reflect the distinction between the capital reserve treatment for Urban ratepayers and the ROE/RORB model and amortization of expense for Rural ratepayers implemented by virtue of the COSA Decision. This properly reflects the well-established regulatory practice that rates are set on a prospective basis and the COSA Decision's direction that Nelson Hydro is to use the COSA as the basis for subsequent RRAs.

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[89] BCUC Order G-119-17 and BCUC Order G-274-19.

[90] Nelson Hydro 2019 Rural Rate Application Order G-274-19 with reasons, p. 9.

For the reasons above, the Panel denies Nelson Hydro's request to assign the capital reserve transfer 100 percent to Common.

3.2 Deemed Capital Structure

In the Reconsideration Application, Nelson Hydro states that the BCUC failed to consider the evidence on the record and imposed a deemed debt-to-equity ratio of 50 percent/50 percent which it is unlikely to achieve, and even if it is achievable, would require several years to do so. Therefore, the BCUC has restricted Nelson Hydro from earning a fair return on its assets in the medium term if not the long term. Nelson Hydro states this outcome could extend well into the future depending on whether Nelson Hydro is able to overcome the challenges and limitations associated with acquiring additional debt. Nelson Hydro states it will take many consecutive years of capital investment in the Rural area to get anywhere near a debt-to-equity ratio of 50 percent/50 percent.[91]

Nelson Hydro submits that the COSA Decision should be varied to continue to allow Nelson Hydro to utilize its actual debt-to-equity ratio for the time being. In addition, Nelson Hydro submits that an appropriate directive would be to direct the utility to begin making efforts to achieve a higher level of debt but that the utility's actual debt-to-equity ratio be used while making these efforts so as to ensure Nelson Hydro earns a fair and reasonable return.[92]

Nelson Hydro notes that the BCUC in the COSA Decision repeatedly characterizes Nelson Hydro's ability to raise additional debt as "theoretically achievable" – a characterization that Nelson Hydro agrees with.[93] Nelson Hydro states its ability to achieve a debt level of 50 percent is purely hypothetical and is not completely within Nelson Hydro's or the BCUC's control. To achieve additional debt Nelson Hydro would need the approval of the electorate, the Regional District of Central Kootenay, and the Inspector of Municipalities.[94] Nelson Hydro explained that the electorate tends to be risk averse when local governments borrow and the fact that the borrowing would be for Rural assets would also likely deter the electorate from approving such borrowing.[95] Nelson Hydro also notes that it cannot borrow on a retroactive basis, and can only borrow for new capital expenditures, which would take significant time to achieve even assuming the required approvals are granted.[96]

Nelson Hydro explains that it is important for its actual capital structure to match its deemed capital structure for regulated rate-setting purposes, as is imperative that Nelson Hydro be able to generate sufficient cash to permit the Rural operations to fund reinvestment in the Rural rate base and that Nelson Hydro be treated in a manner that is fair in relation to its investment in the rural operations. This level of cash funding is not reached under a 50 percent/50 percent debt-to-equity ratio. Nor is a fair return achieved when Nelson Hydro invests equity into the Rural areas, where Nelson Hydro is only compensated as if this funding came from lower cost external debt.[97]

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[91] Exhibit B-1, pp. 12–11.
[92] Ibid., p. 15.
[93] Ibid., p. 14.
[94] Exhibit B-1, p. 14.
[95] Ibid., p. 12.
[96] Ibid., p. 8.
[97] Exhibit B-4, BCUC IR 11.4.

Nelson Hydro notes that comparing a municipal utility's borrowing ability to any commercial utility is not a relevant comparison, as municipalities operate under completely different market realities and legislation. No commercial utility has legislation that says it must get electoral approval to borrow or is restricted in its borrowing to one lender and borrowing based on the market, while a municipality's borrowing is based on restrictive legislation.[98]

Nelson Hydro clarifies it is not saying there should be no assessment of the utility's risks as a detailed assessment was provided in determining that the utility should earn a 9.25 percent ROE.[99] However, if an actual equity ratio is used, Nelson Hydro believes that a 9.25 percent return on that equity remains appropriate and should not be adjusted.[100]

In 2013, the BCUC initiated Stage 1 of the Generic Cost of Capital (GCOC) proceeding to review and determine the ROE and capital structure for a benchmark low-risk utility and a deemed capital structure and deemed ROE for small utilities, particularly those utilities without short-term debt.[101] The 2013 GCOC Stage 1 Decision affirmed deemed debt as is appropriate for small utilities in cases where raising debt is inefficient either due to the high cost of debt issuance relative to the size of the issue makes the effective debt cost higher than it would be otherwise or the size of the utility precludes it from accessing appropriate debt terms.[102]

Shannon Estates Utility Ltd. (SEUL) is one such example where the BCUC has approved a deemed capital structure of 57.5 percent debt and 42.5 percent equity, as the utility is restricted in its borrowing. SEUL is funded solely by its parent company on an interest-free basis. Were this otherwise, SEUL would have been required to incur significant costs and may not have been able to obtain sufficient financing on reasonable terms, as it does not own the type of traditional assets favoured by lenders that could be pledged 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.[103]

The 2013 GCOC Stage 1 Decision states that the BCUC has a duty to approve rates that will provide a reasonable opportunity to earn a fair return on invested capital. In determining the fair return, the BCUC examined the overall return (i.e. the ROE and the common equity component) allowed to the utility.

Consistent with the 2013 GCOC Stage 1 Decision, the COSA Decision confirmed the need for rates that provide a reasonable opportunity to earn a fair return on invested capital.[104] The COSA Decision clarified that risk is a key factor in determining the appropriate capital structure, however, the ability to achieve that capital structure must also be considered.[105] The COSA Decision determined that a deemed equity component of 50 percent is appropriate because 1) Nelson Hydro faces higher risk than the Benchmark Utility and therefore should have a

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[98] Exhibit B-4, BCUC IR 10.4.
[99] Ibid., BCUC IR 11.7.
[100] Ibid., BCUC IR 11.9, 11.10.
[101] 2013 GCOC Stage 1 Decision, p. 1.
[102] Ibid., pp. 103, 105.
[103] Shannon Estates Utility Ltd. Levelized Rate Application for the Shannon Estates Thermal Energy System Decision and Order G-36-21, pp. 12–13.
[104] COSA Decision, p. 62.
[105] Ibid., p. 76.

higher deemed equity than the Benchmark Utility and 2) Nelson Hydro is able to achieve an actual debt level of 50 percent.[106] The COSA Decision described the following three limitations placed on the City of Nelson's ability to borrow for Nelson Hydro:

(a) Section 2(a)(ii) of the Municipal Liabilities Regulation (MLR) prevents municipalities, such as Nelson from incurring a liability if the "total annual servicing cost of the aggregate liabilities is greater than 25 percent of annual revenues."

While Nelson Hydro states that applying the MLR borrowing thresholds to a single department of the City would not present an accurate picture of borrowing capacity, it confirms the City had a Liability Servicing Limit of $12,089,511 in 2019, of which $1,665,350 was utilized, leaving $10,424,161 in liability servicing capacity available.[107]

(b) The Municipal Finance Authority (MFA) requires that the City and, by extension, Nelson Hydro, demonstrate that revenues are sufficient to cover the cost of the borrowing, including principal repayment.

Nelson Hydro states, "The City is required to demonstrate that the revenues that will be raised (whether that is fees or taxation) can cover the debt servicing costs (principal and interest). If the debt was for a Rural asset that was being funded by debt then it would be the Rural rate revenues that would need to be sufficient to cover the debt service costs."[108]

(c) All long-term borrowing needs electoral approval per Section 180 of the *Community Charter*.

Nelson Hydro states that long-term borrowing (borrowing exceeding 5 years) by the City must be approved by the City's electorate, the Regional District of Central Kootenay Board of Directors and the Inspector of Municipalities, except in the case of a limited number of specific statutory exceptions.[109]

The COSA Decision calculated there was capacity to increase borrowings, subject to meeting the other constraints related to debt servicing. Nelson Hydro states that in the COSA Decision that its 2019 annual revenue for the Rural operations is $7,592,000, consequently the estimated ceiling for annual total debt serving cost is $1,898,000 (25 percent x $7,592,000). A total annual debt servicing payment in the amount of $1,898,000, while assuming a five-year loan period at an interest rate of 4.11 percent, would yield a total loan principal amount of $8,423,512 based on annual payments.[110] The COSA Decision noted this amount is approximately 52 percent of the rate base for Rural operations as estimated by Nelson Hydro.[111] The COSA Decision considered that a higher debt ratio in the amount of 50 percent is theoretically achievable and as such a deemed capital structure with a higher debt component would not unfairly restrict Nelson Hydro from earning a fair return on its assets.[112]

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106 Ibid.

107 COSA Decision, p. 70; COSA proceeding, Exhibit B-9, BCOAPO IR 6.5; Exhibit B-15, BCOAPO IR 42.1.

108 COSA Decision, p. 70; COSA proceeding, Exhibit B-19, BCOAPO IR 89.4.

109 COSA Decision, p. 70; COSA proceeding, Exhibit B-4, BCUC IR 11.2.

110 Present Value Calculation = $8,423,512; Pmt = $1,898,000, I/Y = 4.11 percent, N = 5.

111 52 percent = $8,423,512 / $16,103,000 Rural 2019 Mid-Year Rate Base (Exhibit B-15, BCOAPO IR 66.3 Attachment, Table 4).

112 COSA Decision, p. 77.

The decision attached to Order G-119-17 observed a dividend of $2.7 million was budgeted in the revenue requirement to be transferred to the City from Nelson Hydro. At that time, Nelson Hydro provided no explanation as to how this amount was arrived at each year.[113] In order to determine whether the amount of the dividend, and the methodology for determining the amount of the dividend, was reasonable from a regulatory perspective, the decision attached to Order G-119-17 compared the dividend against a proxy return calculated by using Nelson Hydro's actual equity component multiplied by FBC's allowed ROE.[114] The COSA Decision noted that the additional evidence, regarding Nelson Hydro's theoretically achievable debt level and risk assessment against the benchmark to determine an allowed ROE rather than a dividend, distinguished the circumstances in the COSA proceeding from those that led to Order G-119-17 which determined actual capital structure may be used.[115] The COSA Decision also noted that, pursuant to section 75 of the UCA, the BCUC is not bound by previous BCUC decisions.[116]

Positions of Parties

RCIA submits that Nelson Hydro chose to set up the utility as a department of the municipality rather than as a separate municipal entity, and any limitation on lending faced by Nelson Hydro is the result of the City's own decision(s) to create those restrictions, both in terms of the utility's corporate structure and the rules regarding borrowing. RICA notes Nelson Hydro's evidence does not appear to take into consideration the deemed structure would only apply to the Rural assets (including a proportional share of Common assets) and not the entire system.[117]

RCIA acknowledges that the BCUC has the ability to set a capital structure for ratemaking purposes which may or may not mirror the utility's actual capital structure. Therefore, RCIA submits there is no factual error.[118] RCIA also notes that Nelson Hydro fails to provide any calculation or other new evidence demonstrating how or if the deemed capital structure and return for the Rural portion of its system will fail to provide it with a reasonable opportunity to earn a fair return on those assets.[119]

RCIA submits that there are no calculations (either in the original or the Reconsideration Application) to support Nelson Hydro's assertion that it could take years, if ever, before it can achieve the deemed structure.[120]

Notwithstanding this, RCIA acknowledges that it may take some time for Nelson Hydro to achieve this structure on an actual basis, should it choose to do so. Therefore, to continue incenting the utility to maintain service to Rural residents and to alleviate any potential challenges, RCIA suggests the proposed capital structure be phased in to better enable Nelson Hydro to align its actual capital structure to deemed capital structure.[121]

In reply to RCIA, Nelson Hydro submits there would be essentially no difference to financing restrictions for a municipal corporation as for a municipal department, except risks would be higher if the municipality did not

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[113] Order G-119-17 with Reasons for the Decision, pp. 5–6.
[114] Order G-119-17 with Reasons for the Decision, p. 7.
[115] COSA Decision, p. 77.
[116] Ibid.
[117] RCIA Final Argument, p. 6.
[118] Ibid.
[119] RCIA Final Argument, p. 7.
[120] Ibid.
[121] Ibid.

stand behind the municipal corporation. However, Nelson Hydro does acknowledge, "while a municipal corporation would be able to borrow privately, it would not be able to access rates anywhere near those as low as what local governments are able to access."[122]

Nelson Hydro argues that there is no evidence indicating the corporate structure is the result of its "own decision"; and the BCUC has always accepted the current ownership structure and never requested that the City of Nelson explore a different ownership structure.[123]

Nelson Hydro argues that the COSA Decision was an error of law and it is neither correct nor reasonable to impose requirements which cannot reasonably be met. Nelson Hydro reiterates that the deemed capital structure will pose sustainability risks to the utility, impacting all customers.[124]

Finally, Nelson Hydro notes that RCIA could have requested through IRs additional details on how a deemed capital structure will fail to provide a reasonable opportunity to earn a fair return but did not.[125]

Panel Determination

For the reasons set out below, the Panel confirms Nelson Hydro's return on equity at a 50-basis point premium above the benchmark as established by Order G-75-13 at 9.25 percent on a deemed equity component of 50 percent as directed in Order G-196-22. The Panel denies Nelson Hydro's request to set the debt-to-equity ratio to reflect Nelson Hydro's actual debt-to-equity for the estimated rate base of Nelson Hydro's Rural operations and to increase Nelson Hydro's debt in advance of any future COSA filing.

Nelson Hydro's request to vary the debt-to-equity ratio determination rests on its assertion that, contrary to the COSA Decision findings, Nelson Hydro cannot achieve an actual debt level of 50 percent. Nelson Hydro elaborates on its borrowing limitations and challenges to raise additional debt, which it states will leave Nelson Hydro with a deemed debt-to-equity ratio that it cannot actually achieve. Nelson Hydro also submits that borrowing for capital investments in Rural areas must be related to actual capital investment on a go-forward basis and cannot borrow retroactively.

The Panel notes that in the COSA Decision, the BCUC found risk to be a key factor in determining the appropriate capital structure but noted that Nelson Hydro's ability to achieve the capital structure must also be considered. In its risk assessment of Nelson Hydro, the BCUC was not persuaded that the relative difference in risk for Nelson Hydro including its Rural operations warrants more than double the equity component of the Benchmark Utility (i.e. 85 percent versus 38.5 percent). The BCUC then relied on Nelson Hydro's submissions on the City's capacity to raise debt, to conclude a debt ratio of 50 percent to be theoretically achievable. Similarly, the COSA Decision did not follow Order G-119-17, which accepted an actual debt-to-equity ratio to be a more fair and reasonable approach than relying on a deemed capital structure.

The Panel agrees with the COSA Decision that risk is a key factor in determining the appropriate capital structure. Nelson Hydro does not dispute the COSA Decision risk assessment in its Reconsideration Application.

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[122] Nelson Hydro Reply Argument, p. 5, footnote 15.
[123] Nelson Hydro Reply Argument, p. 5.
[124] Ibid.., p. 4.
[125] Ibid., p. 6.

The Panel will therefore not revisit the Nelson Hydro's risk assessment here. Instead, the Panel will focus on whether Nelson Hydro's fair return should be based on a deemed capital structure or a capital structure that reflects Nelson Hydro's actual debt-to-equity ratio.

Using a deemed capital structure is a common practice among utility regulators in Canada. When setting a rate under the UCA, the BCUC must consider whether the rate is insufficient to yield fair and reasonable compensation for the services provided by the utility. A utility must be given <u>an opportunity</u> to earn a fair and reasonable return, but this does <u>not guarantee that it will actually earn such return</u>. The Panel considers that so long as the return, as determined in the COSA Decision, is commensurate to the risks faced by Nelson Hydro as compared to the Benchmark Utility, Nelson Hydro's Rural rate should be sufficient to yield a fair and reasonable compensation. The Panel considers that how Nelson Hydro decides to actually finance itself, albeit subject to certain municipal restrictions, is a decision for the utility and the City. Other utilities in British Columbia, such as small utilities, may choose to finance their business with no actual debt because it is not practical or heavily constrained. Whatever mechanism Nelson Hydro chooses, Rural ratepayers should not bear the burden of the City of Nelson's borrowing restrictions by way of an increase to the equity component beyond what is already fairly compensated via the risk assessment.

At the time of Order G-119-17, Nelson Hydro's fair return was based on a dividend to the shareholder, rather than an allowed return on capital. The BCUC's finding to use the actual debt-to-equity ratio had no bearing on the fair return to the shareholder because the compensation in the 2017 Rate Application was not based on an allowed ROE multiplied by the equity component. Instead, the BCUC used Nelson Hydro's actual equity component to compare Nelson Hydro's proposed $2.7 million dividend payment to the City. Further, actual achieved ROE provides a historical view of actual performance. Differences between the achieved and allowed ROE typically relate to whether the utility is forecasting its revenue requirements appropriately, rather than whether there is a need to alter the capital structure or allowed ROE so that the shareholder is fairly compensated.

As for the details about borrowing calculations put forward by the BCUC in the COSA Decision, Nelson Hydro's argument relies on previous evidence that it cannot reasonably borrow either to the level or speed at which the deemed capital structure can be achieved given municipal restrictions. The evidence in this Reconsideration proceeding does not dispute the specific calculations cited in the COSA Decision, and Nelson Hydro does not provide new evidence to refute those calculations. Additionally, as explained above, using a deemed capital structure is common regulatory practice in Canada. The speed at which actual debt-to-equity ratio may or may not match the deemed capital structure does not impact the allowed fair return in rate setting.

4.0 Other Matters

Mr. Gatto's final argument appears to focus on Nelson Hydro's management of the Rural service area from 2015 to 2020. Mr. Gatto references several past BCUC decisions to form his argument that Nelson Hydro has always attributed all the power purchase costs to the Rural service area while ignoring spending in other areas. He asserts that Nelson Hydro manufactures the situation where the insufficient funds on the Rural side are due to this excessive purchased power cost-loading, and manipulating and adjusting numbers.[126] Mr. Gatto

[126] Mr. Gatto Final Argument, pp. 5, 9.

recommends an audit of the allocation of the power purchase costs using an advisory committee made up of Nelson Hydro, BCUC and other independent committee members.[127]

Furthermore, Mr. Evanchuk and Mr. Gatto make references in their respective final arguments to evidence from Nelson Hydro's 2023 Revenue Requirement Application (2023 RRA).

In reply to Mr. Evanchuk and Mr. Gatto, Nelson Hydro submits that the issues being raised by these interveners are outside the scope of this Reconsideration proceeding, as those issue were addressed in the COSA Decision and Nelson Hydro has not requested that those issues be reconsidered as part of this Reconsideration proceeding.[128]

Panel Discussion

As previously noted in this decision, the COSA Decision set rates on a prospective basis for Nelson Hydro's Rural ratepayers, which follows a well-established regulatory practice and a widely accepted principle of ratemaking. Although there are a few exceptions to the principle against retroactive ratemaking, none of them apply here. Furthermore, as set out in Section 3.1, the Panel denies Nelson Hydro's reconsideration request to change the COSA Decision, which directed Nelson Hydro to allocate 100 percent of the power purchases to Common. As such, the totality of Nelson Hydro's power purchases is allocated to all ratepayers. Therefore, the Panel does not see the need for an advisory committee to audit the allocation of Nelson Hydro's power purchases.

Finally, the Panel makes no comment with regard to the other matters raised by Mr. Gatto and Mr. Evanchuk in relation to the 2023 RRA because those other matters are outside the scope of this Reconsideration proceeding.

DATED at the City of Vancouver, in the Province of British Columbia, this 15th day of November 2023.

Original signed by:

C. M. Brewer
Panel Chair / Commissioner

[127] Ibid., p. 3.
[128] Nelson Hydro Reply Argument, p. 2.

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ORDER NUMBER
G-311-23

IN THE MATTER OF
the *Utilities Commission Act*, RSBC 1996, Chapter 473

and

Nelson Hydro
Application for Reconsideration and Variance of Order G-196-22

BEFORE:
C.M. Brewer, Panel Chair

on November 15, 2023

ORDER

WHEREAS:

A. On December 2, 2022, Nelson Hydro filed an application for reconsideration and variance of Decision and Order G-196-22 pursuant to section 99 of the *Utilities Commission Act* with the British Columbia Utilities Commission (BCUC) in accordance with Part V of the BCUC's Rules of Practice and Procedure (Reconsideration Application);

B. By Order G-196-22 and accompanying reasons for decision dated July 19, 2022, the BCUC issued its decision regarding Nelson Hydro's Cost of Service Analysis (COSA) and Rate Design application (COSA Decision). The BCUC ordered, among other matters, the following:

  i. Nelson Hydro to recalculate its COSA with generation assets and costs assigned 100 percent to Common assets and costs, which are assets and costs that cannot be allocated 100 percent to the Urban or Rural service areas and are broken out to all customers based on usage (Common);

  ii. Nelson Hydro to recalculate its COSA with power purchase costs assigned 100 percent to Common costs; and

  iii. Nelson Hydro's return on equity is set at a 50-basis point premium above the benchmark as established by Order G-75-13 on a deemed equity component of 50 percent;

C. Nelson Hydro requests that the BCUC reconsider and vary Order G-196-22 on the grounds that the BCUC made material errors of law and fact in the following respects:

  i. Nelson Hydro be directed to assign its generation assets and costs 100 percent to its Urban customers in the COSA;

  ii. Nelson Hydro be directed to assign power purchases 33.5 percent to Urban customers and 66.5 percent to Rural customers; and

iii. A debt-to-equity ratio reflecting the utility's actual debt-to-equity be used for the estimated rate base of Nelson Hydro's Rural operations and Nelson Hydro be directed to increase its debt in advance of any future COSA filing;

D. In the event the BCUC confirms the COSA Decision regarding generation assets and costs and power purchases, Nelson Hydro makes the following alternative requests in the COSA (Alternative Requests):

i. To adjust the allocation of power purchases costs from the Coffee Creek Substation to 100 percent to Rural service area; and

ii. To assign the capital reserve transfer 100 percent to Common costs.

E. By Orders G-392-22, G-34-23, G-73-23, and G-175-23, the BCUC established the regulatory timetable for the review of the Reconsideration Application, which included intervener registration, one round of BCUC and intervener information requests, and final and reply arguments; and

F. The Panel has reviewed the submissions received and considers the following determinations are warranted.

NOW THEREFORE pursuant to section 99 of the *Utilities Commission Act*, the BCUC Rules of Practice and Procedure, and for the reasons set out in the decision issued concurrently with this order, the BCUC denies Nelson Hydro's Reconsideration Application to vary the directives in Order G-196-22, including the Alternative Requests. The BCUC confirms the directives set out in the COSA Decision and Order G-196-22.

DATED at the City of Vancouver, in the Province of British Columbia, this 15th day of November 2023.

BY ORDER

Original signed by:

C.M. Brewer
Commissioner

IN THE MATTER OF
the *Utilities Commission Act*, RSBC 1996, Chapter 473

and

Nelson Hydro
Reconsideration and Variance of BCUC Order G-196-22

EXHIBIT LIST

Exhibit No.	Description
COMMISSION DOCUMENTS	
A-1	Letter dated December 30, 2022 – Appointing the Panel for the review of Nelson Hydro Application for Reconsideration and Variance of Order G-196-22
A-2	Letter dated December 30, 2022 – BCUC Order G-392-22 establishing a regulatory timetable
A-3	Letter dated January 25, 2022 – BCUC Information Request No. 1 to Nelson Hydro
A-4	Letter dated February 16, 2023 – BCUC response to Nelson Hydro extension request and Order G-34-23 amending the regulatory timetable
A-5	Letter dated April 3, 2023 – BCUC Order G-73-23 amending the regulatory timetable
A-6	Letter dated May 2, 2023 – BCUC request for Nelson Hydro to respond to Mr. Dan Gatto request for complete and sufficient Information Request responses
A-7	Letter dated June 13, 2023 – BCUC amending the Panel for the review of the application
A-8	Letter dated July 6, 2023 – BCUC Order G-175-23 amending the regulatory timetable with Reasons for Decision
A-9	Letter dated September 29, 2023 – BCUC amending the Panel

Exhibit No.	Description
APPLICANT DOCUMENTS	
B-1	**NELSON HYDRO (NELSON HYDRO)** – Reconsideration and Variance of BCUC Order G-196-22 Application dated December 2, 2022
B-2	Letter dated January 10, 2023 – Nelson Hydro submitting confirmation of Public Notice
B-3	Letter dated February 10, 2023 – Nelson Hydro submitting extension request to respond to Information Requests No. 1
B-4	Letter dated March 16, 2023 – Nelson Hydro submitting responses to BCUC Information Request No. 1
B-5	Letter dated March 16, 2023 – Nelson Hydro submitting responses to Evanchuk Information Request No. 1
B-6	Letter dated March 16, 2023 – Nelson Hydro submitting responses to Gatto Information Request No. 1
B-7	Letter dated March 16, 2023 – Nelson Hydro submitting responses to RCIA Information Request No. 1
B-8	Letter dated April 12, 2023 – Nelson Hydro submitting response on further process
B-9	Letter dated April 25, 2023 – Nelson Hydro submitting reply submission on further process
B-10	Letter dated May 23, 2023 – Nelson Hydro submitting response to Gatto submission
INTERVENER DOCUMENTS	
C1-1	**EVANCHUK, RANDY (EVANCHUK)** - Submission dated January 7, 2023 Request to Intervene representing rural customers
C1-2	Letter dated January 31, 2023 – Evanchuk submitting Information Request No. 1 to Nelson Hydro

Exhibit No.	Description
C2-1	Gatto, Daniel (Gatto) - Submission dated January 19, 2023 Request to Intervene
C2-2	Letter dated February 2, 2023 – Gatto submitting Information Request No. 1 to Nelson Hydro
C2-3	Letter dated April 24, 2023 – Gatto late submission on further process
C2-4	Letter received on April 26, 2023 – Gatto submitting request for clarification in Nelson Hydro response to Information Request No. 1
C2-5	Letter dated May 30, 2023 – Gatto submitting response to Nelson Hydro Information Request No. 2 reply
C3-1	**RESIDENTIAL CONSUMER INTERVENER ASSOCIATION (RCIA)** – Submission dated January 20, 2023 late request to intervene by Samuel Mason
C3-2	Letter dated February 2, 2023 – RCIA submitting Information Request No. 1 to Nelson Hydro
C3-3	Letter dated April 20, 2023 – RCIA submission on further process

INTERESTED PARTY DOCUMENTS

D-1	**NELSON, C. (NELSON)** – Submission dated January 26, 2023 request for Interested Party Status
D-2	**LENGSFELD, R. (LENGSFELD)** – Submission dated January 31, 2023 request for Interested Party Status
D-3	**FAUST, R. (FAUST)** - Submission dated February 3, 2023 request for Interested Party Status
D-4	**MCKAY, D. and R. (MCKAY)** - Submission dated February 6, 2023 request for Interested Party Status
D-5	**DURAND, L. (DURAND)** - Submission dated February 6, 2023 request for Interested Party Status

Exhibit No.	Description
LETTERS OF COMMENT	
E-1	LENGSFELD, R. (LENGSFELD) – Letter of Comment dated February 1, 2023 - Revised
E-2	DURAND, L. (DURAND) – Letter of Comment dated February 6, 2023
E-3	MCKAY, D. & R. (MCKAY) – Letter of Comment dated February 10, 2023
E-4	MURPHY, J. (MURPHY) – Letter of Comment dated February 5, 2023
E-5	CORDS, J. (CORDS) – Letter of Comment dated February 11, 2023
E-6	NASMYTH, D. (NASMYTH) – Letter of Comment dated February 16, 2023
E-7	POSTNIKOFF, C. (POSTNIKOFF) – Letter of Comment dated February 20, 2023
E-8	HILL, K. (HILL) – Letter of Comment dated February 21, 2023
E-9	FAUST, R. (FAUST) – Letter of Comment dated February 22, 2023
E-10	MUNROE, R. (MUNROE) – Letter of Comment dated February 21, 2023
E-11	IWANIK, L. (IWANIK) – Letter of Comment dated April 26, 2023