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**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER C-3-14**

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**IN THE MATTER OF
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473**

and

**An Application by FortisBC Alternative Energy Services Inc. (FAES)
for a Certificate of Public Convenience and Necessity and Approval of Rates Established in Agreements
for Thermal Energy Services for the SOLO District Development**

BEFORE: N.E. MacMurchy, Panel Chair/Commissioner
D.M. Morton, Commissioner February 25, 2014
R.D. Revel, Commissioner

O R D E R

WHEREAS:

- A. On December 27, 2012, the British Columbia Utilities Commission (Commission) issued its Alternative Energy Solutions Inquiry Report which among other things tasked Commission staff to consult with stakeholders to develop a streamlined regulatory framework for Thermal Energy Systems;
- B. By Order G-132-13, dated August 28, 2013, the Commission established a proceeding to review a Commission staff proposal for a streamlined regulatory framework and guide for Thermal Energy Systems (TES Framework Proceeding). The proposed framework, among other things, groups thermal energy systems into two streams, Stream A and Stream B, and also proposes a level of regulatory oversight required for thermal energy systems falling under each stream;
- C. On October 7, 2013, FAES applied to the Commission for an order granting a Certificate of Public Convenience and Necessity (CPCN) for the purchase of the TES component of the SOLO District Development Project (Project) from the developer and approval of the rates established under a Residential and a Commercial Service Agreement (the Application);
- D. On October 31, 2013, the Commission noted FAES' request to have the Application reviewed in the context of the proposed TES Framework and the Commission stated it would be willing to consider the Application in the context of Stream A of the proposed TES Regulatory Framework provided FAES was agreeable to amending its Application;
- E. On November 7, 2013, FAES responded that it would be agreeable to a regulatory review process that would follow the proposed Stream A TES Framework and would make the necessary amendments to its Application that the Commission may require to facilitate an efficient review and approval of the Application;

- F. On November 22, 2013, by Order G-192-13, the Commission established a Regulatory Timetable to review the Application;
- G. The Commission has considered the Application and submissions in the proceeding and finds that while the CPCN should be approved, certain amendments to the Service Agreements are required if the rates are to be found just and reasonable.

NOW THEREFORE, pursuant to sections 45-46, and 59-61 of the *Utilities Commission Act*, with Reasons attached as Appendix A to this Order, the Commission orders as follows:

- 1. The Commission does not approve the SOLO Project on the basis of its conformance with the proposed Stream A TES Guidelines as such an approval would be prospective and of no standing, given that such guidelines have not been approved at the time of this decision issuance.
- 2. While amendments to the Service Agreement are required, the Panel finds that the Project is in the public interest and the Certificate of Public Convenience and Necessity is granted to FAES for the purchase of the SOLO Development Project energy system as described in the Application.
- 3. The rates applied for are not found to be just and reasonable for the reasons set out in the Reasons for Decision and are thus denied. The Panel finds that the rates would be just and reasonable if the amendments set out below and further described in the Reasons for Decision are made. If amended service contracts acceptable to the Commission are filed, the Panel finds that it would be appropriate for future regulatory oversight to be complaint based. Amendments to the Service Agreements required if the rates are to be found just and reasonable are:
 - a. The agreements are to include an itemized break-down of the component costs used in the forecast and actuals in calculating the Performance Ratio and separately identify any carrying costs;
 - b. A statement is to be included in the agreements that FAES will present this cost calculation to its customer(s) and respond to questions to a sufficient level such that the customer(s) can understand the Performance Ratio calculation, including the details of the costs going into the calculation, and rates established in the subsequent term;
 - c. The agreements are to include a requirement that FAES will report to its customer(s) the Performance Ratio calculation, its normalized forecast and actual natural gas fuel and electricity consumption and total thermal energy delivered on a yearly basis;

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- d. The agreements are to include the methodology for the three year rolling average calculation for the minimum consumption limit based on actual consumption;
 - e. The language of the agreements must make it clear that the customer is not responsible for any penalty costs on default by FAES which FAES chooses not to rectify; and
 - f. The information included in the agreements related to the fuel cost deferral account must be amended as set out in the Reasons for Decision.
4. In filing future applications related to the provision of energy to subsequent phases of the proposed development that are interconnected to this Project's thermal energy system, FAES is directed to provide copies of such applications to customers of this Project.

DATED at the City of Vancouver, in the Province of British Columbia, this 25th day of February, 2014.

BY ORDER

Original Signed By:

N.E. MacMurchy
Panel Chair/Commissioner

Attachment

An Application by FortisBC Alternative Energy Services Inc. (FAES)
for a Certificate of Public Convenience and Necessity and Approval of Rates Established in Agreements
for Thermal Energy Services for the SOLO District Development

REASONS FOR DECISION

INTRODUCTION

These Reasons for Decision address the October 7, 2013 application by FAES to the Commission for an order granting a Certificate of Public Convenience and Necessity (CPCN) for the purchase of the thermal energy system component of the SOLO District Development Project (Project) from the developer and for approval of the rates established under a Residential and a Commercial Service Agreement (the Application). Specifically, these Reasons for Decision discuss the conditions for approval of FAES to provide a Thermal Energy System (TES) serving the first phase of the SOLO District Development Project.

FAES describes the Project and necessity for the TES as:

“The SOLO Development will be a 5,100 square metre development consisting of a 45 storey residential condominium tower (strata with 374 units) and a commercial podium including a supermarket. The construction of the Development is underway with occupation scheduled for Q2, 2015.

The Development needs an energy distribution system to serve its future tenants.

The energy system for the SOLO Development was selected by Appia in order to provide its customers with a renewable energy source at a reasonable cost. The selected energy system will advance British Columbia’s energy objectives and assist the developer in achieving a LEED Gold equivalency for the development, which is a standard adopted voluntarily by the developer” (Exhibit B-1, p. 2).

The total area within the building is 39,184 square metres comprising 34,076 square metres of residential space and 5,108 square metres of commercial space (Exhibit B-1, Appendix B, p. 3).

FAES and the developer have entered into agreements (subject to Commission approval) for FAES to purchase the TES assets from the developer at a “not to exceed” purchase price that is below the estimated construction costs. FAES will own and operate the TES and charge rates to the two customers (one residential strata and one commercial customer) essentially for the life of the development but pursuant to 20 year service agreements.

REVIEW OF THE APPLICATION AND PROCESS

Process

FAES requests a CPCN for the Project pursuant to sections 45 and 46 of the *Utilities Commission Act* (UCA) and for approval of rates pursuant to sections 59-61 (Exhibit B-1, p. 5). The Commission established CPCN Guidelines included as Appendix A to Order G-50-10. In making its determinations in this Proceeding, the Commission Panel considered the Application as it relates to the proposed TES Regulatory Framework, which is part of a separate Proceeding. FAES agreed to structure its contractual agreements with its customers to follow the

proposed Stream A TES Framework and agreed it would make the necessary amendments to its Application that the Commission may require to facilitate an efficient review and approval of the Application.

However, given that the TES Framework process is not yet complete, the Panel's decision is based on the requirements of the UCA, including consideration of supporting the provincial energy objectives, and issues arising from Intervener submissions. The Panel does not approve the SOLO Project on the basis of its conformance with the Stream A TES Guidelines as such an approval would be prospective and of no standing, given such guidelines have not been approved at the time of the release of this decision.

Accordingly, the Commission Panel has made its determination regarding the purchase, ownership and operation of the facility by FAES based on the requirements of sections 45 and 46 and the rate approval pursuant to the requirements of sections 59-61 of the UCA. Further, the Panel takes no position on the conformance of this application with a future Stream A regulatory process, should such process be approved.

Participant Submissions

The Commercial Energy Consumers Association of British Columbia (CEC) was the only Intervener to register for and participate in the Streamlined Review Process held on December 17, 2013 in Vancouver. During the Streamlined Review Process CEC asserted that it supports the FAES application for a CPCN and encourage that it be granted, noting however that the rates should be made interim (T1:166-167). The CEC expressed its position on the proposed TES Framework and the associated rate design and rates, calling the rate design: "...complex and problematic for a number of potential future situations and potentially more costly than necessary" (T1:167). Further, the CEC indicated a preference for the basic principles of cost of service and postage stamp rates (T1:167).

The CEC submits that the Commission should keep "rate design questions open so that it has the opportunity to address an evolving set of issues over the next 5, 10, 15, 20 years, and then able the set to change and not end up locking in all these micro utilities" (T1:168).

Commission Discussion and Determination

The Panel does not agree with the CEC that the rates should be based on a postage stamp principle. There is no evidence before the Panel that this would result in a rate that is just and reasonable. Further, no party, other than the CEC, has requested a postage stamp rate. With regard to the CEC's concern about cost of service, the Panel notes that the mechanism proposed by FAES results in the utility recovering its cost of service through future period adjustments of the customers' rates as suggested by the Performance Ratio calculations.

The Panel notes that the CEC chose not to participate in the TES Framework Proceeding where its comments on the TES Framework could more appropriately have been made. The Panel finds CEC's submissions regarding the TES Framework as out of scope and will not consider CEC's comments on the TES Framework any further in making its decision in this proceeding.

The Panel does not agree with the CEC that the rates should be approved as interim. In the Panel's view, it is unreasonable for owners and tenants in the SOLO complex Phase One to face the significant amount of uncertainty that interim rates would entail.

CPCN

In granting a CPCN, the Commission must satisfy itself that there is a need for the project and that it is in the public interest. With respect to the information to be filed, the CPCN Guidelines (Appendix A to Order G-50-10) state:

They [the guidelines] provide general guidance regarding the Commission's expectations of the information that should be included in CPCN applications while providing the flexibility for an application to reflect the specific circumstances of the applicant, the size and nature of the project, and the issues that it raises. An applicant is expected to apply the guidelines in a flexible and reasonable manner. The Commission may issue further directions relating to the information to be included in specific CPCN applications and may require applicants to provide further information to supplement material in filed applications.

FAES supplied information using the draft Stream A TES Registration form (Exhibit B-1, Appendix B). FAES submits that the information filed with the Application is sufficient to grant the approvals sought given the relatively small size of the Project (Exhibit B-1, p. 4).

The CEC did not challenge either the need for the SOLO Project or that it is in the public interest.

Commission Determination

The Panel is satisfied that the evidence provided by FAES in its Application, information request responses and Streamline Review Process is adequate given the specific circumstances of the Application. **The Panel finds that the purchase of the energy system of the Phase One SOLO Development Project from the developer for a sum of \$4.4 million, plus additional capitalized development costs of \$0.2 million incurred by FAES, is both necessary and in the public interest. Accordingly, the Panel grants a CPCN under sections 45 and 46 of the UCA to FAES for this purchase.**

Initial Rate

FAES states that it negotiated a purchase price for the assets that would allow FAES to set an initial rate for its future Thermal Energy Service that is competitive in the market place. As stated by FAES: "we do find that the ten to ten and half cent per kilowatt hour (kWh) range is a competitive price for thermal energy" (T1:47).

To set this rate, FAES states it established a forecast of the costs of providing the service including:

1. Fuel,
2. O&M,
3. Depreciation and Amortization,
4. Taxes, and
5. Capital Carrying Costs including;
 - a. Initial investment, and
 - b. Replacement Capital (Exhibit B-4, BCUC IR 7.1, p. 21).

In summary, the rate in FAES' view is derived on a cost recovery basis with the price negotiated for the energy producing assets designed to ensure that the rate is competitive in the market place.

Escalation and Rate Change Methodology

The initial energy rate applied for is \$0.105/kwh escalated at two percent each year. In the view of FAES, the two percent per annum escalation will adjust the energy rate for inflation. FAES believes that this will result in levelized rates, in real dollars, over the life of the project (T1:46).

In addition to the annual inflation escalator, FAES proposes to adjust the rate every five years by the Performance Ratio and will include a fuel Rate Rider that will be adjusted positively or negatively each year based on actual fuel costs (Exhibit B-3, p. 1).

The Performance Ratio is defined by FAES as: “The ratio of actual costs of providing the Service relative to the forecast costs of providing the Service (set out at the initiation of Service), as reasonably determined by the Utility, calculated in the fourth year of each Performance Term for the previous five years (four years for the first Performance Term)” (Exhibit B-3, p. 3).

FAES provided the following illustrative example for calculating the Performance Ratio for any given five year term (Exhibit B-4, p. 24):

	First Performance Term					
	2015	2016	2017	2018	Total	Notes
Forecast						
Cost of Natural Gas	64	68	71	73	276	
Cost of Electricity	59	62	65	67	253	
Operation and Maintenance	77	92	94	96	358	
Property Taxes	-	-	-	-	-	
Depreciation Expense	163	163	163	163	651	
Amortization Expense ¹	-	-	-	-	-	
Income Taxes	-	-	-	-	-	
Capital Carrying Costs	328	322	311	300	1,261	
Total	691	707	703	699	2,799	
MWh	5,717	5,717	5,717	5,717	22,868	
Forecast Cost \$/kWh	\$ 0.121	\$ 0.124	\$ 0.123	\$ 0.122	\$ 0.122	
Actual						
Forecast Cost of Natural Gas	64	68	71	73	276	1
Forecast Cost of Electricity	59	62	65	67	253	1
Operation and Maintenance	91	82	92	93	358	2
Property Taxes	-	-	-	-	-	2
Depreciation Expense	163	163	163	163	651	2
Amortization Expense ¹	-	-	-	-	-	2
Income Taxes	-	-	-	-	-	2
Capital Carrying Costs	322	322	311	300	1,256	3
Total	700	696	701	696	2,793	
MWh	4,903	6,027	6,031	6,353	23,313	
Actual Cost \$/kWh	\$ 0.143	\$ 0.116	\$ 0.116	\$ 0.110	\$ 0.120	
Performance Ratio					102.2%	

	Second Performance Term				
	2020	2021	2022	2023	2024
Forecast Rates	\$ 0.116	\$ 0.119	\$ 0.121	\$ 0.124	\$ 0.126
Actual Rates	\$ 0.114	\$ 0.116	\$ 0.119	\$ 0.121	\$ 0.123

1 - Fuel variances are captured in the annual Rate Rider

2 - Actual Costs

3 - Updated to reflect changes in net book value and the benchmark rate using 45% equity and 75bps premium

FAES believes that the Performance Ratio mechanism gives FAES an incentive to find efficiencies to bring costs down below the forecast costs which benefits FAES during the current performance period and benefits customers when it is embedded in rates through the calculation of the Performance Ratio (T1:58).

Commission Determination

Based on the evidence provided, the Panel finds that certain amendments to the Service Agreements are required if the rates are to be found just and reasonable. Should the amendments be made as set out in this Decision, the Panel finds that the rates would be just and reasonable and should be approved.

The Panel finds that the understanding and application of the Performance Ratio methodology is a critical element to assess whether the rates remain just and reasonable over the long term. The Panel further notes that FAES is applying for the rates to be regulated on a complaint basis with the objective of reducing the cost of regulatory oversight. The Panel finds that to accommodate this request for light handed regulation, it is critical that FAES' customers have sufficient detailed information on the elements going into the Performance Ratio calculation, such that they can assess whether a complaint to the Commission would be warranted. **Thus, in approving the Performance Ratio methodology, the Panel directs FAES, at least six months prior to implementing a rate change under the Performance Ratio, to provide to its customers a detailed breakdown of the elements going into the calculation.**

Included in this breakdown, FAES is to set out in detail all of the elements contained in the Performance Ratio calculation, including a breakdown of the Capital Carrying Costs. **FAES is also directed to present this information in a manner that allows customers to question FAES on the elements and results of the performance calculation.** In making this determination, the Panel takes no position on whether the initial rate, or the rate escalation methodology, is suitable for a putative Stream A application. In this regard, the Panel notes that the escalation mechanism provides FAES the opportunity to recover its costs of providing service without the use of revenue deferral accounts. While the initial rates may be competitive in the market place, the methodology does not appear to ensure that this will remain the case after rebasing in subsequent periods.

Termination and Default

As applied for by FAES, if the Service Agreements are not renewed or are terminated for any reason, the customer would be required to pay the remaining net book value for the equipment plus any foregone earnings over the 20 year term. Under the wording in the Application, these costs would be applied even in the event where the utility breached any of the material terms and conditions of the service and failed within a reasonable period of time to commence in good faith to rectify the breach (Exhibit B-4, BCUC IR 10.3, p. 29; BCUC IR 10.4, pp. 30-31).

FAES stated that it is prepared to alter the language in the Service Agreements to state it will "not require the customer to make a net book value payment to us in the event that we default" (T1:75). FAES further states that in its view, the Commission has the authority to set service standards for FAES and require FAES to continue to provide service even at FAES' cost. FAES also notes "...the practical reality in our view is that a default on our side is highly unlikely" (T1:76).

Commission Determination

The Panel finds that the termination clauses are reasonable except for the circumstance where the customer terminates the Service Agreement because of a material breach by FAES that is not remedied within a reasonable period of time. If such a breach should occur and not be remedied, the Panel finds it would be unfair for the customer to make a net book value payment or payment for foregone earnings to the utility. **To find rates just and reasonable, the Panel finds that FAES must amend the Service Agreements to include language that eliminates the requirement for a customer to make a net book value payment or payment for foregone earnings in circumstances where the utility has made a material breach of the terms of the Service Agreement and has not acted to remedy the breach within a reasonable period of time.**

Fuel Deferral Account

As part of its rate setting mechanism, FAES requests approval for the establishment of a fuel rate rider. FAES has proposed amendments to the service agreement that would define the rate rider as “[a]n amount per kWh in Canadian dollars for the recovery or refund of the Fuel Deferral Account set each year on a prospective basis by the Utility to achieve a zero balance in the Fuel Deferral Account by the end of the following year” (Exhibit B-3, p. 3). FAES has confirmed that the Fuel Deferral Account would only include natural gas and electricity (Exhibit B-4, BCUC IR 6.1, p. 18). FAES also provided the cost and quantities of natural gas and electricity that went into its forecast cost of fuel for each of the first five years and stated that it is prepared to amend the Service Agreements to provide this information and an updated definition of fuel in the Fuel Deferral Account (Exhibit B-4, BCUC IR. 6.3; BCUC IR 6.4, pp. 19-20).

Commission Determination

The Panel finds that it would provide clarity for FAES customers to have within the Service Agreements the definition of the fuel included in the Fuel Deferral Account. The Panel finds the definition with the agreements is to be amended to make it clear that the Fuel Deferral Account is to include only natural gas and electricity costs. The Panel also finds that the information used by FAES in the calculation of its forecast of natural gas and electricity consumption over the first five years must be included in the Service Agreements. **To find the rates just and reasonable, the Panel finds that FAES must amend the Service Agreements accordingly.**

Future Applications

FAES has provided evidence that the SOLO Project applied for involves Phase One of what is envisioned as a four phase development. It is a matter of record that the energy systems of all four phases will likely be interconnected to allow balancing of energy loads among all parts of the development in the most efficient manner (T1:19-20). It is not currently planned to meter flows of energy between the phases (T1:106). The rates and rate design for the future phases would be the subject of future applications.

Commission Determination

The Panel recognizes that its decision only relates to the SOLO Project, as applied for, which is Phase One of the larger proposed development. There is no evidentiary basis to allow the Panel to judge whether the energy systems of proposed future phases will impact the customers of the Utility in this current application in a positive or negative manner. However, there is sufficient information on the record that there will likely be some form of impact to customers of this phase of the Project. **Accordingly, FAES is directed to provide copies to its SOLO Project customers of any future applications to the Commission related to the provision of energy to future phases of the development that are interconnected to the SOLO Project energy system or have potential impacts to FAES’ SOLO Project customers. It is the expectation of the Panel that these applications will set out the impact of the development of future projects on the energy system of this Project and specifically address any potential impacts on the rates of existing SOLO Project customers.**