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Utilities Commission

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ORDER NUMBER
G-253-24

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

and

FortisBC Alternative Energy Services
Fiscal 2024 – 2025 Annual Cost of Service Rate for the Thermal Energy Service to Delta School District No. 37

BEFORE:
A. K. Fung, KC, Panel Chair
E. B. Lockhart, Commissioner

on September 27, 2024

ORDER

WHEREAS:

A. On June 18, 2024, pursuant to sections 59 to 61 and 89 of the *Utilities Commission Act* (UCA), FortisBC Alternative Energy Services Inc. (FAES) applied to the British Columbia Utilities Commission (BCUC) for approval, on an interim and permanent basis, to increase the cost of service (COS) rate (COS Rate) for thermal energy service provided by FAES to the Delta School District No. 37 (DSD) for the fiscal and contract year from July 1, 2024 to June 30, 2025 (Fiscal 2024/25) by approximately 4 percent from $0.227 per kWh to $0.235 per kilowatt hour (kWh), effective July 1, 2024 (Application);

B. FAES states that the proposed rate change is based on its forecast annual COS to serve DSD for the Fiscal 2024/25 period, inclusive of an equity return using FAES' current approved capital structure and negotiated return on equity (ROE) premium of 50 basis points on the benchmark utility (Benchmark Utility) ROE;

C. By Order G-179-24 dated July 5, 2024, the BCUC established a regulatory timetable for the review of the Application, which included FAES providing notice to DSD, one round of information requests (IRs) by the BCUC and DSD to FAES, and letters of comment. DSD filed a letter of comment on August 29, 2024 and FAES filed a reply on September 5, 2024;

D. By Order G-66-21 dated March 8, 2021, the BCUC established a Generic Cost of Capital (GCOC) proceeding. Stage 1 of the GCOC proceeding determined the deemed capital structure and allowed ROE of FortisBC Energy Inc. (FEI) and FortisBC Inc. Stage 2 will determine matters related to the Benchmark Utility and establish the cost of capital for other utilities in British Columbia;

E. On September 5, 2023, the BCUC issued Decision and Order G-236-23 related to Stage 1 of the BCUC's GCOC proceeding. In that decision, the BCUC directed that all other utilities that currently use the Benchmark Utility (which includes FAES) will have interim rates, effective January 1, 2024, on a refundable or recoverable basis, pending the BCUC's final decision on Stage 2 of the GCOC proceeding;

F. By Order G-6-24 dated January 11, 2024, the BCUC ordered that the Benchmark Utility will be FEI for all utilities in Stage 2 of the GCOC proceeding; and

G. The BCUC has reviewed the Application and evidence filed in this proceeding and makes the following determinations.

NOW THEREFORE pursuant to sections 58 to 61 of the UCA and for the reasons outlined in the decision accompanying this order, the BCUC orders as follows:

1. For Fiscal 2023/24, FAES is approved to charge the COS Rate of $0.227/kWh from January 1, 2024 through June 30, 2024 on a permanent basis.

2. For Fiscal 2024/25, FAES is approved to charge the COS Rate of $0.235 per kWh on a permanent basis, effective July 1, 2024.

3. FAES is directed to amend the COS Rate for DSD from $0.227 per kWh to $0.235 per kWh in the next billing cycle or by no later than November 1, 2024.

4. FAES is directed to establish a new deferral account to record the variance between the Fiscal 2024/25 interim rate of $0.227 per kWh and the permanent rate of $0.235 per kWh from July 1, 2024 to the date the permanent rate is implemented, attracting FAES' weighted average cost of capital, with the disposition of the balance to be addressed in FAES' next rate application.

5. FAES is directed to file, within 30 days of the date of this order, tariff pages for endorsement with the BCUC reflecting the approved COS Rates for Fiscal 2023/24 and Fiscal 2024/25.

6. The live financial model filed in Appendix B to the Application will be held confidential due to its commercially sensitive nature, until the BCUC determines otherwise.

DATED at the City of Vancouver, in the Province of British Columbia, this 27th day of September 2024.

BY ORDER

Original signed by:

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A. K. Fung, KC
Commissioner

DECISION

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1.0 Background

On June 18, 2024, pursuant to sections 59 to 61 and 89 of the *Utilities Commission Act* (UCA), FortisBC Alternative Energy Services Inc. (FAES) applied to the British Columbia Utilities Commission (BCUC) for approval, on an interim and permanent basis, to increase the cost of service (COS) rate (COS Rate) for thermal energy service provided by FAES to the Delta School District No. 37 (DSD) for the fiscal and contract year from July 1, 2024 to June 30, 2025 (Fiscal 2024/25) from $0.227 per kilowatt hour (kWh) to $0.235 per kWh, effective July 1, 2024 (Application). FAES submits that the proposed rate of $0.235 per kWh is driven by a higher return on equity (ROE) and higher operation and maintenance costs.[1]

In 2012, the BCUC approved the Certificate of Public Convenience and Necessity (CPCN) and the agreements, including a rate development agreement (Rate Development Agreement), negotiated between FAES and the DSD for the provision of thermal energy service to buildings in the DSD.[2] FAES submits that it has followed the calculations prescribed in the Rate Development Agreement between DSD and FAES to determine the 2024/25 COS Rate.[3] The Rate Development Agreement terms include a 50 basis points (bps) premium above the benchmark utility (Benchmark Utility) as negotiated by FAES and DSD.[4]As part of the Generic Cost of Capital (GCOC) Stage 1 proceeding that determined the deemed capital structure and allowed ROE for FortisBC Energy Inc. (FEI) and FortisBC Inc., the BCUC directed all other utilities, including FAES, that currently use the Benchmark Utility to have interim rates, effective January 1, 2024, pending the BCUC's final decision on Stage 2 of the GCOC proceeding. Therefore, effective January 1, 2024, the COS Rate for DSD in Fiscal 2023/24 has been set on an interim, refundable or recoverable basis.[5]

On January 11, 2024, the BCUC established that the Benchmark Utility will be FortisBC Energy Inc. (FEI) for all utilities in Stage 2 of the GCOC proceeding.[6] The BCUC set a deemed equity component of 45.0 percent and an allowed ROE of 9.65 percent for FEI.[7]

The BCUC established a regulatory timetable for the review of the Application, which included FAES providing notice to DSD, one round of information requests (IRs) by the BCUC and DSD to FAES, and letters of comment.[8] FAES states that it did not have the opportunity to obtain feedback from DSD prior to filing the Application.[9] However, DSD filed a letter of comment on August 29, 2024 and FAES filed a reply on September 5, 2024.[10]

2.0 Issues Arising

The Panel has reviewed the Application, IR responses, DSD's letter of comment, and FAES' reply. This decision addresses issues raised by DSD, as to whether and to what extent the DSD Thermal Energy System (TES) project continues to warrant a premium over the Benchmark Utility's ROE.[11] While DSD did not comment on other

[1] Exhibit B-1, p. 3.
[2] Orders G-31-12, C-3-12, G-71-12 and G-88-12.
[3] Exhibit B-1, p. 3.
[4] FortisBC Alternative Energy Services Inc. (FAES) Compliance Filing Order G-31-12 Revisions to Rates and Rate Design for Thermal Energy Service to Delta School District Number 37, Exhibit B-1, Attachment 1, p. 2.
[5] Order G-254-23.
[6] Order G-6-24.
[7] BCUC Generic Cost of Capital (GCOC) Proceeding Stage 1, Decision and Order G-236-23 dated September 5, 2023.
[8] Order G-179-24.
[9] Exhibit B-1, p. 4.
[10] Exhibits C1-1 and B-5, respectively.
[11] Exhibit C1-2, p. 2.

elements of the Application, the Panel in this decision also addresses FAES' implementation of permanent rates for DSD and the variance treatment between interim and permanent rates. The Panel finds that FAES' cost of service forecast for Fiscal 2024/25 to be reasonable overall. As such, with the exception of the issues canvassed below, the Panel will not discuss the other components of the Application in detail as they appear to be unopposed by DSD.

2.1 Return on Equity

DSD Letter of Comment

DSD argues that the 2023 increase to the Benchmark Utility's ROE as determined by the BCUC in its Stage 1 GCOC proceeding does not and should not apply to the DSD TES project because there has been no material change in risk associated with the DSD TES project since 2023/24. DSD views that the 2012 CPCN decision does not preclude the BCUC from reconsidering the appropriate ROE in relation to the DSD TES project.[12]

DSD notes the BCUC's findings in the 2023 GCOC Stage 1 Decision for FEI, primarily that the political risks faced by FEI's shareholders have increased significantly since 2016, due to, among other factors, energy transition from fossil fuels to cleaner sources of energy through electrification. The BCUC granted FEI an allowed ROE of 9.65 percent in the 2023 GCOC Stage 1 Decision.[13] However, as the BCUC indicated to utilities in Stage 2 of the GCOC proceeding that they should not assume they will receive premiums above the earned return of FEI due simply to differences in size, DSD argues the same reasoning is applicable to the current Application for the DSD TES.[14]

DSD submits that the risks to FAES have not increased since Fiscal 2023/24. The DSD TES contributes to lower greenhouse gas emissions and FAES does not face energy transition risk as compared to FEI. DSD assesses that FAES is of lower risk relative to FEI for Indigenous rights and engagement, energy price risk, and market/demand risk.[15] Accordingly, DSD submits that the BCUC ought not to approve a higher ROE for the DSD TES simply because FEI received a higher ROE in the 2023 GCOC Stage 1 Decision or because FAES is smaller in size than FEI.[16]

FAES Reply

FAES submits that the cost of capital in its proposed COS Rate is reasonable and the BCUC should reject DSD's position. First, FAES notes that DSD agreed in the Rate Development Agreement to a 50 bps premium above the benchmark, which the BCUC subsequently approved, and argues that there is no basis to change that negotiated premium. Additionally, FAES points out that the DSD TES differs from FEI in terms of size, geographic concentration, complexity and customer profile.[17]

Second, FAES asserts that DSD failed to acknowledge that the increase in FEI's allowed ROE in the GCOC Stage 1 proceeding was determined based on financial modelling of proxy groups, and not an analysis of FEI's business risk. Instead, the BCUC accounted for FEI's increased business risk through FEI's equity thickness. FAES interprets

[12] Exhibit C1-2, pp. 2-4.
[13] Exhibit C1-2, p. 6.
[14] Exhibit C1-2, pp. 7-8.
[15] Exhibit C1-2, pp. 9-10.
[16] Exhibit C1-2, p. 8.
[17] Exhibit B-5, pp. 3-4.

that a higher ROE may be required to meet the Fair Return Standard due to changing financial conditions notwithstanding that a utility's business risk may not have materially changed.[18]

Third, FAES submits that it would be inappropriate to consider the allowed ROE for the DSD TES in isolation from other components of its cost of capital, citing that its equity thickness remains at 40 percent as negotiated by the parties. When the BCUC reviewed the deemed debt rate for the DSD TES in 2020, the BCUC had similar commentary in that it was not persuaded to adjust the debt term in isolation without reviewing the FAES' debt-to-equity ratio and ROE for the project.[19]

2.2 Implementation of Permanent Rates and Variance Treatment between Interim and Permanent Rates

Directive 2 in Order G-254-23 states that the COS Rate for DSD of $0.227 per kWh is confirmed as an interim rate, on a refundable or recoverable basis pending the BCUC's final decision on Stage 2 of the GCOC proceeding. Since then, in January 2024, the BCUC in Stage 2 of the GCOC proceeding established that FEI is the Benchmark Utility.[20]

In the Application, FAES proposes to maintain the current interim rate until the BCUC issues its final determination on this Application, given the current COS rate of $0.227 per kWh is approved on an interim basis.[21] FAES does not expect the Stage 2 outcome of the GCOC will have an impact on the DSD's Benchmark Utility ROE.[22]

One of the issues in this proceeding is when to implement permanent rates and how to account for the variance between the interim and permanent rates.

FAES views that the Panel in this proceeding should decide on the treatment of the variance between the current interim rates and the proposed rate. FAES submits that since DSD's rates will not be impacted by Stage 2 of the GCOC proceeding, the BCUC could:

- make the existing Fiscal 2023/24 COS Rate of $0.227 per kWh permanent, with the understanding that the variance in the cost of service due to the increase in Benchmark Utility ROE has been captured in the District Deferral Account with the calculation of the proposed COS Rate for Fiscal 2024/25; and
- approve FAES' proposed Fiscal 2024/25 rate of $0.235 per kWh on a permanent basis effective July 1, 2024, and direct that any variance between the existing interim rate be addressed in a billing adjustment in the next billing cycle for the DSD following the establishment of permanent rates.[23]

FAES provides the following bill adjustment estimates from July through December 2024:

Table 1: Estimate of Variance between Interim and Proposed COS Rate

Estimated Billing Adjustment	Unit	Jul-24	Aug-24	Sep-24	Oct-24	Nov-24	Dec-24
Forecast Thermal Output	*MWh*	42	35	220	581	858	1,107
Rate Increase	*$/kWh*	0.008	0.008	0.008	0.008	0.008	0.008
Monthly Bill Adjustment	*$ (000's)*	0.3	0.3	1.8	4.6	6.9	8.9
Total Adjustment	*$ (000's)*	0.3	0.6	2.4	7.0	13.9	22.7

[18] Exhibit B-5, pp. 4-5.
[19] Exhibit B-5, pp. 5-6.
[20] Order G-6-24
[21] Exhibit B-1, p. 3.
[22] Exhibit B-1, p. 4.
[23] Exhibit B-3, BCUC IR 1.1.

FAES notes that an alternative option to a one-time bill adjustment to DSD is to have the variance between the interim rate and the final rate be recorded in a new deferral account, with the disposition of the balance of that deferral account being addressed in the next fiscal year rate setting process in the calculation of the COS Rate.[24]

3.0 Panel Determination

The Rate Development Agreement stipulates certain conditions that were agreed upon by FAES and DSD. These negotiated provisions include, among other rate schedule and cost of service items, a 60/40 debt/equity capital structure and cost of debt. While DSD has provided some evidence regarding FAES' business risk in relation to the DSD TES in its letter of comment in this proceeding, the Panel is not convinced that adjusting only the allowed ROE component is appropriate. Similar to the reasoning in the BCUC's decision in Order G-226-20, we find that setting a fair return for a utility involves considering many components beyond the allowed ROE. For instance, the capital structure must also be reviewed in conjunction with the allowed ROE. Furthermore, the Rate Development Agreement contains many terms negotiated by FAES and DSD and the agreement should operate and be construed in its entirety. We are not convinced that adjusting only one aspect (i.e., the allowed ROE) of that agreement is fair and reasonable to either party. **Accordingly, the Panel determines that the Fiscal 2023/24 and Fiscal 2024/25 COS Rates should adhere to the negotiated Benchmark Utility's ROE plus 50 bps as set out in the Rate Development Agreement.**

The BCUC by Order G-254-23 directed that the Fiscal 2023/24 rate of $0.227 per kWh, effective January 1, 2024, would remain interim pending the BCUC's final decision on Stage 2 of the GCOC proceeding. Subsequently, the BCUC has determined that FEI would serve as the Benchmark Utility. Based on FAES' submissions in this proceeding, the Panel is satisfied that it can and should determine the Fiscal 2023/24 and Fiscal 2024/25 COS Rates on a permanent basis notwithstanding the BCUC's previous orders as those rates are neither affected by nor contingent on the outcome of Stage 2 of the GCOC proceeding. Accordingly, waiting for a final decision on Stage 2 of the GCOC proceeding is unnecessary and undesirable in light of the unique circumstances applicable to FAES' rate-setting mechanism for the DSD TES.

The Panel finds that it would be more efficient to set permanent rates in this proceeding given that the Benchmark Utility's ROE upon which the negotiated 50 bps premium is based is now known, rather than prolonging FAES' interim rate pending the BCUC's decision on Stage 2 of the GCOC proceeding. We also note that the variance in the cost of service due to the increase in the existing Fiscal 2023/24 COS Rate of $0.227 per kWh attributable to the increase in the Benchmark Utility's ROE has already been captured by FAES in the District Deferral Account with the calculation of the proposed COS Rate for Fiscal 2024/25. Finally, as the BCUC has previously noted, DSD, as a municipal school district, has unique budgeting constraints which may preclude it from adjusting its annual budget, including rates charged to DSD by FAES, once that budget has been approved.[25]

The Panel finds FAES's proposal to capture the variance between the Fiscal 2023/24 COS Rate of $0.227 per kWh and the increase attributable to the increased Benchmark Utility ROE in the District Deferral Account to be a reasonable method to account for the cost of capital difference between January 1, 2024 through June 30, 2024 arising as a result of Order G-254-23. Otherwise, FAES would have to make a bill adjustment to DSD or recalculate the Fiscal 2024/25 proposed COS Rate to account for that cost of capital difference for the period. **Therefore, for Fiscal 2023/24, the Panel approves the interim rate of $0.227 per kWh from January 1, 2024 through June 30, 2024 on a permanent basis.**

[24] Exhibit B-3, BCUC IR 1.1.

[25] FAES 2018/19 Revenue Requirements and Cost of Service Rates TES Delta School District proceeding, Decision and Order G-84-19 dated April 16, 2019, p.39.

When it filed the Application, FAES proposed to maintain the $0.227 per kWh interim rate beyond July 1, 2024 and did not consult with DSD prior to filing the Application. By now, several months have passed and FAES proposes a one-time bill adjustment to DSD. As DSD was silent on the variance treatment of the interim rate, the Panel is uncertain about the potential impact on a retroactive bill adjustment for a school district. FAES indicates that such bill adjustment can range from $300 in a summer month to $8,900 in a winter month, depending on consumption and the timing of this final decision. We find that implementing the Fiscal 2024/25 COS Rate in a timely manner would benefit FAES and DSD by minimizing the size of further adjustments. As for the outstanding balance arising from the approved Fiscal 2024/25 COS Rate from July 1, 2024 until the implementation of that rate by the next billing cycle, we consider that establishing a new deferral account to capture the variance since July 1, 2024 will not harm either party.

In Section 2.0 above, the Panel noted that FAES' cost of service forecast for Fiscal 2024/25 appears to be reasonable and uncontested by DSD. **Accordingly, for Fiscal 2024/25, FAES is approved to charge the COS Rate of $0.235 per kWh on a permanent basis, effective July 1, 2024. The Panel directs FAES to amend the COS Rate for DSD from $0.227 per kWh to $0.235 per kWh in the next billing cycle or by no later than November 1, 2024. FAES is further directed to establish a new deferral account to record the variance between the Fiscal 2024/25 interim rate of $0.227 per kWh and the permanent rate of $0.235 per kWh from July 1, 2024 to the date the permanent rate is implemented. This new deferral account is approved to attract FAES' weighted average cost of capital, with the disposition of the balance to be addressed in FAES' next rate application.**

The Panel recommends that FAES obtain feedback from DSD prior to filing future rate applications so as to facilitate a better understanding between the parties with respect to any proposed rate increases and help resolve potential issues prior to filing.

DATED at the City of Vancouver, in the Province of British Columbia, this 27th day of September 2024.

Original signed by:

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A. K. Fung, KC
Panel Chair/Commissioner

Original signed by:

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E. B. Lockhart
Commissioner