Suite 101, 310 Ward Street, Nelson, British Columbia, V1L 5S4

December 2, 2022

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

Attention: Sara Hardgrave, Acting Commission Secretary

RE: Nelson Hydro – Cost of Service Analysis and Rate Design Application – Project No. 1599166 – Decision and Order G-196-22 – Application for Reconsideration and Variance of Order G-196-22

Dear Ms. Hardgrave,

Nelson Hydro writes to the Commission to submit the attached Application for Reconsideration and Variance of Decision and Order No. G-196-22 (the "Application") in accordance with Part V of the Commission's Rules of Practice and Procedure and pursuant to section 99 of the *Utilities Commission Act* ("UCA") which allows for the Commission to reconsider, vary or rescind a decision or order made by it. The filing date of the Application is consistent with the December 2, 2022 filing date as set by Commission Letter L-40-22.

As set out in the Application, Nelson Hydro requests that the BCUC exercise its powers under section 99 of the UCA to reconsider and vary two aspects of Decision and Order No. G-196-22: 1) the Directives concerning allocations of generation and power purchases in the utility's Cost of Service Analysis; and 2) the Directive for the utility to utilize a debt-to-equity ratio of 50 percent/50 percent in calculating the rate base of its Rural operations.

Sincerely,

Scott Spencer
Nelson Hydro General Manager

Copies: Gabriel Bouvet-Boisclair, Deputy Corporate Officer
Kevin Cormack, City Manager

Nelson Hydro Cost of Service Analysis and Rate Design Application
Project No. 1599166

Application for Reconsideration and Variance of

British Columbia Utilities Commission

Decision and Order G-196-22

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I. INTRODUCTION

1. Nelson Hydro files this application (the "Reconsideration Application") pursuant to section 99 of the *Utilities Commission Act* ("UCA") and in accordance with Part V of the British Columbia Utilities Commission's ("BCUC" or the "Commission") Rules of Practice and Procedure, Order G-178-22 (the "Rules") for reconsideration and variance of the Commission's Decision and Order G-196-22 (the "Decision and Order"), dated July 19, 2022 with regard to Nelson Hydro's Cost of Service Analysis ("COSA") and Rate Design Application ("COSA & RD Application").

2. Specifically, Nelson Hydro seeks to vary the Decision and Order in the following respects:

   (a) Nelson Hydro be directed to assign its generation assets and costs 100 percent to its Urban customers in the COSA;

   (b) Nelson Hydro be directed to assign power purchases 33.5 percent to Urban and 66.5 percent to Rural;

   (c) 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.

3. Nelson Hydro does not seek reconsideration and variation of the Decision and Order in any other respect.

4. Nelson Hydro respectfully submits that the Commission's Decision and Order contains material errors of fact and law that justify variation of Order G-196-22 as described above.

5. The consequences of these errors as detailed below are that:

   (a) the City of Nelson (as the owner of Nelson Hydro) is deprived of the full benefit of its generation and the ability to determine how to best utilize its generation;

   (b) the City of Nelson (as the owner of Nelson Hydro) is not able to earn a fair return on its Rural assets as is required under regulatory law.

6. The following sections of this Reconsideration Application set out:

   (a) the applicable procedure on an application for reconsideration;

   (b) a summary of Nelson Hydro's grounds for reconsideration; and

   (c) a detailed discussion of each of the grounds for reconsideration.

II. PROCEDURE ON RECONSIDERATION

7. Section 99 of the *UCA* provides that: "The 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."

8. Section 27.03 of the BCUC's Rules states that "unless prior permission of the BCUC is obtained, an application for reconsideration must be filed with the BCUC within 60 days of the issuance of the order or the reasons for decision, whichever is later."

9. Following issuance of the Decision and Order, Nelson Hydro requested that its right to submit an application for reconsideration be extended until 60 days beyond the time that a rate determination be made in the COSA

& RD Application. At that time, Nelson Hydro anticipated that a rate adjustment based on the COSA would be forthcoming. The BCUC granted this request in Letter L-33-22.

10. On October 3, 2022, Nelson Hydro filed, as a compliance filing, the recalculated COSA (the "Modified COSA") as directed by the Decision and Order. As the Modified COSA did not support any rate adjustment, Nelson Hydro recommended that no such adjustment be made. By separate correspondence, Nelson Hydro then indicated it would proceed with an application for reconsideration of the Decision and Order and proposed that the deadline for such a submission be set for December 2, 2022. The Commission accepted this proposal in Letter L-40-22.

11. Section 26.04 of the BCUC's Rules identifies the items that must be addressed in an application for reconisderation. Such an application must:

    (a) Be in writing and, unless prior permission of the BCUC is obtained, not longer than 30 pages (excluding appendices and/or attachments);

    (b) Identify the decision affected;

    (c) State the applicant's name and the representative's name (if applicable);

    (d) Describe the impact of the decision and how it is material;

    (e) Set out the grounds for reconsideration in accordance with Rule 27.05; and

    (f) Set out the remedy the applicant is seeking.

12. Nelson Hydro submits that this Application satisfies the requirements of Section 26.04 of the Rules.

13. Section 27.05 of the BCUC Rules provides that an application for reconsideration of a decision must contain a concise statement of the grounds for reconsideration, which must include one or more of the following:

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

    (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 issurance of the decision; or

    (e) Where there is otherwise just cause.

14. As set out in detail below, Nelson Hydro's Application is founded on errors of law and fact in the Decision and Order.

III. SUMMARY OF GROUNDS FOR RECONSIDERATION

15. Nelson Hydro seeks reconsideration and variance of the Decision and Order on the grounds that the Commission Panel made material errors of law and fact in its decision. These errors relate to two separate issues: first, the Panel's directives regarding the COSA's allocation of generation and power purchases

between the Urban and Rural areas; and second, the Panel's finding that the utility can raise additional debt and as such, a deemed debt-to-equity ratio of 50 percent/50 percent is appropriate.

A. Determinations Regarding the COSA's Allocation of Generation and Power Purchases

16. As part of the COSA & RD Application, Nelson Hydro filed a COSA for approval. The purpose of the COSA is to determine an equitable allocation of Nelson Hydro's costs between its Rural and Urban customers.

17. The COSA assigned the utility's generation assets and costs 100 percent to its Urban customers and valued any surplus generation supplied to Rural customers at the FortisBC Inc. ("FBC") wholesale energy rate.

18. The COSA also assigned power purchases 33.5 percent to Urban customers and 66.5 percent to Rural customers.

19. The Commission panel rejected Nelson Hydro's assignment of generation assets and costs as proposed, citing the following reasons:

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

    (b) There is no sound regulatory reason for assigning the generation assets and costs 100 percent 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.[1]

20. Based on this reasoning, the Panel directed Nelson Hydro to recalculate the COSA with generation assets and costs assigned 100 percent to Common assets and costs.

21. The Panel, relying on the same reasoning as it did in rejecting the proposed allocation of generation, also rejected the proposed allocation of power purchases and directed that they be treated as common costs.[2]

22. Nelson Hydro respectfully submits that the Panel's decisions on these allocations result in a material impact to Nelson Hydro and the Panel's reasoning contains both factual and legal errors that warrant reconsideration.

23. First, in justifying its Decision and Order, the Commission notes repeatedly that the utility's generation assets are located outside of the City of Nelson and in the Rural area.[3] In fact, the generation assets are located within the City of Nelson. While the Commission notes that the location of the generation assets was not "determinative", the Decision and Order clearly ascribed significant weight to the location of the generation assets in rejecting the allocations of generation and power purchases as proposed by Nelson Hydro in the COSA.

24. Second, the Commission failed to properly interpret and consider Nelson Hydro's significent limitations and borrowing restrictions under the *Community Charter, Local Government Act* and related regulations.

25. The factual error regarding the location of the generation assets along with the legal error regarding Nelson Hydro's borrowing restrictions under the *Community Charter* leaves the Commission's reasoning that it has provided for a fair return on investment to Nelson Hydro unsupported. Ultimately the result of the errors leaves Nelson Hydro in a situation of not achieving the fair return on investment it is entitled to receive under the Fair Return Standard.

[1] Decision and Order, G-196-22, p. 26.
[2] ibid, p. 32.
[3] ibid, pp. 16, 26.

26. Nelson Hydro further submits that if the Commission upholds their decision and order to allocate 100% of generation to Common, the Panel should direct Nelson Hydro to modify the COSA to also allocate the proportionate amount of Capital Reserve Transfer to Common.

27. The Commission should accept Nelson Hydro's original proposed allocations based on the errors identified above. However, if the Commission were to not do so, an additional factual error by the Commission would warrant a modified outcome regarding the allocation of generation and power purchases as it related only to the utility's Coffee Creek substation.

28. Under the reasoning used in the Decision and Order, all energy and demand billing (i.e. power purchases) should be allocated 100 percent to Rural. This is because the Decision and Order reasoned that allocations should be based on the physical flows of power. The Coffee Creek Substation cannot serve Urban customers, and in fact, there is a physical separation of a portion of the utility's power flows. Thus, the Decision and Order contained a factual error by failing to recognize this circumstance. Accordingly, under the reasoning set out in the Decision and Order, energy and demand billing from the Coffee Creek Substation should be allocated 100% to Rural.

B. Determinations Regarding the Utility's Debt-to-Equity Ratio

29. As part of the COSA & RD Application, the BCUC reviewed and examined the apoproach to determine the City's allowed return, which included a comprehensive examination of Nelson Hydro's cost of capital.[4] No expert evidence was led by any other party on capital structure or allowed return. The only expert evidence on the topics was provided by Nelson Hydro.

30. In the Application, Nelson Hydro submitted that it is properly financed by a capital structure of roughly 15 percent debt and 85 percent equity and this actual ratio was appropriately used in calculating the utility's allowed return. This debt-to-equity ratio was accepted and approved by a prior Commission Panel in Nelson Hydro's 2017 Reconsideration Application in Order G-119-17.

31. The Commission rejected Nelson Hydro's position and held that a deemed debt-to-equity ratio of 50 percent/50 percent is appropriate for Nelson Hydro's Rural operations for the purpose of setting rates.[5] The primary justification for that decision seems to flow from submissions from BCOAPO who filed no expert evidence on the topic and relied on a comparative utility, Bolalex Ocean Falls Limited Partnerhsip, which bears little to no resemblance to Nelson Hydro's rural operations nor the underlying nature of Nelson Hydro, a municipal utility.

32. Nelson Hydro submits that the Commission's determination on Nelson Hydro's allowed capital structure for the purpose of rate setting ignores the evidence and submissions made in this proceeding and is based on a factual error.

33. The Commission reasoned that its determination was appropriate based on a finding that "Nelson Hydro is able to achieve an actual debt level of 50 percent."[6]

34. Nelson Hydro submits that the Commission failed to consider the legal limitations on Nelson Hydro's ability to borrow despite abundant unchallenged submissions on the topic. In particular, the Commission overlooked that fact that such borrowing requires multiple approvals from the electorate and different levels of government over which Nelson Hydro has no control. While Nelson Hydro may "theoretically" be able to achieve a higher level of borrowing, it does not independently have the ability to do so and the Commission failed to consider the practical realities associated with additional borrowing. It is very

[4] Decision and Order G-196-22, p. 61.
[5] *Ibid*, p. 76.
[6] *Ibid*.

possible that the electorate would reject such borrowing, leaving Nelson Hydro with a deemed debt-to-equity ratio that it actually cannot achieve. Furthermore, Nelson Hydro cannot borrow on a retroactive basis, but would only be able to do so for new capital expenditures which would take significant time to achieve even assuming the required approvals are granted.

35. As was explained in the evidence in the proceeding, borrowing for capital investment in rural areas must be related to actual capital investment on a go-forward basis. Nelson cannot, under the *Municipal Liabilities Regulation* (the "MLR") "borrow" the difference between the 15% debt component approved by the Commission in 2017 and the new 50% debt component approved in 2022 pursuant to the Order and Decision. Nelson Hydro, under its applicable municpal legislation, can only borrow what may be required for future projects and it would take many years of capital investments on a go-forward basis to approach the level now imposed by the Commission. This circumstance is unique to a municipal utility as opposed to a private shareholder-owned utility which has the flexibility to adjust debt-to-equity ratios subject to its corporate governance.

36. The Commission erred in presuming Nelson Hydro has such immediate flexibility and the impact of an immediate shift from 15% to 50% is punitive to the utility and is contrary to the right of Nelson Hydro to earn a fair return under the Fair Return Standard, as was recognized in the Commission's 2017 Order G-119-17.

37. The Panel correctly identified the Fair Return Standard as having three requirements for a fair and reasonabe return on capital:

    (a) The comparable investment requirement – a reasonable return on capital, should be comparable to the return available from the application of the invested capital to other enterprises of like risk;
    (b) The financial integrity requirement - a reasonable return on capital, should enable the financial integrity of the regulated enterprise to be maintained; and
    (c) The capital attraction requirement - a reasonable return on capital, should permit incremental capital to be attracted to the enterprise on reasonable terms and conditions.[7]

38. However, the Commission erred in the application of the Fair Return Standard to Nelson Hydro's unique context and operational constraints.

39. Accordingly, given this context, the Commission's decision to immediately impose a deemed 50 percent/50 percent debt-to-equity ratio based on a finding that Nelson Hydro is able to achieve an actual debt level of 50 percent does not reflect the evidence in the record and results in an unfair outcome and a breach of the Fair Return Standard.

40. The Commission should vary the Decision and Order to direct Nelson Hydro to make efforts to increase its debt level going forward and continue to use the utility's actual debt-to-equity ratio for the purposes of calculating the utility's allowed return.

IV. ERRORS IN COMMISSION DETERMINATION REGARDING ALLOCATIONS OF GENERATION AND POWER PURCHASES

A. Summary of Utility's Proposed Allocations and Commission Decision

41. In the COSA & RD Application, Nelson Hydro proposed to allocate the generation assets as 100% Urban and value any surplus generation that is supplied to Rural customers at the FBC wholesale energy rate.

B. The Commission Erred in Fact and Law and Should Have Accepted the Utility's Proposed Allocations

[7] Decision and Order G-196-22, p. 62.

The Commission Incorrectly Assumed that the Generation Assets are Located in the Rural Area

42. Nelson Hydro submits that the Panel's Decision was unreasonable as the Panel made a key error of fact which has a material bearing on the Decision and Order.

43. The Panel's Decision and Order consistently highlighted the importance of the location of assets in allocating their associated assets and costs. The Panel expressly recognized, in deviating from Nelson Hydro's proposed allocations, that their disagreement on "the assignment of generation and power purchase costs, are <u>likely to have a material effect on the ultimate allocation of costs</u> between the Rural and Urban customer classes, and consequently on Rural customers' rates." [emphasis added][8]

44. The Panel made an error of fact when it found that Nelson Hydro's generation assets "reside in the Rural area". In fact, the generation assets reside in the City of Nelson (i.e., the Urban area) and have since a boundary expansion was effected in 2003. Nelson Hydro would not have presumed the Panel did not know where the key generation assets were within the City. The locations of the assets are a key aspect of Nelson's position and are a material factor in the Decision and Order.

45. While the Panel noted that the location of the generation assets was "not determinative", that factual error served as the foundation for the Panel's finding that their location "did not support an allocation of 100 percent of the assets and costs to the Urban customers".

46. Nelson Hydro submits that any error made by the Panel in assessing the underlying factual context of the location of generation assets has a material bearing on the decision reached by the Panel, and submits the Panel recognized same. While the location of assets was deemed "not determinative",[9] the assessment exceeds the materiality threshold required by the BCUC's Rules.[10]

47. The decision of the Panel is to be reviewed on a standard of reasonableness.[11] 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.[12] A decision cannot be upheld if the Panel reached an outcome based on flawed logic; both the outcome of the Decision and Order and the process by which it was reached are to be considered.[13]

48. 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.[14] Nelson submits that the factual error led to the Decision and Order being reached on an improper basis and had a material effect on the ultimate allocation of costs. If Nelson Hydro had been aware of the Panel's erroneous assumption the generation assets were located in the Rural area, something Nelson Hydro had not contemplated given this was not an issue addressed in the proceeding, it would have highlighted the associated costs and risks assumed by the City of Nelson which further supported its core position the generation assets are owned by the City for the benefit of Urban customers.

49. Nelson Hydro further submits that it is unfair and unreasonable for Rural customers to have the benefit of common cost allocation of the generation assets as found by the Commission, while Rural customers make no contribution to the capital reserves of Nelson Hydro which support the generation assets. In its decision

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[8] Decision and Order G-196-22, p. 1.
[9] *Ibid.*
[10] Order G-178-22, Rules of Practice and Procedure, s. 27.05(a).
[11] *Canada (Minister of Citizenship and Immigration) v. Vavilov*, 2019 SCC 65, at para 85 [*Vavilov*].
[12] *Ibid.*
[13] *Ibid* at para 83.
[14] *Vavilov* at para 86.

and order G-119-17, the BCUC approved the applied-for transfer to the Capital Reserve and accepted Nelson Hydro's practice of financing its capital expenditures primarily through the use and management of this fund.[15] In Decision and Order G-274-19, the Commission further indicated that making no allocation to the Capital Reserve Fund by Rural ratepayers is unreasonable.[16] In the original COSA submission, Nelson Hydro allocated 100% of the capital reserve transfer to Urban[17] based on 100% allocation of the generation to Urban. If the Commission upholds its Decision and Order to allocate generation and power purchases to Common, the Commission should also direct that the capital reserve contributions should also be so allocated.

C. Alternatively, The Commission Erred in Failing to Differentiate Power Purchases at Coffee Creek Substation

50. As set out above, the Commission should vary the Decision and Order to utilize the allocations of generation and power purchases in the COSA as initially proposed by Nelson Hydro. However, in the event that the Commission does not do so, Nelson Hydro has identified an additional critical factual error in the Decision and Order that justifies an adjustment to the allocation of power purchase costs.

51. The Decision and Order directs that Purchased Power and Generation Costs be allocated 100% as a common cost. However, the reasoning used in the Decision and Order to support this outcome cannot be applied with regard to power purchases from FBC at the utility's Coffee Creek Substation. As explained below, applying the reasoning from the Decision and Order in a consistent manner, all energy and demand billing from the Coffee Creek substation should be allocated 100% to Rural as that energy and demand can be allocated only to those who can, and do, use it, the Rural customers

52. As summarized above, the Commission rejected Nelson Hydro's proposal that the utility's generation be allocated to Urban based on policy decisions by City Council. Instead of accepting an allocation based on policy, the Decision and Order determines that the allocation should be based on the physical flows of power, as outlined in the following excerpt from the Decision and Order:

> *… if there were a clear separation of the generation assets between those used by Urban and Rural customers, then some or all of the generation assets and costs could reasonably be assigned between those two groups and any residue assigned to Common. This is the case for distribution substation assets and costs, for example, which the COSA assigns to Urban, Rural and Common based on the physical location of the assets.*
>
> …
>
> *However, there is <u>no clear separation</u> of the generation assets in this instance.*
>
> …
>
> *There is <u>no physical separation of the power flows</u> between Urban and Rural customers. All the power from Nelson Hydro's generating facilities is delivered by its one integrated transmission system into its <u>one integrated distribution system</u> to service both Urban and Rural customers. Nelson Hydro's Urban and Rural customers draw their power from one common pool.*[18] [emphasis added]

53. This same common pool logic is then applied equally to the costs of power purchases from FBC.[19]

[15] Decision and Order G-119-17, Appendix A, p. 15
[16] Decision and Order G-274-19, Appendix A, p. 9
[17] 2019 COSA, Table E-2
[18] Decision and Order G-196-22, pp. 26-27.
[19] ibid, pp. 30-31.

54. The factual error in the above excerpt is that the power from the Coffee Creek Substation 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 the Coffee Creek Substation 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 logical scenario where power would be supplied to the Urban area from the North Shore as it can already be supplied through parallel substations at Mill Street and Rosemont which are supplied from Granite Terminal which is fed in parallel by Bonnington Falls Generating Station and FortisBC. Accordingly, using the reasoning from the Decision and Order, energy and demand billing from the Coffee Creek Substation should be allocated 100% to Rural.

55. Nelson Hydro recognizes that there may have been some confusion regarding language used in the course of the proceeding that described Nelson Hydro as having an "integrated" system and hydraulic generation that can serve both Urban and Rural service areas. Both of these statements are true in the sense 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 the Coffee Creek Substation, such connection is not possible. Nelson Hydro presented information regarding the Coffee Creek Substation as described above from the very outset of this proceeding. For example, in the Application it was noted that:

> *. . . it is worth noting that a significant number of Rural customers are served directly from FortisBC's transmission lines on the Northshore through the City's Coffee Creek substation. Therefore, for these customers, the purchased energy is not 'pooled and indistinguishable once it enters that distribution system.*[20]

56. Accordingly, under the reasoning set out in the Decision and Order (which was based on factual and legal errors as described above), the energy and demand billing from the Coffee Creek Substation should be allocated 100% to Rural. The Panel's Decision and Order to not do so clearly rested on a failure to recognize that the Coffee Creek Substation cannot serve Urban customers and, in fact, there is a physical separation of a portion of the utility's power flows.

V. ERRORS REGARDING NELSON HYDRO'S ABILITY TO BORROW

57. As part of its Application, Nelson Hydro submitted that it is properly financed by a capital structure in accordance with what actually exists (i.e., roughly 15 percent debt/85 percent equity). As explored in detail in the Proceeding, Nelson Hydro's capital structure is heavily skewed to equity as a result of its municipal ownership, which limits the amount of, and manner by which, the City can take on debt for Nelson Hydro.

58. This position is consistent with the Commission's Decision in 2017 where it concluded that the application of a debt-to-equity ratio in accordance with what actually exists (i.e., roughly 15 percent debt/85 percent equity) was a fair and reasonable approach for Nelson Hydro to use in calculating the utility's allowed return. Notably, the reasoning supporting the Commission's holding was that "imposing a deemed debt to equity ratio on Nelson Hydro, which is similar to other regulated utilities where such a capital structure cannot be achieved would have the potential to unfairly restrict the utility from earning a fair return on its assets."[21]

59. In the Decision and Order, the Commission failed to consider the evidence in the record and imposed a deemed debt-to-equity ratio of 50 percent/50 percent. Nelson Hydro submits that the Commission has now imposed a deemed debt-to-equity ratio on Nelson Hydro that it is unlikely to achieve, and even if it is achievable, would require several years to do so. As such, the Commission has restricted Nelson Hydro from, at a minimum, earning a fair return on its assets in the medium term if not the long-term. This outcome could very likely be extended well into the future depending on whether Nelson Hydro is able to overcome the

[20] Exhibit B-1, Application, p. 56.
[21] Decision and Order G-119-17, p. 9.

challenges and limitations associated with acquiring additional debt. Even if that is the case, it will take many consecutive years of capital investment in the Rural area to get anywhere near a debt-to-equity ratio of 50%/50%.

A. Summary of Submissions on Capital Structure and Commission's Decision

60. The subject of the utility's debt-to-equity ratio was explored at length in the proceeding.[22]

61. As the Commission reviewed in the Decision and Order, Nelson Hydro is subject to the following limitations and challenges in borrowing:

    (a) Section 2(a)(ii) of the MLR prevents municipalities from incurring a liability if the "total annual servicing cost of the aggregate liabilities is greater than 25 percent of its annual revenues."

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

    (c) All long-term borrowing requires electoral approval pursuant to Section 180 of the *Community Charter* as well as approval by the Regional District of Central Kootenay Board of Directors and the Inspector of Municipalities (except in a case of limited number of specific statutory exceptions that would not apply to borrowing for Nelson Hydro).

62. Significantly, during the proceeding, Nelson Hydro repeatedly explained that achieving electoral approval for long-term borrowing in general is far from guaranteed. For example, in response to BCUC IR No. 4.2.1, Nelson Hydro provided examples where the electorate voted against borrowing. Nelson Hydro further explained that the electorate tends to be risk averse when local governments borrow and the fact that the borrowing at issue would be for Rural assets would also likely deter the electorate from approving such borrowing. The very real possibility that proposed borrowing could fail to receive electoral approval was reiterated in responses to BCOAPO IR No. 6.5 and BCUC IR No. 11.2 and 72.1. In response to BCUC IR No. 72.1, Nelson Hydro stated that:

> *Borrowing for the purposes of Nelson Hydro is not necessarily prohibited, but it is very difficult to achieve due to multiple policy and legislative constraints, limits on financial indicators needed to demonstrate that the debt can be serviced, and the fact that the borrowing would need to be approved by voters. For Nelson to borrow to fund the rural utility, which will at best yield interest payments and a small return on equity, but makes no contribution to reinvestment reserves, and no ability to charge principal repayments through rates,* ***is highly unlikely to be supported by voters****. Nelson's voters have demonstrated limited interest in borrowing even when there are benefits to Nelson – much less when it is only about serving the rural areas. [emphasis added]*

63. In response to BCUC IR 11.2 requesting the utility to recalculate the return on rate base based on a deemed equity thickness of 40%, Nelson Hydro stated that such an exercise could not be completed give that there were significant challenges to borrowing on this scale. Specifically, Nelson Hydro explained:

> *The calculations cannot be performed. It is impossible to finance the $42.532 million Rate Base with equity at 40% ($17.012 million) and debt at only $5.467 million.* ***There is also no way to credibly hypothesize about the missing $20 million of capital ($42 million Rate Base less $17 million equity and $5 million debt) as coming from new debt, given there are significant challenges to Nelson Hydro's ability to borrow on that scale.*** *As there is no source for that capital, even to perform the calculations there would be no coherent way to provide the hypothetical $20 million in capital. [emphasis added]*

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[22] See Nelson Hydro responses to BCUC IRs Nos. 11.2, 11.3, 41.3, 41.4, 70.3, 71.2, 71.3, 71.4, 71.4.1, 71.6; see Nelson Hydro responses to BCOAPO IRs Nos. 6.1-6.5.1; 36.1-36.5; 43.3; see Nelson Hydro responses to RCIA IRs No. 11.3, 18.1

The response then continued on to reiterate that such borrowing would need approval by the electorate and there are political reasons to suggest such borrowing would not be approved. Nelson Hydro provided a similar response in regard to requested calculations set out in BCUC IR No. 71.6.

64. In response to BCUC IR No. 41.4, Nelson Hydro discussed the implications of the BCUC establishing a deemed capital structure for the utility. Nelson Hydro explained that it would be "unfair and prejudicial to Nelson Hydro since there is ***simply no way*** it could raise that 35-45% of capital from new debt – the Municipal legal and practical restrictions that apply would not allow this to occur." [emphasis added] Likewise, in response to BCOAPO IR No. 43.3, Nelson Hydro noted that it "is heavily equity financed because the establishment of higher levels of debt is not practical or in many cases possible."

65. In Nelson Hydro's Reply Argument, the utility indicated that it could seek to increase borrowing once "full phase-in has been achieved."[23] Nelson Hydro, at this time, also reiterated that it cannot increase its actual debt-to-equity ratio retroactively, but that it could only seek to do so on a go-forward basis subject to the various approvals required.[24] Nelson Hydro further emphasized in its Response to Intervener Sur Reply that statements about potentially achievable debt targets were all in the context of a full phase-in of rates as proposed in the COSA & RD Application.[25]

66. The Decision and Order recognized that in response to BCUC IR No. 41.4, Nelson Hydro stated that it would not be able to achieve a debt component of 50-60%.[26]

67. The Decision and Order calculated the maximum amount of additional debt that could be achievable by Nelson Hydro based on the limitation from Section 2(a)(ii) of the MLR (i.e., 25 percent of annual revenues). The Commission noted that this would be "subject to meeting the other constraints related to debt servicing."[27]

68. Subsequently, the Commission went on to write:

> *Therefore, the Panel is not persuaded that 15 percent is the maximum level of debt (and correspondingly 85 percent is the lowest level of equity) that can reasonably be achieved for the Rural operations of Nelson Hydro. Notwithstanding the submission made by Nelson Hydro, the Panel considers that a higher debt ratio in the amount of 50 percent is* ***theoretically achievable****.The Panel notes that BCOAPO proposed a 50 percent/50 percent debt to equity ratio. The Panel also considers that the determinations it has made to the cost allocations in previous sections of this decision* ***will likely result*** *in increases in both the estimated rate base for Nelson Hydro's Rural operations, as well as the annual estimate of revenues for same. Consequently, the Panel anticipates a debt ratio of 50 percent will continue to be* ***theoretically achievable****. [emphasis added].*

69. In determining that a deemed debt-to-equity ratio of 50 percent/50 percent is appropriate for Nelson Hydro's Rural operations, the Commission wrote the following:

> *The Panel accepts that the City is somewhat constrained by its ability to raise debt to support Nelson Hydro. Nelson Hydro further asserts that its proposed 85 percent equity component is the lowest achievable level for Nelson Hydro. Further, Nelson Hydro asserts that a debt greater than actual (15 percent of capital structure) is not achievable. However, the Panel notes that Nelson Hydro states in its sur-reply that it "believes that achievable debt targets should be based on the percentage of Nelson Hydro's Rural assets as a percentage of the City's overall assets" and that "this statement is in reference to potentially achievable future debt targets – after the full phase-in has been*

[23] Nelson Hydro Reply Argument, p. 5.
[24] *Ibid,* pp. 5-6.
[25] Nelson Hydro Response to Intervener Sur Reply, p. 2.
[26] Decision and Order, G-196-22, p. 71.
[27] Ibid, p. 77.

completed." Nelson Hydro further states that the debt-to-equity issue could be structured in the future to meet City Council's legislative and operational requirements and potentially alleviate some rate pressure on Rural ratepayers. ***Given these statements, it appears to the Panel that there may be circumstances within which it is possible for Nelson Hydro to raise a greater amount of debt than current levels of approximately 15 percent of the Nelson Hydro rate base for its Rural operations.***[28] *[emphasis added]*

70. Nelson Hydro submits on a plain reading of the above paragraph the Panel has failed to provide Nelson Hydro with a fair return on its capital in accordance with the Fair Return Standard. It is unreasonable to assert it is fair to a utility to be in a position "where there may be circumstances within which it is possible to raise a greater amount of debt than the current levels of 15%…" and then require that the debt level be immediately raised to 50%. Nelson Hydro submits it is absolutely correct that there are no circumstances under which it can raise a level of debt within the next 5 years which remotely approaches the level the Commission has imposed. The result of this aspect of the Decision and Order is that Nelson Hydro will not receive a fair return on its investment.

71. Nelson Hydro clearly articulated the facts which restrict its ability to meet the "theoretical" target imposed in the Decision in response to BCUC Information Request 36.4. The circumstances are real and making a presumption that borrowing against rural assets, which are approximately 10% of Nelson's overall assets, even if that could be done, which it cannot, would not achieve a 50/50 debt to equity ratio. Even, if common assets are taken into account, Nelson Hydro's assets as a percentage of the City's overall assets would be in the 15% – 20% range. The Commission erred in assuming the theoretical target is achievable. As it is not achievable, the Fair Return result justifies using actual debt equity levels..

B. The Commission Erred in Determining That Nelson Hydro Is Able to Achieve An Actual Debt Level of 50 Percent

72. As set out above, the Decision and Order reviews the primary constraints and challenges associated with Nelson Hydro achieving a higher amount of debt. The Commission repeatedly characterizes Nelson Hydro's ability to raise additional debt as "theoretically achievable"[29] – a characterization that Nelson Hydro agrees with. The Commission further recognizes that the capacity to raise additional debt may be limited to certain circumstances ("there may be circumstances where it is possible for Nelson Hydro to raise a greater amount of debt than current levels of approximately 15 percent of the Nelson Hydro rate base for its Rural operations."[30]).

73. However, despite repeatedly recognizing the challenges and limitations Nelson Hydro faces in acquiring additional debt, and that any such borrowing ability is uncertain and dependent on third-party aprovals, the Commission moves on to conclude that it "considers the deemed equity component of 50 percent is appropriate because. Nelson Hydro is able to achieve an actual debt level of 50 percent."[31]

74. The Commission's finding that Nelson Hydro "is able to achieve an actual debt level of 50 percent" is speculative and factually inaccurate. Further, it does not reflect the evidence submitted in the Proceeding which was summarized and reviewed in the Decision and Order. Neither the Commission nor Nelson Hydro are able to make this statement with any certainty. Rather, Nelson Hydro's ability to achieve a debt level of 50 percent is purely hypothetical and is not completely within Nelson Hydro's or the Commission's control. This is because for Nelson Hydro to achieve additional debt it will need the approval of the electorate, the Regional District of Central Kootenay, and the Inspector of Municipalities.

75. For the Commission to make such a significant determination regarding Nelson Hydro's capacity to borrow, which ignores the abundant evidence in the record that there is no certainty that Nelson Hydro can achieve

[28] Decision and Order, G-196-22, p. 76.
[29] ibid, p. 77.
[30] ibid, p. 76
[31] ibid, p. 76.

more debt, and to direct the utility to utilize this deemed capital structure immediately, departing from its previous reasoning, is unfair, prejudicial and based on conjecture.

76. The Commission has imposed very real and severe consequences on Nelson Hydro based on the unsupported assumption that Nelson Hydro could "theoretically" achieve a debt level that would match the amount deemed by the Commission.

77. A more accurate determination regarding Nelson Hydro's ability to take on more debt that is supported by the evidence in the record is that Nelson Hydro can make efforts to take on additional debt for future borrowing but there is no guarantee that it will be successful and any such borrowing would not be in place for some time.

C. The Commission Should Vary the Decision and Order to Allow Nelson Hydro to Earn a Fair Return

78. In Order G-119-17 the Commission stated: "What is most important is that a utility receive a rate of return that allows it to continue to exists as well as attract capital and investors while treating ratepayers reasonably."[32] Also in Order G-119-17, where the Commission approved use of Nelson Hydro's actual debt-to-equity ratio, the Commission noted that "imposing a deemed debt to equity ratio on Nelson Hydro which is similar to other regulated utilities when such a capital structure cannot be achieved would have the potential to unfairly restrict the utility from earning a fair return on its assets."[33]

79. The impact of the Commission's decision to deem a debt-to-equity ratio for Nelson Hydro of 50 percent/50 percent, and to do so immediately without giving the utility any opportunity to achieve additional debt (which is itself not certain), is to prevent Nelson Hydro from receiving a fair and reasonable return on its investment for the time being.

80. In order to ensure that Nelson Hydro is given the opportunity to earn a fair return, any departure from the Commission's 2017 Decision accepting Nelson Hydro actual debt-to-equity ratio should reflect Nelson Hydro's very real borrowing limitations. Nelson Hydro has reasonably and appropriately relied on this decision and has continued to fund projects through capital reserves consistent with how municipalities fund all of their utilities.

81. Nelson Hydro submits that the Commission should vary the Decision and Order 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 from the Commission 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.

VI. SUMMARY AND CONCLUSION

82. Nelson Hydro submits that the errors outlined herein have a compounding effect and each contributed to aspects of the Decision and Order which are insufficiently substantiated and prejudicial to the interests of the City of Nelson andand further are contrary to the fair return standard to which Nelson Hydro is entitled.

83. The factual errors underlying the Decision and Order's findings with respect to the ownership of Nelson Hydro's generation assets and the physical separation of the Coffee Creek substation led to an outcome where Urban ratepayers are to subsidize power purchase costs for which they receive no benefit, and deprive them of the benefits arising from the 100% allocation of generating assets and costs to which they are entitled.

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[32] Decision and Order G-119-17, p. 8.
[33] ibid, p. 8.

84. As outlined above, the Decision and Order is to be reviewed on a standard of reasonableness.[34] The factual error underpinning the Coffee Creek Substation and the generation assets serve as examples highlighting aspects of the Decision and Order which were not justified based on the facts constraining the decision maker.[35] A decision cannot be upheld if the Panel reached an outcome based on flawed logic.

85. Nelson submits that the factual errors led to the Decision and Order being reached on an improper basis and had a material effect on the ultimate allocation of costs.

86. Nelson Hydro submits the deprivation of these due benefits and the inappropriate allocation of power purchase costs have a material effect on Urban ratepayers. The Decision and Order should be reconsidered and varied in both respects.

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[34] *Vavilov* at para 85.

[35] *Ibid.*