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Patrick Wruck
Commission Secretary
British Columbia Utilities Commission
Suite 410, 900 Howe Street
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**Kyuquot Power Ltd. – 2024 Revenue Requirements – Project No. 1599520**
**Directive 4 of Order G-53-24 - Request for Extension to Filing Date and Change in Scope**

Kyuquot Power Ltd. ("KPL") writes to request both an extension to the filing date and a change in scope for Directive 4 of Order G-23-24 ("Request"). In addition, KPL is requesting that the deemed interest rate on notional debt be set at 5.00 percent for the approved interim rates under Order G-53-24. KPL is making the Request in order to be able to reasonably respond to the circumstances of Directive 4.

Directive 4 of Order G-53-24 ('Directive 4") states;

> "KPL is directed to file for BCUC review, within 15 days of the date of this order, the agreement for the Intercompany Advance transaction undertaken in fiscal 2020/21"

KPL advises that the Intercompany Advance in fiscal 2020/21 and all the intercompany advances/withdrawals since inception resemble equity investments ("Equity Advances") rather than debt obligations. The Equity Advances from the KPL's parent company include rates of return, if any, and repayment of principal to the parent company based on maintaining the near-term (annual) viability of KPL's business and cashflows.

For revenue requirement applications, KPL uses notional debt and a deemed interest rate on notional debt. The debt is notional as KPL has used a capital structure of 60% third-party debt, despite the fact that KPL never has been able to secure 60% third-party debt using KPL assets only. The interest rate on this notional debt is "deemed".

This notional debt of 60% and corresponding notional 40% equity and deemed interest on this debt and deemed return on this equity is what is used for rate making purposes and not Equity Advances and any return on it.

The Intercompany Advance in fiscal 2020/21 was undertaken as an Equity Advance in the normal course of business and consistent with past accounting practices of KPL. The transaction was not undertaken on the basis of a specific agreement. Accordingly, KPL does not have an agreement to file for BCUC review and, further, the rate of return on the Equity Advances is highly variable (and was nil in fiscal

2021/2022). There is limited, if any, value in comparing the variable return rates on Equity Advances to a deemed interest rate and return on equity on notional debt and equity.

Background

KPL, since commencement of operations in 2006, has been equity financed by Equity Advances. The capital stock (shareholders equity) on the financial statements of KPL is $1.00. The parent company of KPL, Synex Energy Resources Ltd. ("SERL"), has provided the necessary capital funds to KPL in the form of Equity Advances. The Equity Advances have no specified terms for repayment and a return rate is set by SERL, at times, based on Canadian bank prime rates of interest plus a margin. SERL commonly waives the return charges on a permanent basis. SERL waives the return rate charges based on its assessment of the ability of KPL to make a return or principal payments without unduly affecting KPL's business. The use of Equity Advances instead of shareholders equity is a common corporate arrangement and is generally tax efficient. Certainly, KPL has paid nominal, if any, income taxes since inception. The customers of KPL have benefitted from the corporate arrangement as the KPL tariff rates do not include recovery of any income taxes paid.

The financial statements for KPL are based on International Financial Reporting Standards ("IFRS") accounting. With respect to the Equity Advances in fiscal 2020/21, the KPL accounting balances for the past five years were as follows:

| Date | Canadian Western Bank Loan Principal Amount | Equity Advances Principal Amount | Total |
|---|---|---|---|
| June 30, 2019 | $ 566,623 | $ 780,000 | 1,346,623 |
| June 30, 2020 | $ 497,486 | $ 800,000 | 1,297,486 |
| June 30, 2021 | $ 0 | $ 1,393,248 | 1,393,248 |
| June 30, 2022 | $ 0 | $ 1,393,248 | 1,393,248 |
| June 30, 2023 | $ 0 | $ 1,313,855 | 1,313,855 |

Synex International Inc. (now Synex Renewable Energy Corporation) ("SXI"), the parent company of SERL and KPL, announced in June 2021, that it had closed the refinancing of SXI and its subsidiaries and certain subsidiaries of SXI had entered into non-recourse lending agreements with a new lender. The Canadian Western Bank withdrew all it's financings with SXI and its subsidiaries and its outstanding debts were settled. KPL was not part of the refinancing and, accordingly, the balance in the table above as of June 30, 2021 shows no third-party debt (but an increase in Equity Advances).

Reasons for Decision for Order G-53-24

The following statements are provided in the Panel Determination under Section 2.5 Deemed Interest of the Decision;

> "In respect of the Intercompany Advance, KPL failed to comply with section 50 of the UCA requiring it to seek BCUC approval prior to making a material alteration to a security arrangement. The purpose of such an application is to ensure that financial arrangements that could impact ratepayers are properly reviewed by the BCUC. In this case, since the

> Intercompany Advance and loan guarantee agreements were not reviewed, the Panel is concerned about the accuracy of the 5.00 percent interest rate. We do not, however, consider it to be practical to delay this proceeding while a review is undertaken. As such, the Panel directs KPL to file for BCUC review, within 15 days from the date of this Decision, the agreement(s) for the Intercompany Advance.
>
> Should the BCUC's section 50 review determine that the interest rate or loan guarantee amount, or both are excessive or inaccurate, a rate adjustment may be necessary. Therefore, while the Panel finds the requested 5.00 percent return on interest provides a reasonable basis for determining the Revenue Requirement for the 2024 Test Year, this is subject to adjustment upon the BCUC's final determination in the review of the Intercompany Advance agreement(s)."

KPL acknowledges that it failed to seek BCUC approval prior to the cancellation of the Canadian Western Bank ("CWB") lending agreement ("CWB Loan"). However, in this case, the prior approval requirement would have been of no consequence. CWB indicated during the refinancing process, that CWB would not continue, in any case, with lending to SXI or any of its subsidiaries (the KPL Loan was very minor compared to the CWB Loans to other SXI subsidiaries). The CWB Loan was paid out in full at the closing of a new lending agreement with a separate lender.

KPL enquired but was not able to secure non-recourse lending from the new lender for KPL, particularly as the new non-recourse lending to other SXI subsidiaries was in an amount in excess of $14 million and dwarfed the balance of the necessary lending to KPL of about $500,000. Based on the unilateral cancellation by CWB of the KPL loan and no interest of the new lenders to lend money to KPL seeking prior approval for cancellation of the CWB Loan would not have had any effect. KPL could not stop the CWB loan cancellation or require the new lender to provide a loan to KPL.

<u>New Filing for a Deemed Interest Rate on Notional Debt</u>

KPL's revenue requirements application that followed the cancellation of the CWB Loan was concluded by a BCUC Decision and Order G-213-21 dated July 12, 2021 ("2021 Decision"). This decision included the following excerpts;

> Page 14: "The Panel finds the forecast deemed interest and allowed ROE provides a reasonable basis for determining the Revenue Requirement for the 2021 Test Year"
>
> Page 11: "KPL submits that the new financing provided by its parent company has a long-term annual interest rate of 4.767 percent, which is higher than the CWB interest rate. KPL expects to prepare an application to the BCUC for approval of a revised demand interest rate, however it anticipates time will be needed for a decision on the application, once filed. Therefore it submits that the notional interest rate of 5.0 percent is both fair and reasonable."

KPL has not prepared and filed for a revised deemed interest rate on notional debt. KPL has been very involved since July 2021 with regulatory proceedings, all of which are expected to have greater operational and financial impact than a potential change in the deemed interest rate on notional debt. Further, given that bank prime interest rates have risen since significantly since July 2021, KPL expects that the revised deemed interest on notional debt will be higher the than 5.00 percent that is currently used.

KPL has a strong incentive to secure third-party debt financing but none is currently available. Without third-party debt financing, the returns to KPL on its total financing is limited to the weighted average cost of capital as approved by the BCUC, currently 6.8 percent.

<u>Request for a change in scope and an extension to the filing date for Directive 4 of Order G-23-24 Submission in respect of Directive 4</u>

KPL is requesting a change in scope for Directive 4. The change in scope includes for KPL to file an application for a revised deemed interest rate on notional debt ("Rate Application"). The Rate Application will conform to the expectations of KPL for a reasonable deemed interest rate. The former interest rates were determined a number of years ago and Canadian bank lending rates have varied considerably since that time. The Rate Application by KPL should permit the BCUC to provide a decision on KPL's deemed interest rate on notional debt.

Under Directive 1 of Order G-23-24, KPL's rate changes are approved on an interim and refundable basis pending the outcome of BCUC's current generic cost of capital proceeding and KPL's filing of the agreement(s) for the Intercompany Advance in Directive 4. Under the proposed change in scope for Directive 4, filing of the Rate Application would supplant the filing of the agreement(s) for Intercompany Advances.

KPL is requesting an extension to the filing date for Directive 4 to July 3, 2024. The current generic cost of capital proceeding includes for final arguments of utilities to be submitted on July 3, 2024. The Rate Application by KPL to BCUC is complementary to the cost of capital being determined in the GCOC .hearing. Accordingly, both the GCOC hearing record and the decision by the BCUC on the deemed interest rate are necessary for BCUC to decide the outcome of the "interim and refundable basis" for KPL tariff rates.

In addition, KPL is requesting that the deemed interest rate on notional debt be set at 5.00 percent for the approved interim rates under Order G-53-24.

If further information or clarification is required, please contact either the undersigned at 604-992-3850 / gregsunell@gmail.com.

Yours truly,
**KYUQUOT POWER LTD.**

*Original signed by:*

Greg Sunell
Consultant to Kyuquot Power Ltd.