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January 23, 2004

Mr. Richard Stout  
Chief Regulatory Officer  
British Columbia Hydro and Power Authority  
17<sup>th</sup> Floor, 333 Dunsmuir Street  
Vancouver, B.C. V6B 5R3

Dear Mr. Stout:

Re: British Columbia Hydro and Power Authority ("BC Hydro")  
Vancouver Island Call for Tenders

In its Decision dated September 8, 2003 ("VIGP Decision"), the Commission concluded that it had not been established that Vancouver Island Generation Project ("VIGP") is the most cost-effective means to reliably meet Vancouver Island power needs and denied the Certificate of Public Convenience and Necessity ("CPCN") application. The Commission however, encouraged BC Hydro to proceed with a Call for Tenders ("CFT") and stated that, based on the results of the CFT, the Commission is prepared to consider any future application for CPCN approval or Electricity Purchase Agreement ("EPA") approval on an expedited basis.

BC Hydro subsequently announced that it would issue its CFT on October 31, 2003.

In a letter dated October 23, 2003, counsel for BC Hydro requested that "...the Commission decide as a preliminary matter whether the terms of the CFT as proposed are appropriate, so that the Panel making the decision on the selected project does not [need to] revisit that issue". BC Hydro proposed a schedule to allow for stakeholder input, including workshops and a comment process following the issuance of its CFT and requested that the Commission decide by January 15, 2004 "...whether the CFT as designed is appropriate". In its letter dated October 24, 2003, the Commission stated its intention to provide its response on the appropriateness of the terms of the CFT by January 15, 2004. The process proposed by BC Hydro in its October 23, 2003 letter and contemplated in the Commission's response was described in the CFT package issued by BC Hydro on October 31, 2003.

Additional correspondence between BC Hydro and the Commission concerning process has also been provided by BC Hydro to potential bidders, VIGP Intervenors and other stakeholders and interested persons in BC Hydro's subsequent December 15, 2003 filing.

The further process provided for additional workshops and forums and further opportunities for comment and input, including comments to the Commission by January 9, 2004 and reply submissions by BC Hydro on January 13, 2004.

In a letter to the Commission dated December 29, 2003, counsel for Norske Skog Canada Limited ("NorskeCanada") expressed concern about the lack of a more formal process for participants and the Commission to consider the CFT materials. This process concern, as well as concerns related to substantive aspects of the CFT, have also been raised by many others (in response to NorskeCanada's letter) both directly to the Commission and indirectly, i.e. with BC Hydro in accordance with the schedule established by BC Hydro. Having considered the comments received, the Commission does not consider that the further delay which would result from a more protracted process at this stage is justified or is necessary in the circumstances.

NorskeCanada and others, though not unanimously, appear to support BC Hydro's suggestion that the Commission should conduct a review of the CFT now. The Commission Panel is mindful of the comments of BC Hydro, NorskeCanada and others that a Commission Panel ruling at this time could be of assistance and provide a measure of regulatory certainty.

The Commission Panel, however, is also mindful that a CFT process is within the purview of the utility which, as the Commission accepted in the VIGP Decision, "...has the initial responsibility to plan for its future resource additions". The Commission also noted in that Decision that "It will be BC Hydro's choice whether to proceed with the CFT recognizing that BC Hydro must develop sufficient information to identify the most cost-effective resource addition for Vancouver Island" and that "The results of the CFT would provide valuable information for BC Hydro to discharge its responsibility."

While the VIGP Commission Panel encouraged BC Hydro to proceed with the CFT and to closely follow the schedule set forth in Schedule A, the VIGP Decision neither proposed changes to, nor endorsed, Schedule A. And in its recent December 10, 2003 letter, the Commission Panel confirmed that it considers the CFT to be a process designed and implemented by BC Hydro.

Nevertheless, the Commission Panel wishes to assist participants and believes that it can provide some comments that are not intended to and will not be determinative of any issue or matter raised so as not to inappropriately bind BC Hydro or to fetter the Commission Panel in respect of its authority when ultimately called upon to consider any CPCN applications and/or EPAs, following the CFT process.

Given that several aspects of the CFT and evaluation criteria have yet to be finalized and disclosed, the Commission Panel considers that the CFT continues to be a work-in-progress which will continue to evolve as the process unfolds. The Commission Panel anticipates that its comments will be helpful to BC Hydro and other participants and may potentially obviate the need for a protracted review at a later stage.

The Commission Panel commends BC Hydro for providing many opportunities to potential bidders and other stakeholders to comment on and provide input to the CFT process. BC Hydro has made a considerable effort to reduce the 'black box' aspect of its Net Present Value ("NPV") model and to increase the transparency of its CFT process. However, as suggested in the VIGP Decision, it should be possible to develop a simplified NVP model specifically for the CFT and the Commission Panel intends that its comments below will be helpful to that end.

In the letter dated December 10, 2003, the Commission Panel requested that BC Hydro "...clearly state the approvals, determinations or directions that it is seeking" with the filing of the revised CFT to be filed on December 15, 2003. In the same letter, the Commission stated it would "...make whatever approvals, determinations and directions it considers appropriate to assist BC Hydro and the CFT bidders in this process, having regard to the nature and quality of information it may receive".

### Major Issues with the CFT

Bidders and other interested parties have submitted a large number of questions and comments about the CFT. Many parties feel that the CFT was structured to favour gas-fired generation, particularly a facility like VIGP. BC Hydro responded in the Question and Answer portion of its Vancouver Island CFT website, in replies to individual parties, in the bidder comments and responses filed on December 15, 2003 and in its January 13, 2004 submission. The January 13, 2004 filing also includes a number of revisions that have been made to the CFT and Appendix C to the filing identifies several areas where BC Hydro intends to revise the CFT.

There remain a number of areas where parties have concerns about the structure and underlying principles of the CFT process and the CFT Evaluation Methodology. The Commission notes that the following issues seem to be of particular concern.

### Scope of the CFT

The scope of the CFT is for 150 to 300 MW of dependable generation capacity on Vancouver Island to be in service by May 1, 2007. Load management (Demand Side Management) and load curtailment projects are not eligible. The Commission Panel agrees with BC Hydro that the VIGP Decision should establish the parameters and design of the CFT. The first full paragraph on page 83 of the VIGP Decision especially the following excerpt is relevant to the scope of the CFT:

*“The Commission Panel encourages BC Hydro to seek approval for projects with an aggregate capacity of at least 150 MW as long as each project is cost-effective, and the aggregate capacity is required to meet Vancouver Island and system load requirements. If the Dependable Capacity does not exceed 115 MW, then the Commission Panel expects that BC Hydro will consider other resource additions, including VIGP/GSX, CBG, Resource Smart, contracted load reductions and new peak shaving initiatives, for meeting the load requirements...” (emphasis added)*

The VIGP Commission Panel also stated, as set forth in the above excerpt, that BC Hydro should consider other resource additions if the Dependable Capacity (cost-effective) from the CFT does not exceed 115 MW. The Commission Panel encourages BC Hydro to accept a cost-effective portfolio with dependable capacity as low as 115 MW before considering “other resource additions” than on-Island generation. The following excerpt of the VIGP Decision at page 22 should be considered in the context of load curtailment:

*“The Commission Panel concludes that no contracted demand reductions should be added to dependable supply for the purpose of the Application. Nevertheless, arrangements with NorskeCanada for short-term load curtailments are an attractive option in the event that BC Hydro needs to bridge a period until a resource like a 230 kV transmission line, other on-Island generation, or even VIGP can be completed.”*

### Transmission Deferral Credit

The CFT Evaluation Methodology includes a transmission deferral credit in the NPV portfolio analysis for capacity in excess of 150 MW, based on a deferral of the construction of the 230 kV lines to Vancouver Island. The VIGP Decision, at page 81, suggests that BC Hydro calculate the CFT Benchmark based on certain inputs. Those inputs do not include a transmission deferral credit. Although generation sited near load and demand side management often attracts a transmission deferral credit, such a credit was not suggested by the VIGP Decision.

Consistent with the more simplified analysis contemplated in the VIGP Decision, BC Hydro should not expect that the transmission deferral credit will be accepted by the Commission Panel reviewing the project(s) selected by the CFT.

#### Staged Addition of Capacity Resources

The CFT Evaluation Methodology does not provide for the staged addition of capacity resources, and the effect such staging would have on the portfolio analysis. Consistent with the focus on additions of at least 150 MW and the desire for a simplified analysis, the portfolio approach with no staging can reasonably be anticipated to be acceptable to the Commission Panel reviewing the project(s) selected by the CFT.

#### Sale of VIGP Assets

The CFT establishes \$50 million as the fixed price for the purchase of VIGP assets, and the CFT Evaluation Methodology includes a \$50 million NPV credit for portfolios that include VIGP assets and a \$20 million NPV credit for portfolios that do not.

The VIGP Decision at page 82 states:

“The Commission Panel accepts the position of most intervenors that sunk costs are not relevant to this project selection decision and should not be used in the NPV analysis, either as an addition to IPP project costs or included in the CFT Benchmark.”

The CFT design as related to the VIGP assets may not be inconsistent with the VIGP Decision; however, the treatment of, and the value determination of, the VIGP sunk costs as proposed in the CFT will need to be justified in any application for approval of the project(s) selected by the CFT.

#### Gas and Electricity Prices

The CFT Evaluation Methodology uses five pairs of gas and electricity prices to assess a range of energy prices and gas turbine heat rates. The simple, unweighted average of the NPV results for the five scenarios is proposed to be used to determine the Net Portfolio Cost for each portfolio. Several participants in the VIGP hearing expressed concern about the price forecasts advanced by BC Hydro at that time, and some participants in the CFT have indicated that events since the VIGP Decision have tended to validate the concerns about the potential for higher gas prices than were raised in the hearing.

The Commission Panel recognizes the value of scenario analysis to identify the risk and vulnerability of each resource portfolio to higher or lower energy prices and technological improvements, and will expect BC Hydro to include these results with its filing following the CFT. However, BC Hydro should not assume that when reviewing the CFT the Commission Panel will accept that equal weight should be assigned to the results for each of the five scenarios.

In the filing following the CFT, BC Hydro is encouraged to include a portfolio analysis based on the CFT Benchmark gas price forecast from the VIGP Decision and the corresponding electricity price forecast.

#### Gas Transportation Costs

CFT bidders with gas-fired projects can select a “tolling” option whereby BC Hydro assumes the gas delivery and price risk for both commodity and transportation to the plant gate. The portfolio analysis will include BC

Hydro's gas transportation costs for tolling projects, using transportation costs to be determined by BC Hydro not less than 30 days before the Tender Closing Time. The costs may reflect utilization of the Georgia Strait Crossing ("GSX") pipeline and/or upgrades on the Terasen Gas (Vancouver Island) Inc. system, with the objective of identifying the most cost-effective solution to any tolling obligation that BC Hydro may assume.

BC Hydro intends to permit a CFT bidder to use gas transportation capacity that it currently holds. Nevertheless, it is not clear to the Commission why a bidder should not be able to choose a tolling option for the gas commodity without transportation.

The VIGP Decision at page 82 encouraged BC Hydro to ensure that there is good evidence for all gas transportation alternatives to GSX:

"For the purposes of the CFT, the Commission Panel encourages BC Hydro to accept long-term transportation service from TGVI equally as well as it would be prepared to accept a proposal using GSX transportation. If BC Hydro proceeds with the CFT, it should ensure that there is good evidence for all gas transportation alternatives to GSX so that such alternatives can be fairly evaluated."

In its filing following the CFT, BC Hydro will be responsible for demonstrating that the gas transportation cost represents the most cost-effective solution.

#### Electrical Network Upgrade Costs

BC Hydro will bear the cost of network upgrades on Vancouver Island, but these costs will be included in the portfolio analysis as a charge against the portfolio. The British Columbia Transmission Corporation will estimate the upgrade cost for each portfolio.

The Commission Panel accepts in principle that the portfolio analysis should include network upgrade costs on Vancouver Island. At the same time, the need for each bidder to be treated fairly with regard to upgrade cost is aligned with the interests of ratepayers that the most cost-effective project(s) be selected.

The filing following the CFT should include information about the network upgrade costs that were used in the portfolio analysis to demonstrate the reasonableness of the costs and their allocation.

#### Other CFT Issues

Bidders and other interested parties commented on a number of other aspects of the CFT where BC Hydro has established mandatory requirements, may file revised information or will make discretionary judgments.

Examples of these matters are:

- mandatory criteria assessment;
- development risk assessment;
- fuel supply certainty assessment;
- 97 percent availability for October to March;
- table of number of starts per year for a dispatchable plant;
- performance security and liquidated damage provisions;
- energy margin credit; and
- proven technology that has been in service for three years.

The Commission Panel considers that the foregoing examples are provisions that are valid in concept, but which BC Hydro should review as to the specified requirements and their interpretation. The Commission Panel will be concerned if such requirements are more stringent or less flexible than the minimums that are needed, thereby increasing costs for ratepayers by disqualifying otherwise worthwhile projects or by increasing bid prices.

#### Project(s) Review

The Commission Panel encourages BC Hydro to proceed with the CFT. At the bottom of page 77, the VIGP Decision states:

“Based on the results of the CFT, the Commission is prepared to consider any future application for CPCN approval or Electricity Purchase Agreement approval on an expedited basis.”

Approval of the project(s) selected following the CFT process may require a further review of the CFT process and design. As always, the onus of proof will be borne by the Applicant. The Commission suggests that the reference to “60 days after the Effective Date” in Section 3.1 of the Preliminary Form EPA be changed to 90 days after the filing date of an application with the Commission, and the reference to “75 days after the Effective Date” in Section 3.4 be changed to 105 days from the filing date of an application with the Commission.

The Commission requests that BC Hydro provide a copy of this letter to all CFT bidders and VIGP Intervenors.

Yours truly,



Robert J. Pellatt

RHH/cms

cc: Other Parties that filed written comments