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January 8, 2004

British Columbia Utilities Commission
Box 250
Sixth Floor, 900 Howe Street
Vancouver, B.C.
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Attention Robert Pellatt, Commission Secretary

Dear Sirs:

British Columbia Hydro and Power Authority ("BC Hydro") Call for Tenders for Capacity and Associated Energy on Vancouver Island (the "CFT")

We make this submission on behalf of Vancouver Island Gas Joint Venture (the "**Joint Venture**") in response to BC Hydro's request that certain stakeholders provide comments with respect to its CFT process. We understand that BC Hydro proposes to make an application to the Commission for approval of the CFT process and we ask that the Joint Venture's comments herein be considered if such an application is filed.

The participants in the Joint Venture are, collectively, the largest customers of BC Hydro. In addition, the Joint Venture is the largest customer of Terasen Gas (Vancouver Island) Inc. ("**TGIV**") and thus has a concern with respect to the co-dependent relationship between BC Hydro and TGVI for the supply of energy on Vancouver Island. The Joint Venture mills require supplies of reliable and low cost energy from both BC Hydro and TGVI in order to remain financially viable in the highly competitive international markets in which they operate. Directly and indirectly, the well-being of literally thousands of customers of BC Hydro and TGVI is linked to the Joint Venture mills. Accordingly, the Joint Venture mills and, more broadly the public, have a vital interest in ensuring that the CFT process produces an optimal solution to the problem of an electricity capacity shortfall on Vancouver Island.

The Joint Venture is concerned that the CFT process is not designed to produce the best and most appropriate solution to that problem. Moreover, the Joint Venture is concerned

that the procedure proposed by BC Hydro for the approval of the CFT process could be an impediment to finding that solution.

The Joint Venture has several concerns as follows:

1. CFT Approval by the BCUC

While we appreciate the need for a measure of certainty amongst bidders, the Joint Venture is very concerned that the procedure for approval of the CFT could have the effect of foreclosing or limiting a full and fair hearing and consideration of the issues required in relation to an application for a certificate of public convenience and necessity (“CPCN”) under section 45 of the *Utilities Commission Act* (British Columbia) (the “UCA”). If the Commission approves the CFT process, we fear that it will be extremely difficult for the Commission later, in the context of an application for a CPCN, to challenge the results of the CFT process. At a minimum, the Commission will not be perceived as being completely unbiased in its consideration of the broader public interest questions relevant to a CPCN. Put simply, the Commission will have painted itself into a corner.

As the Commission’s letter of December 10, 2003 states, the CFT process is a BC Hydro process. BC Hydro has

- established the objectives for and parameters of the CFT,
- imposed the conditions to be met for acceptance of bids and bidders,
- established the criteria by which bids in response to the CFT will be evaluated,
- imposed the terms of the Electricity Purchase Agreement (“EPA”), and
- retained discretion with respect to the selection of successful bids.

In the act of designing the CFT process BC Hydro will necessarily influence, limit and shape its outcome – regardless of BC Hydro’s intent. While PwC is to provide a fairness opinion, that opinion is limited in scope to commenting simply upon whether BC Hydro has faithfully followed the process. It ignores the more fundamental questions of whether the process itself is fair. More importantly, it ignores the critical question of whether the process is appropriate to achieve the optimal solution in the public interest.

At what stage will the questions of whether the CFT process and its objectives are appropriate to find the best solution for BC Hydro’s customers be considered in a fair, open and impartial way? When will BC Hydro’s customers have an opportunity to fairly address those questions?

The Joint Venture is concerned that broader public interest concerns that require consideration will be by-passed by the approach adopted by BC Hydro. For example, it appears implicit in any generation proposal that will rely upon natural gas to fire generating facilities that gas transmission service will be available from TGVI. It also seems to be assumed that TGVI will add facilities and capacity to provide that service. The Joint Venture has indicated a willingness to discuss with BC Hydro the possibility of making its firm capacity entitlement from TGVI available to BC Hydro. If such an arrangement can be reached, the need for TGVI to add new facilities and capacity may be obviated or reduced. Among other broader issues requiring consideration are the following:

- (a) In our understanding, if CFT fails to identify a portfolio of projects providing capacity in excess of 150 MW, BC Hydro will revert to its previous proposal. How and when was it determined that the public interest requires a minimum of 150 MW of capacity be installed effective 2007? At the December 19th workshop, several Intervenors questioned whether this was the best solution from the perspective of the ratepayers. The Joint Venture was not, and we suspect other Intervenors were not, satisfied with BC Hydro's responses.
- (b) Is it fair and appropriate for BC Hydro to charge the full cost of upgrades and related system improvements against certain projects? Upgrade costs for projects north of cutline D may force many projects to Nanaimo and south. Is that appropriate?
- (c) It is not clear yet how other potentially attractive generation options in the Lower Mainland, coupled with transmission to Vancouver Island, are evaluated in the model.
- (e) The risk of co-dependence of gas (TGVI) and electricity has not been identified by BC Hydro as a relevant evaluation factor. TGVI is pursuing the LNG, compression and looping option to serve VIGP and ICP (and others). When does this approach lead to another pipeline crossing to meet demand growth? How will this prospect be evaluated? Are there technical risks with the TGVI proposal? What exactly is the TGVI proposal?
- (f) BC Hydro appears to have designed the CFT process and evaluation criteria so as to preclude the possibility of phasing in projects for generation capacity in a manner that will efficiently address supply requirements. Why?

In our respectful submission, there are a host of important issues that require detailed consideration and testing in a public hearing by the Commission before any project is certified as required in the public interest. We urge that the Commission guard against confusing the question of the fairness of the CFT process with the question of whether the result of the process is the optimum solution. The two are vastly different questions.

2. *CFT Review Process*

While the Joint Venture appreciated the opportunity to attend the BC Hydro workshop in Nanaimo on December 19, 2003, it has concerns regarding the procedure to approve the CFT process. The Intervenors are being asked to provide submission regarding the process before the final details of the process are settled and disclosed and before an application is presented to the Commission. Worse still, the bidders are given no opportunity to make submissions directly to the Commission. The proposal that bidder comments be filtered through BC Hydro and provided indirectly to the Commission is not satisfactory. Nowhere in this sequence are the bidders or the Intervenors afforded an opportunity to review and comment directly to the Commission with respect to the final CFT process or the application that BC Hydro proposes to make to the Commission for approval thereof.

In our respectful submission, the procedure by which BC Hydro seeks the approval of the Commission is wholly unfair and a denial of the most basic principles of natural justice. Moreover, in the context of the Joint Venture's concern that the Commission's approval of the CFT process will pre-judge the important issues that ought to be considered in relation to an application for a CPCN, the significance of these procedural flaws is magnified.

3. *Bias in favour of Gas-fired Generation*

At the December 19th workshop, several Intervenors voiced the concern that the CFT and the evaluation criteria were "skewed" in favour of gas-fired projects. We also understand that a number of the bidders have expressed the same concern. If and to the extent that concern is well-founded, a number of serious related concerns arise.

In general terms, any bias in the CFT or the evaluation criteria to any particular type of project means that no one can have confidence that the projects selected represent the best solution from the perspective of BC Hydro's customers. Given BC Hydro's significant investment to date in its own gas-fired generation project on Vancouver Island, it may be that a gas-fired generation project will serve BC Hydro's corporate interests, and perhaps vindicate the judgment of those within BC Hydro who advocated the VIGP. However, those are precisely the factors that should cause the Commission to be extraordinarily vigilant in scrutinizing the CFT and its evaluation criteria.

At the December 19th workshop, the Joint Venture expressed its concern regarding reliance on gas from two perspectives as follows:

- (a) To the extent that gas for on-Island generation is to be supplied by TGVI, the Island's gas and electricity needs will be substantially dependent upon, and hence vulnerable to, a single high pressure gas transmission pipeline (the "HPTS") over a marine crossing in an area prone to earthquakes. It has not yet

been demonstrated how this co-dependent relationship can be seen as offering reliable service. In our understanding, BC Hydro has not factored the risks associated with this co-dependent relationship into its CFT evaluation criteria.

(b) The Joint Venture is acutely aware of TGVI's willingness to offer up "firm" gas transportation service – provided, of course, that the so-called "firm" service is fully interruptible. Given its experience at the ICP in Elk Falls, we are surprised that BC Hydro has not been far more rigorous in demanding iron-clad guarantees from TGVI with respect to the timely availability, and ongoing reliability, of adequate supplies of firm gas transmission capacity from TGVI. BC Hydro's advice that it is 'discussing' gas supply arrangements with TGVI is wholly unsatisfactory. From the provisions of the EPA, it appears that BC Hydro is very demanding of bidders in terms of the reliability of service backed by onerous liquidated damage requirements. We submit that it is vital that the Commission be satisfied that TGVI demonstrate that it has sufficient actual firm capacity to meet BC Hydro's requirements in a way that does not put the Joint Venture, or others, at further risk of interruption or curtailment of gas or electricity service.

For greater certainty, the Joint Venture's use of the phrase "**firm**" capacity means actual physical capacity to deliver gas in the contracted amount 24 hours per day every day of the year in every year during the term of the contract assuming that all other core customer peak load requirements and all other firm contract requirements can be satisfied, without curtailment, based on projections for the coldest day in 20 years.

4. *Other Issues/Concerns*

Capacity vs. Energy – BC Hydro is seeking capacity as opposed to energy. It views the CFT as a means to replace capacity that will be lost when certain of its transmission capacity is de-rated in 2007. The additional capacity must be available 97% of the time for at least six months of the year. As a result, the process will be biased against projects, such as peaking facilities that will run only on demand, that do not provide capacity. It is clear that BC Hydro is not seeking the lowest cost energy solution. This begs the question as to whether the public interest is best met by this particular addition of capacity. A broader consideration of BC Hydro's energy and capacity requirements for Vancouver Island should be conducted. Perhaps a better solution would be the addition of supplies of lower cost energy to meet peaking requirements. How and when will that question be examined?

Load Management – BC Hydro made it clear that demand side management initiatives would not replace its perceived need to install capacity. Indeed, BC Hydro advised that its forecasts for energy requirements on Vancouver Island already contemplate an allowance for 100 MW of demand reductions based on demand side initiatives. BC

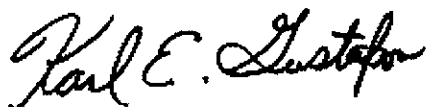
Hydro has provided no information in support of the assertion that 100 MW of demand reductions can or will be achieved. Furthermore, it has not provided information as to whether even greater load reductions cannot be achieved through load management initiatives. Is it appropriate for BC Hydro to exclude load reduction and load management projects from eligibility to participate in the CFT process?

Supply Portfolios – Reliability – BC Hydro has said that it will evaluate all approved bid proposals in all possible combinations to ascertain which proposal or combination of proposals best addresses its needs. The evaluation criteria do not give weight to the important benefit of enhanced reliability that will be achieved by aggregating supply from a number of smaller independent projects.

Terms of EPA – A question was raised as to whether the terms of the proposed EPA were not unfair and unduly onerous with respect to the liabilities to which the bidders were being asked to accept under the EPA. It was pointed out that bidders were asked to accept exposure to substantial liability for liquidated damages (presumably in circumstances where BC Hydro itself would be shielded from such liability by the terms of its tariffs). To the extent that this was perceived as unfair or unduly onerous, bidders will tend to reflect the risk in higher costs. BC Hydro alleged that the EPA terms are “industry standard practices”. In our view, that is an extremely subjective assessment. Further, there is a puzzling inconsistency in BC Hydro’s approach. On the one hand, BC Hydro imposes onerous conditions on bidders to ensure reliability while at the same time appearing to be favourably disposed to relying upon uncertain gas supply from TGVI.

In our respectful submission, it is important for the Commission to give careful consideration at this time to the broader questions relevant to the public interest. The CFT process evaluation methodologies and objectives require detailed public scrutiny before any approval is given.

Yours truly,



Karl E. Gustafson, Q.C.
for **Lang Michener, LLP**

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