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January 10, 2019

British Columbia Utilities Commission
Suite 410, 900 Howe Street
Vancouver, B.C.
V6Z 2N3

Attention: Mr. Patrick Wruck, Commission Secretary and Manager, Regulatory Support

Dear Mr. Wruck:

Re: FortisBC Energy Inc. (FEI)

Project No. 1598974

Application for Approval of an Operating Agreement between the City of Kelowna and FEI (the Application)

Response to the British Columbia Utilities Commission (BCUC) Information Request (IR) No. 1

On October 9, 2018, FEI filed the Application referenced above. In accordance with BCUC Order G-209-18 setting out the Regulatory Timetable for the review of the Application, FEI respectfully submits the attached response to BCUC IR No. 1.

If further information is required, please contact Ilva Bevacqua, Manager of Regulatory Compliance and Administration at (604) 592-7664.

Sincerely,

FORTISBC ENERGY INC.

Original signed:

Doug Slater

Attachments

1.0 Reference: OPERATING AGREEMENT

Exhibit B-1, Cover Letter, p. 1; FortisBC Energy Inc. and City of Surrey Applications for Approval of Terms for an Operating Agreement (FEI-Surrey Operating Agreement),

FEI Final Argument, p. 17; Exhibit B1-5, CEC Information Request (IR) 1.6.2

Standard form operating agreement

FortisBC Energy Inc. (FEI) states in their current application that the terms of the new FEI-City of Kelowna Operating Agreement negotiated by FEI and the City of Kelowna are consistent with the Keremeos Terms, which Order C-8-14[1] ruled could be used as the basis for comparison in future operating agreement applications.

On page 17 of FEI's final argument in the FEI-Surrey Operating Agreement proceeding, FEI stated that the Keremeos Agreement was not appropriate for the Surrey context, given that the "…municipalities subject to those terms are less urbanized than Surrey, with limited natural gas facilities, and smaller populations."

The following table has been compiled by British Columbia Utilities Commission (BCUC) staff to compare the municipalities of Surrey, Kelowna and Keremeos:

Municipality	Population (2016)[2]	Gas premises count (2016)[3]	Gas consumption (2016)[4]	Distribution mains (km)[5]
Surrey	517,887	114,009	13,681,766	2143
Kelowna	127,380	40,809	4,343,137	820.9
Keremeos	1,502	983	72,844	17.7

1.1 Please discuss what FEI considers to be the limits of applicability of the Keremeos Agreements, in terms of: urbanisation, gas facilities, population or other characteristics.

[1] FortisBC Energy Inc. Application for Approval of an Operating Agreement with the Village of Keremeos, Order C-8-14 dated July 24, 2014.
[2] FortisBC Energy Inc. and City of Surrey Applications for Approval of Terms for an Operating Agreement (FEI-Surrey Operating Agreement), Exhibit B1-6, BCUC IR 1.4.2.
[3] Ibid., Exhibit B1-5, CEC IR 1.6.2.
[4] Ibid.
[5] FEI-Surrey Operating Agreement, Exhibit B1-9, City of Surrey IR 1.1.

Response:

In the response below, we have endeavoured to provide some background, explain why FEI proposed to apply the Keremeos terms in the case of Kelowna, and provide some commentary on how the Keremeos agreement could be applied going forward.

Background

FEI (through its predecessor companies Inland Natural Gas Co. Ltd. and BC Gas Utility Ltd.) and the City of Kelowna entered into a Franchise Agreement, the term of which expired on October 31, 2018. The Franchise Agreement had been extended six times with the last extension in November 2001. FEI and the City negotiated a new operating agreement dated September 27, 2018, which is consistent with the approved terms of the Village of Keremeos Operating Agreement (Keremeos Agreement).

With the grant of a deemed CPCN under the UCA in the early 1980s, franchise agreements became unnecessary. Operating agreements, which do not grant exclusive rights to FEI (or its predecessor), have been used to replace Franchise Agreements with municipalities as they expire. The 3 percent fee (characterized as an operating fee in these agreements) was just carried over when negotiating the new operating agreements with municipalities.

The Keremeos Agreement originates from a public review process conducted by the BCUC in 2006, when FEI (then Terasen Gas) applied for approval of terms of a new form of operating agreement with 10 Interior municipalities[6]. The terms of the new form of operating agreement were negotiated with the 10 Interior municipalities with Franchise Agreements which expired on December 31, 2005, through the Union of British Columbia Municipalities (UBCM). This review process involved submissions from municipalities on the operating fee and various alternative methods of calculating it. Various municipalities, including the City of Kelowna, filed comments in that regulatory review process. During that proceeding, there does not appear to have been evidence considering the applicability of urbanization, gas facilities, population or other characteristics in the calculation of the operating fee. The operating fee provision was considered as part of an overall package negotiated by the parties.[7] After conducting its review process, the BCUC approved the 10 new Interior operating agreements that included an operating fee calculated based on three percent operating of gross revenues (Orders C-7-06 through C-16-06).

The operating agreement terms approved by Orders C-7-06 through C-16-06 then formed the basis of the Interior Standard form Operating Agreement terms, later amended by Order G-113-12, and further by Order C-8-14. Order C-8-14 then directed that the Keremeos terms were to

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[6] The 10 municipalities were the Town of Oliver, District of 100 Mile House, City of Cranbrook, Town of Creston, City of Fernie, City of Grand Forks, District of Hudson's Hope, City of Kimberley, Town of Osoyoos, and City of Rossland.

[7] Order C-7-06, recital K: "Among other things, Terasen Gas and the Municipalities stated that the agreements are "package deals" with considerable amount of compromise involved, including the fees agreed to within the package, and outlined their significant concerns to the added complexity, costs, communication and need to renegotiate if a fee margin were imposed."

be used as the basis for comparison for future operating agreement applications. Since the issuance of Order C-8-14, no further guidance has been provided by the BCUC to use terms other than the Keremeos terms to commence discussions with municipalities for new terms to operating agreements. As such, in the absence of BCUC directions otherwise, the Keremeos terms were used to commence discussions with both Surrey and Kelowna. Kelowna accepted those Keremeos terms, but Surrey did not.

Although the BCUC had approved the Keremeos terms, the BCUC has also determined in past proceedings that it would review the circumstances in each municipality and determine the appropriate terms and conditions on an individual basis.[8] FEI articulated in the Surrey proceeding, and remains of the view, that this case by case approach is appropriate.

Relevant Considerations

In FEI's view, urbanization, gas facilities, operating environment, and population are all relevant considerations as to whether the Keremeos terms should be applied without modification. Other relevant considerations include the historical context (predecessor utility arrangements), existing operating agreement terms, and other trade-offs or demands made by the municipalities. The overall objective is to achieve a commercial arrangement that is fair to both FEI's customers and the municipality in question (a win-win).

As set out above, in the absence of BCUC direction otherwise, the Keremeos terms were used to commence discussions with both Surrey and Kelowna. Kelowna accepted those Keremeos terms, but Surrey did not.

Basis for Accepting Keremeos Terms for Kelowna, Notwithstanding Surrey Proceeding

The combination of the above considerations had caused FEI to propose for Surrey an operating fee that was based on 0.7 percent of delivery margin (a fee of approximately $600 thousand based on recent 2016 experience). For instance, Surrey had never previously received an operating fee, had never granted an exclusive franchise to FEI's predecessor, and was also demanding very costly concessions from FEI in terms of the allocation of relocation costs that differed from the allocation in the Keremeos agreement. At the same time, the Keremeos approach of using 3 percent of gross revenues to calculate an operating fee would have yielded an annual operating fee of approximately $3 million because of the higher volumes associated with Surrey's urban setting. FEI believes that its proposed terms in Surrey are appropriate in those circumstances.

The Keremeos terms contain an operating fee based on 3 percent of gross revenues. This fee originated long ago in franchise agreements signed between Inland Natural Gas Co. Ltd. and a number of interior municipalities. The inclusion of a franchise fee in those agreements was stated to be in consideration for, among other things, exclusivity. The origins of the amount of the fee is unknown. In 1977, the Energy Commission (predecessor to the BCUC) held an inquiry into franchise fees. The Energy Commission found that franchise fees were not in the

[8] Order L-4-02, dated February 4, 2002, and reiterated in Order C-7-03, dated September 2, 2003, Appendix A, page 3.

public interest. It issued an order cancelling all franchise fees in the province. (That aspect of the order was overturned on appeal for reasons relating to procedural fairness, and there does not appear to have been any further process. The new statute in 1980 included a deemed CPCN and a provision that nullified franchise agreements in existence.) The Energy Commission made a number of observations that underscore the murky origins of, and questionable rationale for, the practice of calculating a franchise fee based on 3 percent of gross revenues:

> The reason for the level of the fee is even more obscure than the origin of the franchise agreement. Apart from the prevalence of a "most favoured nations clause" in the existing franchise agreements, there appears to be no clear reason that the fee has been set at 3% of the gross revenue in virtually all of the cases where it applies. There does not appear to have been any quantification of costs to be reimbursed or of values recognized in the determination of the fees. There was no evidence in the inquiry which would support their existing level. Historically, the utilities have been able to include as a part of their utility cost-of-service the full amount of the franchise fees paid to the municipalities. There has, therefore, been little motivation, other than concern for the competitive price advantage of gas, for the utilities to limit the amount of the fee.
>
> Certain of the industrial consumers evinced a concern, shared by the Commission, that the application of a fixed percentage fee to the gross revenue of the utility constitutes an unreasonable basis for the franchise payment. As has been indicated, no evidence was available as to the reason the 3% was originally set. Even assuming there was some logical basis for it in the first instance and there was some significant relationship between the cost and prospective revenue at that time, the same relationship between costs of service and revenue does not now exist. The municipalities were unable to provide any evidence of actual costs which would be covered by the fee. There are, no doubt, some costs to the municipalities associated with the operation and maintenance of a gas distribution system. It should be noted, however, that direct costs arising out of the laying of mains, extensions or connection services are borne by the utility on a project-by-project basis. Municipal costs associated with utility operations relate to unforeseen direct costs and indirect administrative costs. However, the cost of gas bears no necessary relationship to either the additional costs imposed on a municipality by virtue of the use of its facilities by the utility or to the value of the franchise itself. The rather arbitrary nature of the fee is only exacerbated by the introduction of additional external arbitrary costs, such as the cost of gas. It is well known that the cost of gas has increased very substantially over the past three years beyond the control of the utility or the municipality; the imposition of the 3% on this increased cost of gas has contributed substantially to the revenue flowing to the municipalities from the franchise fee. Certain municipalities have enjoyed substantial increases in revenue resulting from annexation of outlying areas in which the heavy concentration of industry results in increased franchise fees disproportionate to any costs involved. [Emphasis added.]

During discussions with Kelowna, FEI was cognizant of the protracted negotiations with Surrey and what it had proposed for Surrey with respect to an operating fee. Ideally, FEI would have been able to wait for any guidance provided by the BCUC in the Surrey decision, but that proceeding has been going on for almost two years and the Franchise Agreement with Kelowna had already been extended six times (the last time in November 2001).

Kelowna, while significantly smaller than Surrey, is still a large suburban municipality (as the statistics cited in the preamble demonstrate). This consideration, on its own, would tend to weigh in favour of a fee calculated for Kelowna on a basis different from that provided in the Keremeos terms. However, FEI believes an operating fee for Kelowna based on the Keremeos terms is appropriate for the following reasons which are elaborated on below:

1. Kelowna's expired agreement also contained the same operating fee calculated in the same manner as the Keremeos terms, so maintains the status quo; and

2. Kelowna, unlike Surrey, did not require substantive revisions to any of the Keremeos terms.

FEI provides the following further background and context for these two reasons.

1. Status Quo for Kelowna:

Kelowna is located in the Interior region, which was previously served by Inland Natural Gas Co. Ltd. All of the municipalities in that region that have an agreement, have an operating fee calculated based on 3 percent of gross revenues. The proposed agreement maintains the status quo for Kelowna because the expired agreement contains the same operating fee provision calculated on the same basis. As such, the operating fee does not represent a new fee for FEI's customers. Reducing the fee will lead to a reduction in revenue for Kelowna.

Surrey has operated without receiving an operating fee for decades. Operating fees are currently not, and have never been, collected on behalf of any Lower Mainland municipality[9].

2. Kelowna Accepted the Keremeos Terms without Revision:

In the case of discussions with Kelowna, Kelowna accepted the standard Keremeos terms without requiring substantive revisions.

In the case of Surrey, discussions commenced with the Keremeos terms, which Surrey was unwilling to accept. There was a lengthy, and sometimes contentious, negotiation process. Negotiation on the terms of a new operating agreement with Surrey presented FEI with the first opportunity to "seek a method in future agreements to convert the fee to a charge on Utility Margin, so as to stabilize the costs to utility customers" as directed by the BCUC in Order C-7-03[10].

[9] FEI-Surrey Operating Agreement, Exhibit B-1, Application, Section 3.3.1.

[10] Order C-7-03, dated September 2, 2003, Appendix A, page 5.

Additionally, on the agreed-to terms between FEI and Surrey, there are certain terms that are more favorable to Surrey as compared to other municipalities.[11] Surrey also wanted FEI to pay most relocation costs, which is different from the Keremeos agreement. In the end, FEI was seeking to ensure that FEI customers receive a fair agreement overall and the proposed operating fee in that proceeding was part of that fair package.

General Comments Regarding Limits of Keremeos Agreement

Although it is not possible to articulate a bright line as to where the Keremeos agreement can be used, we offer these general comments.

The overall objective is to achieve a commercial arrangement that is fair to both FEI's customers and the municipality in question (a win-win). It is necessary to look at the overall package, including the operating fee and other rights and concessions made, and how they will play out in the specific municipality. This precludes a one size fits all approach.

Broadly speaking, however, FEI sees municipalities falling into three groups once we have the guidance of the BCUC on the Surrey agreement:

Smaller municipalities	The Keremeos agreement would generally be a sound basis for proceeding[12], varied for specific circumstances
Larger municipalities on Vancouver Island or Interior	The starting point would be the Keremeos agreement, varied for specific circumstances; but, the operating fee might have to be reduced for proportionality
Lower Mainland municipalities with legacy operating agreements with no fee	The starting point would be what the BCUC determines for Surrey, varied for specific circumstances

The Keremeos agreement works for small municipalities, in part because the absolute dollar value of an operating fee is small regardless of how it is calculated, there is less activity in the municipality, and the municipality is agreeing to pay for relocations. There is a point at which negotiating a different operating fee is an exercise in diminishing returns. However, as municipalities get larger and more densely urbanized, the 3 percent formula is more prone to yielding a fee that is out of proportion to benefits that FEI/FEI customers are getting back under the agreement. This is most acute in the Lower Mainland, but the risk exists in other large municipalities as well.[13] In those circumstances, it becomes more important to consider whether the overall gives and takes reflected in the Keremeos agreement would continue to deliver benefits to customers.

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[11] FEI-Surrey Operating Agreement, Exhibit B1-4, BCOAPO IR 1.1.1 and Exhibit B1-6, BCUC IR 1.4.5.

[12] Regardless, FEI believes that the operating fee should be expressed as a percentage of delivery margin, rather than gross revenues.

[13] The amount in dollars yielded by the Kelowna three percent operating fee based on 2016 gross revenue was just over $1 million. While still a large amount, Kelowna's operating fee is substantially smaller than one based on three percent of gross revenue for Surrey, which would be more than three times Kelowna's.

There is currently a practical impediment to FEI negotiating a different operating fee for larger Interior or Vancouver Island municipalities, even if FEI considers that a lower operating fee might be warranted. The practical reality is that 3 percent of gross margin is going to be the starting point for negotiations because (a) the BCUC's approval of the Interior agreement (Keremeos terms), and (b) the fact that operating agreements for municipalities in the Interior and Vancouver Island already have an operating fee calculated on that basis. Negotiating a change is difficult in light of these facts. In that context, FEI regards 3 percent of gross revenues as the upper limit unless other concessions are made that are not in the Keremeos agreement. Conversely, the municipalities see 3 percent as the minimum unless they obtain other concessions from FEI. Breaking this practical deadlock would require the BCUC to express a view about the principles to be applied when negotiating with those municipalities that currently receive a fee, and to express the view that operating fees can or should be lower.

These practical impediments do not arise in the Lower Mainland, because the municipalities are starting from a different point: they have never had an operating fee. In such cases, it makes sense to use the principled approach outlined by FEI in the Surrey application. FEI has resisted the argument made by Surrey that, in effect, they should get a 3 percent fee based on gross revenues because other municipalities do.

FEI looks forward to receiving the guidance of the BCUC's decision on the Surrey operating agreement on the principles to be applied in calculating a fee and on other contentious issues, which it will use to inform future operating agreement negotiations.

1.2 Please discuss if, and how, the BCUC should review each operating agreement based on such limits of applicability.

Response:

Consistent with BCUC Order L-4-02, dated February 4, 2002, the BCUC stated that it would review the circumstances in each municipality and determine the appropriate terms and conditions on an individual basis.[14] FEI believes the BCUC should continue to review each operating agreement application on its own merits in the context of all relevant considerations as noted in the response to BCUC IR 1.1.1.

[14] Reiterated in Order C-7-03, Appendix A, page 3.

2.0 Reference: OPERATING AGREEMENT

Exhibit B-1, Appendix A, p. 11

Operating fee calculation

The City of Kelowna and the predecessor companies to FEI (Terasen Gas Inc. [Terasen Gas], BC Gas Utility Ltd. and Inland Natural Gas Co. Ltd.) entered into a Franchise Agreement when natural gas was first made available to the Okanagan in 1957.

Approved by Order C-15-80[15] , FEI (through predecessor company, Inland Natural Gas Co. Ltd.) entered into a Franchise Agreement with the City of Kelowna on January 20, 1978. Order C-2-02[16] extended the Franchise Agreement between FEI (through predecessor company, BC Gas Utility Ltd.) and the City of Kelowna to October 31, 2018.

2.1 Please provide a copy of the previous operating agreement between FEI (or its predecessor companies) and the City of Kelowna.

Response:

Please refer to Attachment 2.1, which includes the executed Franchise Agreement dated April 2, 1980 and the most recent amending agreements.

2.1.1 Please identify and explain any differences between the terms of the previous operating agreement and the proposed operating agreement.

Response:

The previous (now expired) agreement was developed as a franchise agreement, rather than an operating agreement. Like many agreements entered into by Inland Natural Gas Co. Ltd. at that time, it conveyed exclusive rights to serve the municipality, for instance.

While the proposed agreement is an operating agreement, the cost implications remain similar. Notably:

- Relocations requested by the municipality are at the expense of the municipality,
- FEI is not required to pay permit fees; and

[15] Inland Natural Gas Co. Ltd. Application for Approval of a Franchise with the City of Kelowna, Order C-15-80 dated June 12, 1980.

[16] BC Gas Utility Ltd. Application for Approval to Extend the Gas Franchise Agreement with the City of Kelowna, Order C-2-02 dated February 22, 2001

- An operating fee based on three percent of gross revenues to be collected by FEI and remitted to the municipality.

The proposed operating agreement is based on the Keremeos terms and contains language that reflects current operating practices.

In Section 11 of the new operating agreement, FEI agrees to pay the City of Kelowna:

> …a fee of three percent (3%) of the gross revenues (excluding taxes) received by FortisBC for provision and distribution of all gas consumed within the Boundary Limits of the Municipality provided that the Municipality [City of Kelowna] is permitted by law to charge such a fee. Such amount will not include any amount received by FortisBC for gas supplied or sold for resale.

2.2 Please discuss why a three percent operating fee of gross revenues is appropriate in the case of the City of Kelowna?

Response:

As discussed in the FEI-Surrey Operating Agreement proceeding, FEI does have reservations about the approach reflected in the Keremeos terms and other operating agreements that provide for an operating fee calculated based on 3 percent of gross revenues. In the Surrey proceeding, FEI has proposed an alternative approach that was

- calculated based on delivery margin, and
- reflected 0.7 percent of delivery margin.

In the FEI-Surrey Operating Agreement proceeding, FEI advanced several reasons why its proposal for Surrey made sense, which we continue to believe are compelling. These reasons could, if accepted by the BCUC in the Surrey proceeding, make a case for considering different approaches in the case of Kelowna as well.

Please refer to the response to BCUC IR 1.1.1 where FEI explains the context and why, in the case of the City of Kelowna, FEI was prepared to proceed with the Keremeos terms including the 3 percent operating fee on gross revenues at this time.

2.3 Please provide a full definition of “gross revenues.”

Response:

Gross revenues is calculated by taking the Delivery Charges + Commodity Charges + Operating Fee. This results in the Operating Fee line item on a customer's bill being calculated by taking the total Delivery and Commodity charges and multiplying by 3.09 percent.

2.4 Please clarify what is meant by the sentence: "Such amount will not include any amount received by FortisBC for gas supplied or sold for resale."

Response:

To clarify the calculation of the operating fee on the bill, based on the terms of the new operating agreement (as was the case for the expired operating agreement), FEI is authorized to calculate the operating fee on total gross revenue on FEI's bills to customers. For Transportation Service customers[17] who provide their own natural gas commodity (through a marketer or shipper agent), FEI only provides delivery services and the operating fee is calculated on the total gross revenue on their FEI bills which does not include commodity (the commodity is billed to the customer directly by their gas marketer or shipper agent). For residential customers enrolled in the Customer Choice Program, they have signed up with a gas marketer to provide their natural gas commodity; however, this remains on FEI's bills to customers and is included in the total gross revenue upon which the operating fee is calculated.

The intent of the term "gas supplied or sold for resale" is meant to exclude any gross revenues FEI would receive for gas which it supplies or sells to a third party (wholesaler) who re-sell that gas to an end-user. The following are three examples of where this clause might be applicable. First, if there were another natural gas distributor operating within the boundaries of a municipality (such as a resort community, or First Nations community). Second, a third-party natural gas fueling station that provided public refueling service. Third, a third-party liquefied natural gas (LNG) facility that provided LNG to end-use customers. At present, this clause does not have applicability in Kelowna or other municipalities.

2.4.1 Please provide illustrative examples of FEI gas supply or sales that would meet this exclusion from gross revenues.

[17] For example Rate Schedules 22, 23, 25, and 27.

1

2 **Response:**

3 Please refer to the response to BCUC IR 1.2.4.

4

3.0 Reference: OPERATING AGREEMENT

BC Gas Utility Ltd. Application for Approval of an Operating Agreement and Addendum with the Corporation of the District of Salmon Arm, Order C-7-03 with reasons for decision dated September 2, 2003;

FEI-Surrey Operating Agreement, FEI Final Argument, pp. 24, 49–56

Delivery margin or gross revenues as a basis for calculating operating fees

Order C-7-03 directed Terasen Gas to seek a method in future agreements to convert the operating fee to a charge on utility margin. By Order C-9-06[18] , the BCUC accepted the continuing use of a three percent fee based on Terasen Gas and municipal submissions in support of continuing with the revenue-based fee.

In the current FEI-Surrey Operating Agreement proceeding, FEI argued that the three percent fee only makes sense in smaller municipalities. On page 24 of FEI's final argument, FEI stated:

> …calculating an Operating Fee with reference to delivery margin, rather than gross revenue: (i) provides a more direct link between the Operating Fee and what FEI/FEI customers are receiving in return; (ii) yields more stable revenues; and (iii) affects Sales and Transport customers in the same way.

3.1 Did FEI consider the use of delivery margin when negotiating the current operating agreement with the City of Kelowna?

Response:

FEI proposed the Keremeos terms as the starting point for negotiations with the City of Kelowna for the reasons discussing in the response to BCUC IR 1.1.1.

However, FEI continues to believe that the use of delivery margin for calculation of an operating fee with the City of Kelowna and other municipalities is a preferable way to calculate an operating fee. There is a more logical connection between delivery margin and an operating fee than there is with gross revenues that are affected by fluctuations in gas costs.

[18] Terasen Gas Inc. Application for Approval of an Operating Agreement with the City of Cranbrook, Order C-9-06 dated August 10, 2006.

3.1.1 If yes, please explain the reasons for selecting gross revenue.

Response:

Please refer to the response to BCUC IR 1.3.1.

3.1.2 If not, please explain why the use of delivery margin was not considered.

Response:

Please refer to the response to BCUC IR 1.3.1.

3.2 Please provide the percentage operating fee, including the assumptions used, if FEI were to use delivery margin to calculate the operating fee.

Response:

FEI has responded to this question using two different methods. In the first, FEI assumes that the dollar amount of the fee is maintained, but that the fee is applied to the delivery margin rather than the gross revenue. In the second, FEI has calculated a percentage based operating fee using the same method that FEI proposed for Surrey.

Method 1: Amount of Fee Maintained

The amount of the operating fee remitted to Kelowna in 2016 was $1,029 thousand. Dividing this fee by the Kelowna weather-normalized delivery margin for that same year of $23,961 thousand, yields and operating fee of 4.3 percent, when applied to the delivery margin.

Method 2: Surrey Calculation of Operating Fee

In the FEI-Surrey Operating Agreement proceeding, FEI proposed the quantum of operating fee be calculated using estimates for three categories based on 2016 activity levels: 1) Permit and pavement cut fees, calculated as if FEI was not a utility and had paid those fees for the equivalent work; 2) Operating efficiencies for staff that FEI would have had to hire to process permits and pay fees had they been required; and 3) Avoidance of disputes and litigation if they existed on a similar scale to what was experienced in Surrey. The following amounts are calculated for these three categories based on assumptions and estimates for activity levels in Kelowna in 2016:

- *Estimated permit and pavement cut fees for a non-utility in Kelowna* – calculated as follows:
    - Road Use Permit Calculation: New Services (461) + New Mains (34) + Abandonments (127) = 622 X $60 per Permit = $37,320
    - Traffic Obstruction Permit Calculation: 112[19] road repairs X $170 per Permit = $19,040.
    - Pavement Cut Fees and Degradation Permit Calculation: 112 bell holes X 540 = $60,480
    - Pavement Cut Fees and Degradation Permit Calculations: 180 metres of pavement cut X $80 per square metres of pavement cuts = $14,400
    - TOTAL: $131,240
- *Operating efficiencies if permit fees were paid to Kelowna* - An amount reflecting notional operating efficiencies brought about by the new operating terms, based on reduced staff time and resources to process permits of the nature charged to non-utilities and to expedite service to customers. This has been estimated by FEI, based on the number of permits estimated for 2016 above, as equal to approximately 0.5 FTEs that would otherwise have to be hired; and
- *Avoidance of hypothetical disputes and litigation* – While FEI's operating and working relationship with Kelowna does not have the long history of disputes and litigation as in the case of Surrey, the certainty of having agreed upon terms and conditions may have the following benefits:
    1. Differences will be resolved through a cost and time effective dispute resolution process that does not result in litigation unless other mechanisms have first been exhausted, such as mediation and arbitration;
    2. Clearly defined terms and conditions will reduce the risk of disputes around municipal requirements for the construction of FEI's infrastructure and the allocation of costs relating to relocation of FEI or municipal infrastructure.

While it is not possible to predict legal costs, reflecting some amount of avoided legal costs in the operating fee as part of an overall agreement to maintain a strong working relationship with a municipality can be justified as being in the overall interest of FEI customers. Based on a similar ratio of dispute/litigation costs used for Surrey and applied to the estimated work activity

[19] Data is an estimate based on a ratio of activity when compared to Surrey.

for Kelowna as noted above, results in a value of $37,000 for avoided disputes/litigation for Kelowna.

Based on the assumptions noted above, if an operating fee were to have been proposed for Kelowna on a delivery margin basis, based on the model FEI has proposed in the FEI-Surrey Operating Agreement proceeding, it would be calculated as follows: the total of the above three amounts, divided by FEI's Delivery Margin revenue attributable to Kelowna for 2016. The calculation yields the percentage that would be used to calculate the quantum of an operating fee, if the BCUC approved one on the basis of the operating fee proposed for Surrey, based on a percentage of delivery margin going forward for Kelowna.

The following amounts are estimated for 2016 for each of the three above described components.

Component	2016 Estimate
Notional Permit and Cut Fees	$131,240
Notional Operating Efficiencies	$50,000
Hypothetical Avoidance of Potential Litigation	$37,000
Total:	**$218,240**

Using the same weather normalized delivery margin revenue for 2016 of $23,961 thousand and the total estimate of activities/costs of $220 thousand (rounded), results in an operating fee at less than 1 percent of delivery margin (0.9 percent if calculated using all of the costs above, or 0.75 percent if calculated excluding the potential litigation costs, that have not been relevant in Kelowna) for Kelowna.

4.0 Reference: OPERATING AGREEMENT

FEI-Surrey Operating Agreement, FEI Final Argument, pp. 3, 25; Exhibit B1-9, City of Surrey IR 1.1; Exhibit B1-17, Panel IR 1 1.5

Commercially reasonable consideration

On page 3 of FEI's final argument in the FEI-Surrey Operating Agreement proceeding, FEI stated that:

> Since Operating Fees are contractual consideration, not a municipal entitlement, the amount of any Operating Fee collected from FEI customers should be proportional to what FEI/FEI customers are getting from the municipality in return.

In response to a Panel IR, FEI stated:

> …the business rationale for entering into an operating agreement is that there is value to the utility and its customers in having protocols in place and avoiding disputes; however, the amount of the operating fee in previous instances has generally been a product of the historical context.
>
> FEI's position is that an operating fee can be justified if it is reasonable in its amount. **A reasonable operating fee, being contractual consideration, should reflect what else FEI is providing to the municipality and what FEI customers are getting in return[20].**

In the FEI-Surrey Operating Agreement proceeding, FEI argued that $600,000 is a "commercially reasonable consideration."[21]

4.1 Please explain why FEI states that a three percent fee is commercially reasonable in the case of the City of Kelowna, including a discussion of the value or benefit FEI customers derive from the payment of the operating fee to the City of Kelowna.

Response:

Please refer to the response to BCUC IR 1.1.1 which discusses the context as to why FEI agreed to the three percent fee in the proposed operating agreement in the case of the City of Kelowna.

The proposed operating agreement with Kelowna will continue to provide operational efficiencies and benefits, avoids any potential for Kelowna to attempt to levy permits and permit fees, avoid disputes, and provides for Kelowna to pay 100 percent of costs for relocations of

[20] FEI-Surrey Operating Agreement, Exhibit B1-17, Panel IR 1 1.5, emphasis added.
[21] Ibid., FEI Final Argument, p. 25

FEI's facilities requested by the municipality. In terms of the provision, calculation, and payment of an operating fee to Kelowna, this all remains unchanged in the proposed operating agreement as compared to the expired agreement. As such, there is no fundamental change to the value and benefit FEI customers have derived and will continue to derive from the operating fee. In cases where municipalities have historically received operating fees based on three percent of gross revenue, the BCUC has previously found that, "the 3% fee is not unreasonable for the concessions provided by the municipality."[22]

4.1.1 Please provide and explain any metrics or considerations that FEI used to determine that three percent is a commercially reasonable consideration.

Response:

Please refer to the response to BCUC IR 1.4.1.

In the FEI-Surrey Operating Agreement proceeding, FEI has argued that in the context of the CoS waiving any rights to require individual permits and collect permit fees, FEI has offered to pay an operating fee calculated at 0.7 percent of delivery margin, or approximately $600,000 in 2016, which is already approximately $250,000 more than the permitting fees that CoS would otherwise have sought to charge FEI based on FEI's activities. The additional $250,000 yielded by the formula over and above CoS' claimed permit fees recognizes efficiencies and a notional amount for avoided disputes.[23]

FEI further stated that "FEI and/or its contractors do, from time to time, pay individual permit fees in municipalities without an operating fee." [24]

4.2 Please confirm if FEI is required to pay individual permit fees to the City of Kelowna in the terms of the previous and new operating agreement.

[22] Order C-7-03, dated September 2, 2003, Appendix A, page 5 [emphasis added].
[23] Ibid., FEI Final Argument, p. 3.
[24] Ibid., Exhibit B1-17, Panel IR 1 1.4.

Response:

Based on the terms of the previous and new operating agreement, FEI is not required to pay permit fees to the City of Kelowna.

The following table has been compiled by BCUC staff based on information presented in the FEI-Surrey Operating Agreement proceeding:[25]

	Kelowna	Surrey
Distribution gas mains (km)	820.9	2143.1
High pressure pipelines – IP & TP (km)	42.4	104.9
Total amount FEI has charged to the municipality for reimbursement of FEI costs to relocate:		
- Distribution mains ($ from 2012–2016)	$122,341	$1,652,021
- High pressure pipelines ($ from 2012–2016)	$833	$2,936,085
Total cost	**$123,174**	**$4,588,106**
Gross operating fee (2015)	$1,152,144	
Gross operating fee (2016)	$1,029,095	

4.3 Please compare the contractual agreements regarding both relocation cost definition and cost allocation between FEI and the City of Kelowna, and FEI and the City of Surrey with regard to:

a. High pressure pipelines, with reference to both intermediate (IP) and transmission pressure (IT); and

b. Distribution gas mains.

Response:

The relocation costs of high pressure pipelines and distribution gas mains in the current 1957 Agreement between FEI and the City of Surrey, the expired agreement between FEI and the City of Kelowna, and the proposed operating agreement with the City of Kelowna are all equal in that the municipality pays for the costs of changing the location of FEI's facilities when such change is requested by the municipality.

[25] Ibid., Exhibit B1-9, City of Surrey IR 1.1.1.

In the FEI-Surrey Operating Agreement proceeding, the terms that FEI proposed to the BCUC with respect to costs for municipally requested relocation of high pressure pipelines are more favorable for Surrey (an allocation of 50/50 between Surrey and FEI) than the Kelowna proposed operating agreement (Keremeos terms which is 100 percent to the municipality). With respect to gas mains, in the Surrey-FEI Operating Agreement proceeding FEI has proposed the same allocation (100 percent if the municipality makes the relocation request) as the terms in the Kelowna proposed operating agreement (Keremeos terms). (Surrey, by contrast had proposed that FEI bear 100 percent of the costs of relocation in most instances, both for gas mains and high pressure pipelines.)

5.0 Reference: OPERATING AGREEMENT

FEI-Surrey Operating Agreement, Exhibit B1-17, Panel IR 1.3–1.5

Municipal entitlement to compensation

In response to the Panel IRs in the FEI-Surrey Operating Agreement proceeding, FEI stated that:

> There is no requirement in the UCA [Utilities Commission Act] that an order under sections 32–33, regardless of whether that takes the form of an approved operating agreement or a specific one-off direction, must include provision for rent or compensation payable to the municipality. FEI has, therefore, been approaching operating fees from the perspective of whether or not it is reasonable to agree to collect one from FEI customers on behalf of a municipality given what FEI/customers are getting in return under the agreement.

5.1 How has FEI applied this approach to the new operating agreement with the City of Kelowna?

Response:

Please refer to the responses to BCUC IRs 1.1.1 and 1.1.2.

Attachment 2.1

THIS AGREEMENT made this 2nd day of April in the year of our Lord One Thousand Nine Hundred and ~~Seventy-nine~~ Eighty.

BETWEEN:

THE CORPORATION OF THE CITY OF KELOWNA, a municipal corporation incorporated under the laws of the Province of British Columbia;

(hereinafter called the "Municipality")

OF THE FIRST PART

AND:

INLAND NATURAL GAS CO. LTD., a body corporate duly incorporated under the laws of the Province of British Columbia, and having its registered office in the City of Vancouver, in the said Province;

(hereinafter called the "Company")

OF THE SECOND PART

WHEREAS the Company has entered into Gas Purchase Contracts for the supply of gas by pipeline for the purposes of making same available for distribution in British Columbia in accordance with the terms of such Contracts.

AND WHEREAS the Company was formed for the purpose of engaging in the business of transporting, supplying, distributing and selling gas for industrial, commercial, domestic and other uses for power, heat and energy, and pursuant to the terms and conditions of its contracts with its supplier(s), has available for such uses supplies of gas for the purpose of making same available to the Municipality and to consumers or customers within, or in the environs of, the Municipality.

AND WHEREAS the Company will construct and operate all the necessary facilities, pipelines, mains and pipes for a supply of gas (which term as used in this Agreement shall include natural gas, synthetic natural gas, liquefied natural gas, liquefied petroleum gas, manufactured gas and/or other utility gases or any of them or any mixtures thereof) to the Municipality and/or such consumers or customers as are situated within the boundary limits thereof, and is willing to do so on the terms and conditions hereinafter set forth.

AND WHEREAS it is to the mutual advantage of the Company and the Municipality to extend the present Franchise Agreement, with minor modifications, all in accordance with the terms and conditions as hereinafter provided.

AND WHEREAS the Company has constructed the necessary transmission and distribution facilities, all in accordance with governmental, municipal, or other regulatory authorities having jurisdiction over same for the supply of gas to and within the Municipality.

NOW THEREFORE THIS INDENTURE WITNESSETH that in consideration of the premises and mutual covenants and agreements herein contained, the parties hereto agree as follows:

1. The Company agrees to obtain a supply of gas subject as hereinafter provided, to distribute and sell gas within the boundary limits of the Municipality, and, subject as hereinafter provided, the Municipality insofar as and to the

extent that it is able and so empowered, hereby grants to, bestows and confers upon the Company the exclusive charter, right, franchise or privilege to supply gas by pipeline to the Municipality and its inhabitants and to consumers or customers situated within its boundary limits for the term of Twenty-one (21) years from the date of the expiry of that Franchise Agreement dated the 21st day of January, 1957, which expired on the 20th day of January, 1978.

2. The Company agrees that the gas supplied to the Municipality and its inhabitants and to consumers or customers situated within its boundary limits shall at all times be of a quality and standard conforming with the regulations for the time being in force and from time to time formulated under the provisions of the Gas Inspection Act being Chapter 129 of the Revised Statutes of Canada, 1952, and any amending statutes, and also conforming with any regulations or laws applicable thereto, whether such regulations or laws be made or issued by the Government of Canada or by the Province of British Columbia and whether now or hereafter brought in force and effect.

3. Subject as hereinafter provided, the Municipality hereby grants to the Company the authority, permission and right for the term of this Agreement as set out in Clause One (1) hereof to enter in, upon and under all public thoroughfares, highways, roads, streets, lanes, alleys, bridges, viaducts, subways, public places, squares and parks within the boundary limits of the Municipality and over which the Municipality has control and authority for such permission and right to give, and the same to use, break up, dig, trench, open up and excavate, and therein, thereon and thereunder place, construct, lay, operate, use, maintain, renew, alter,

repair, extend, relay and/or remove a distribution system which term means mains, pipes, valves and facilities for the purpose of carrying, conveying, distributing, supplying and making available for use gas within the said boundary limits of the Municipality as and in the manner herein set out, but excludes any transmission or main pipeline and appurtenances which are an integral part of the natural gas transmission system bringing gas to the boundary limits of the Municipality or through the Municipality by transmission lines to enable distribution to other areas outside its said boundary limits or to other Municipalities or other unorganized areas.

4. Before placing, constructing or laying down the distribution system, or any part thereof, the Company shall file with the Municipality, or such officer or official thereof as shall be designated from time to time for such purpose by the Municipality, detailed plans and specifications showing the size and dimensions of the mains and pipes thereof, the proposed depth thereof below the surface of the ground, and the proposed location thereof, and the same shall not be placed, constructed or laid down without the approval of the Municipality or of such designated officer or official, as the case may be, PROVIDED ALWAYS that such approval shall not be unreasonably withheld. In establishing location of mains, the Company shall endeavour to use lanes or alleys in preference to streets, where same are available and the use thereof is compatible with and conforms to the general economics and engineering of the distribution system or the relevant portion thereof.

5. The Company shall give written notice to the Municipality or such officer or official thereof as shall be designated from time to time by the Municipality for the purposes in the next preceding clause set out, of its intention to break up, dig, trench, open up or excavate any, or in or on any, public thoroughfare, highway, road, street,

lane, alley, bridge, viaduct, subway, public place, square or park within the boundary limits of the Municipality, not less than three (3) clear days before the beginning of such work, except in such cases of repair, maintenance or the like that can reasonably be deemed to be emergencies or in the interests of the health or safety of the public, or of the safety of property by whomsoever owned, or any of them, in which cases no notice need be first given but shall be given as soon as practicable thereafter. The provisions of this clause shall apply notwithstanding the provisions of the next preceding clause and the grant of the approval or approvals therein referred to.

6. Should any of the public thoroughfares, highways, roads, streets, lanes, alleys, bridges, viaducts, subways, public places, squares or parks, under or on which any part of the distribution system of the Company lies or is constructed, be legally closed as such or alienated by the Municipality or by or under any other paramount authority, the Company agrees that with all reasonable speed and dispatch after receipt of written notice from the Municipality, it will remove and (if possible and practicable) relocate, subject as aforesaid to the approval of the Municipality or its Engineer, that part of its distribution system so affected by such closure or alienation, the cost of such removal and/or relocation to be at the cost and expense of the Municipality, unless such removal and/or relocation has been enforced upon the Municipality by any such other paramount authority without the Municipality having applied therefor.

7. The Company agrees with the Municipality that it will create and cause as little damage as possible in the execution of the authorities, permissions and rights to it hereby granted and will use its best endeavours to cause as little obstruction or inconvenience or danger as possible during the progress of any of the work hereinbefore set out,

and will place and maintain such warning signs, barricades, lights or flares on, at or near the site of any work in progress as will give reasonable warning thereof and protection therefrom to members of the public, and further agrees to restore without unreasonable delay the said public thoroughfares, highways, roads, streets, lanes, alleys, viaducts, bridges, subways, public places, squares and parks so broken up, dug, trenched, opened up or excavated to a state of repair or condition as nearly as possible as existed immediately before the commencement of such work.

8. The distribution system of the Company and the mains and pipes thereof shall be laid in such manner as not to interfere with any public or private sewer or any other pipe, conduit, duct, manhole or system belonging to the Municipality or which shall have been previously laid down and be then subsisting in any said public thoroughfare, highway, road, street, lane, alley, bridge, viaduct, subway, public place, square or park by, or with the permission or approval of, the Municipality or by virtue of any charter or right granted by competent government or municipal authority.

9. The Company agrees with the Municipality that it will protect, indemnify and save harmless the Municipality from and against all actions, proceedings, claims and demands of any corporation, firm or person against the Municipality and will reimburse the Municipality for all damage and expenses caused to it, in respect of or by the execution by the Company of the authorities, permissions and rights hereby to it granted or by reason of the construction, maintenance or operation of the distribution system of the Company within the boundary limits of the Municipality,

except where same is not caused by or contributed to by the negligence or default of the Company, or its servants or agents.

10. The Municipality agrees with the Company that before it makes any additions, repairs or alterations to any of its public services within the boundary limits of the Municipality, and which said additions, repairs or alterations may in any way affect any part of the distribution system of the Company, or any equipment thereof, it will give to the Company at its main office within the boundary limits of the Municipality, or at its Head Office in the City of Vancouver, British Columbia, not less than three (3) clear days notice thereof, except in such cases of repair, maintenance or the like that can reasonably be deemed to be emergencies or in the interests of the health or safety of the public, or of the safety of property by whomsoever owned, or any of them, in which case no notice need be first given but shall be given as soon as practicable thereafter. The Company shall thereupon be entitled to appoint a representative to supervise or advise in respect to such additions, repairs or alterations and so long as the directions, instructions or advice of such representative are or is followed or complied with by the Municipality, the Municipality shall be relieved from all liability in connection with any damage done to the property of the Company by reason of such additions, repairs or alterations.

11. Subject to the next clause hereof, the Company agrees with the Municipality that during the term of this Agreement as set out in Clause One (1) hereof and the

exclusive charter, right, franchise and privilege herein granted, but commencing only after the construction and putting into service of facilities so to do, it will supply such reasonable quantities of gas as may be required for consumption or purchase by its customers or consumers within the boundary limits of the Municipality subject, however, to the terms and conditions of the service agreement between the customer or consumer and the Company, PROVIDED THAT such requirements are to be supplied to places or buildings lying or being on property fronting or lying alongside a main or pipe of the distribution system of the Company. The property line of such property shall be the place of delivery of all gas supplied by the Company, but the Company shall provide and install a meter suitably located on the property to be supplied with gas. The Company shall also supply and install a service pipeline from the property line to the meter on and in accordance with the costs and terms set forth in the Company's tariff and revisions thereto as filed with and approved by the British Columbia Energy Commission, from time to time. The said meter and service pipeline shall be located and installed in a manner and at a location selected by the Company, and shall remain the property of the Company. The expense and risk of utilizing and using such gas after delivery at the said property line shall be borne by the consumer or purchaser and not by the Company unless any loss or damage occasioned by such utilization or user is directly attributable to the negligence or carelessness of the Company, its servants or agents.

12. Notwithstanding anything to the contrary in this Agreement contained, and in particular notwithstanding the provisions of Clauses One (1), Two (2) and Eleven (11) hereof, the obligations, duties and covenants of the Company herein contained, and on its part to be performed and carried out,

and the performance of this Agreement, are subject from time to time to (a) fire, explosion, lightning, tempest, the elements, adverse weather or climatic conditions, acts of God, force majeure, actions or acts or restraints of enemies, foreign princes and governments (whether foreign or domestic), strikes, lockouts, riots, shortage of labour or materials, civil insurrection, delays in or shortage of transportation, impossibility or difficulty of or in manufacturing, mixing, procuring, receiving, distributing or delivering gas, or impossibility, difficulty or delay in procuring, acquiring or receiving materials or equipment required or advisable for the placing, construction, maintenance or operation of the distribution system or any pipeline or facility for bringing gas to the boundary limits of the Municipality, and generally all shortage of supply or delays in delivery caused or resulting directly or indirectly from causes beyond the reasonable control of the Company, and (b) the operation of the entire natural gas transmission pipelines of its supplier(s) (including gathering lines), and (c) the construction and operation of the transmission or main pipeline and appurtenances of the Company required to bring gas from such natural gas pipeline to the boundary limits of the Municipality.

13. Subject as hereinafter provided, the Municipality agrees with the Company that it will not during the term of this Agreement as set out in Clause One (1) hereof, itself construct, operate or maintain a distribution system for the supplying of gas to the Municipality and/or its inhabitants and/or consumers or customers within its boundary limits, or to use the public thoroughfares, highways, roads, streets,

lanes, alleys, bridges, viaducts, subways, public places, squares or parks under its control or owned by it, or any part of them, for such purposes.

14. The Company agrees that the rates which the Company will charge for gas sold to the Municipality or other consumers or customers taking delivery in the manner aforesaid within the boundary limits of the Municipality shall be the applicable rates filed with and approved by the British Columbia Energy Commission.

~~15. Either party hereto shall have the right at any time~~ prior to Six (6) months before the expiration of the term of Twenty-one (21) years hereinbefore in Clause One (1) set out to give to the other party notice in writing of its desire to renew this Agreement and the exclusive charter, right, franchise and privilege hereunder for a further term of Twenty-one (21) years or lesser years, and upon such terms and conditions as may be mutually agreed upon. As soon as possible after giving of such notice the parties shall, in the interest of both of them, enter into negotiations looking towards such renewal and shall use their best endeavours to bring such negotiations to a mutually satisfactory conclusion before the expiration of the ~~first mentioned term of Twenty-one (21) years.~~

16. In the event that prior to Six (6) months before the expiration of the term of Twenty-one (21) years hereinbefore referred to neither party shall have given to the other party the notice in writing of its desire for renewal as in the next preceding clause set out, or, in the event that such a notice in writing shall have been duly given but the parties shall not have agreed on all the terms and conditions of such renewal by the expiration of the said term

of Twenty-one (21) years, then, and in either of such events, the Municipality shall have the right to purchase from the Company its whole business and undertaking within the boundary limits of the Municipality and being its distribution system and all its lands, buildings, plants, equipment, apparatus, vehicles, supply lines, supplies, stocks, tools and machinery and generally every and all its property and assets forming part of, or actually used or available for use exclusively in its undertaking or business of manufacturing, treating, processing, supply and distributing gas to consumers or purchasers within such boundary limits of the Municipality. PROVIDED THAT the Municipality shall not be entitled to purchase and the right of purchase hereinbefore given shall not cover any part of the business, undertaking or transmission or main pipelines (with appurtenances) of the Company situate either inside or outside the boundary limits of the Municipality which are an integral part of the transmission system bringing natural gas to or through the Municipality or which the Company considers necessary to it in the manufacture, mixing, transportation, storage, distribution, supply or sale of gas to other areas, corporations or persons not covered by this agreement. In the event that the Municipality shall acquire and desire to exercise the said right to purchase it shall exercise the said right by notice in writing given to the Company not later than Three (3) days after the expiration of the said term of Twenty-one (21) years, and a sale and purchase made under this clause shall become, and be deemed to have become, effective at midnight of the last day of the said term of Twenty-one (21) years.

17. In the event of a sale and purchase by the Municipality under the provisions of the next preceding clause, the purchase price payable by the Municipality to the Company for the said business and undertaking (which price is herein-

after referred to as "the price") shall be such as may be agreed in writing between the parties not later than One (1) month after the said effective time of the sale and purchase, or within such further time as the parties may decide upon in writing PROVIDED THAT in the event of failure so to agree, or in the event of failure to agree as to whether or not any item or items of property is or are parts of the undertaking being sold and purchased, the matter in dispute shall be referred to arbitration held under the provisions of the Arbitration Act of the Province of British Columbia, wherein each party hereto shall appoint one arbitrator, and the said arbitrators so appointed shall appoint a third. In determining the price, whether by negotiation or by arbitration, same shall be the fair value of the business and undertaking as a going concern at the said effective time of the sale and purchase, but it shall not include anything for any charter, franchise, right or privilege granted to the company under this agreement, nor shall the so-called "scrap-iron" rule be applied in determining such fair value. The price shall be paid to the Company within Ninety (90) days after the determination thereof and shall carry interest at the rate of three (3) per cent per annum from the effective time of sale and purchase to payment of the price. In the event that after the price is determined the laws of British Columbia require the consent of the Lieutenant-Governor in Council to the sale and purchase or to any by-law that is enabling, or require the assent of the citizens, rate payers, or electors of the Municipality to the sale and purchase or the raising of money therefor, and such consent or assent is refused then the Company and the Municipality shall be released from all obligations to complete such sale and purchase pursuant to such notice, but the Municipality shall pay all expenses or costs of the Company incurred in any arbitration held, and the Company

shall be entitled to retain or be reimbursed for all profits made in the operation of the undertaking from the said effective time of sale.

18. In the event of a sale and purchase by the Municipality under the provisions of Clause Sixteen (16) hereof, the authorities, permissions, charters, privileges, rights, and franchises given to the Company by Clauses One (1) and Three (3) hereof, and the duties and obligations of the Company referred to in Clauses One (1), Two (2) and Eleven (11) hereof, shall terminate and cease at the said effective time of sale and purchase.

19. If at any time during the term of this Agreement as set out in Clause One (1) hereof, any dispute, difference or question shall arise between the parties hereto touching the construction, meaning or effect of this Agreement, or any clause thereof, or as to the extent or limit of any authority, permission, right, duty, obligation, benefit or liability of the parties hereto, then every such dispute, difference or question shall be referred to a single arbitrator appointed by the parties hereto or, in default of Agreement, by and under the provisions of the Arbitration Act of the Province of British Columbia, and the said arbitration shall be held under the provisions of that Statute.

20. The award, determination or decision made under any arbitration held pursuant to the terms of this Agreement shall be final and binding upon the parties hereto, save as in the Arbitration Act of the Province of British Columbia otherwise provided.

21. Subject always to the provisions of Clause Twelve (12) and Clause Nineteen (19) hereof, in the event of the Company making an authorized assignment or having a receiving order made against it under the Bankruptcy Act and during bankruptcy failing to comply with any of the terms or conditions of this Agreement on its part to be observed or performed, or, the Company not having made an authorized assignment or having a receiving order made against it under the Bankruptcy Act, upon any wilful failure or neglect by the Company to comply with any of the major terms or conditions of this Agreement and on its part to be observed or performed which continues for Thirty (30) days after the receipt of written demand by the Municipality for the observance or performance of such terms or conditions, the Municipality shall have the right by written notice to the Company to terminate this Agreement. The rights of the Municipality under this clause are and shall be in addition to or without prejudice to any other rights at law or in equity which it may have against the Company for or by reason of any breach by the Company of this Agreement or any part thereof.

22. Upon the termination of this Agreement at the expiration of the ~~said term of Twenty-one (21) years~~ as set out in Clause One (1) hereof without a sale and purchase of the business and undertaking of the Company taking place under the provisions of Clauses Sixteen (16) to Eighteen (18) inclusive, hereof or upon the termination of this Agreement by cancellation notice from the Municipality under the provisions of Clause Twenty-one (21) hereof, the distribution system of the Company shall be and be deemed always to have been and to remain its own property and as such may be used by it in its business or removed in whole or in part as it shall see fit, and for such purposes, or either of them, said

distribution system may remain in, on or under all the public thoroughfares, highways, roads, streets, lanes, alleys, bridges, viaducts, subways, public places, squares and parks within the boundary limits of the Municipality and the Company may enter in, upon and under the same and the same to use, break up, dig, trench, open up and excavate for the purpose of the maintenance, renewal, repair, removal or operation of such distribution system, or any part thereof, but not for the extension thereof, PROVIDED THAT the Company shall in so doing comply with and be bound by the provisions of Clauses Two (2), Five (5), Six (6), Seven (7) and Nine (9) hereof, mutatis mutandis, notwithstanding the termination of this Agreement.

23. As compensation for the use by the Company of the public thoroughfares, highways, roads, streets, lanes, alleys, bridges, viaducts, subways, public places, squares and parks as provided in Clause Three (3) hereof, and for the exclusive charter, right, franchise, or privilege to supply gas by pipe-line as provided in Clause One (1) hereof, the Company shall pay to the Municipality on the first days of November in each of the years 1978 to and including 1998 or such earlier year in which this Agreement may expire under the provisions hereof a sum equal to Three (3%) per cent of the amount received in each immediately preceding calendar year by the Company for gas consumed within the boundary limits of the Municipality, but such amount shall not include revenues from gas supplied for resale, and, within Ninety (90) days after the twenty-first (21st) anniversary of the date of this Agreement or after such earlier date on which this Agreement may expire under the said provisions hereof the Company shall pay to the Municipality a sum equal to Three (3%) per cent of the amount received by the Company for gas consumed, save as aforesaid, within the boundary limits of the Municipality during the period from the commencement of the calendar year in which such anniversary or

earlier date falls to such anniversary or earlier date, as the case may be. Since this agreement is an extension of that Franchise Agreement dated the 21st day of January, 1957, which expired on the 20th day of January, 1978, it is agreed therefore that the following provisions as found on Page 15, starting in Line 33 of the aforesaid agreement, shall be waived:

> "...and, within ninety (90) days after the twenty-first anniversary of the date of this agreement or after such earlier date on which this agreement may expire under the said provisions of Clause Nineteen (19) hereof the Company shall pay to the City a sum equal to three per cent (3%) of the amount received by the Company for gas consumed, save as aforesaid, within the boundary limits of the City during the period from the commencement of the calendar year in which such anniversary or earlier date falls to such anniversary or earlier date, as the case may be."

In any event, this new agreement shall recognize that the Company shall pay to the Municipality on the 1st day of November in the year 1978 a sum equal to Three (3%) per cent of the amount received in the immediately preceding calendar year, i.e. 1977, by the Company for gas consumed within the boundary limits of the Municipality, except as provided herein, which shall not include revenues for gas supplied for resale. The amount received by the Company in any particular period for gas so consumed, and upon which the aforesaid percentage compensation is based, shall be that amount for the equivalent period upon which the percentage tax provided under Section 333 of the Municipal Act, 1960, Revised Statutes of British Columbia, Chapter 255, as now enacted would be payable and as if said percentage compensation herein provided were a tax provided for under said section, and such compensation shall not be or be deemed to be a tax or in lieu of any taxes, rates or licence fees otherwise properly payable to the Municipality. In the event that

during the currency of this Agreement, the Company should enter into any contract or franchise agreement similar to this Agreement with another Municipality named and set out wherein under a similar clause to this Clause Twenty-three (23) the Company shall agree to pay to such Municipality, as compensation for the use by the Company of the public thoroughfares, highways, roads, streets, lanes, alleys, bridges, viaducts, subways, public places, squares and parks for like purposes as in Clause Three (3) hereof set out, a greater percentage compensation than Three (3%) per cent of revenues as herein provided, then such greater percentage shall be and be deemed to be substituted for the Three (3%) per cent in this clause provided, but only applicable to the amounts received by the Company for gas consumed within the boundary limits of the Municipality, save as aforesaid, from the effective date of such other contract or franchise agreement until the expiration of the term of this Agreement as provided in Clause One (1) hereof or until the sooner termination hereof as hereinbefore provided.

24. Any notice, demand or request required or desired to be given or made under or in respect of this Agreement shall be deemed to have been sufficiently given to or made upon the party to whom it is addressed if it is mailed at Kelowna, British Columbia, in a prepaid registered envelope addressed respectively as follows:

(a) If given to or made upon the Municipality:

The City Clerk,
The Corporation of the City of Kelowna,
1435 Water Street,
Kelowna, B.C. V1Y 1J4

(b) If given to or made upon the Company:

The Corporate Secretary
Inland Natural Gas Co. Ltd.
1066 West Hastings Street
Vancouver, B.C. V6E 3G3

and any notice, demand or request so given or made shall be deemed to have been received and given or made on the day after the mailing thereof. In the event the Company changes its Head Office address, the Municipality shall be notified in writing.

25. Notwithstanding anything to the contrary in this Agreement contained, this Agreement shall be subject to the provisions of the Pipelines Act, the Gas Utilities Act and the Energy Act of the Province of British Columbia and the proper authorities and powers of the British Columbia Energy Commission, and nothing herein shall exclude, or be deemed to exclude, the application of the provisions of the said Acts or any jurisdiction thereof or of the said British Columbia Energy Commission.

26. The Company covenants and agrees with the Municipality that in the construction of any extension or extensions of its distribution system which may be made from time to time, it will insofar as it considers it practicable, and provided that the Company shall not consider in so doing that it will or might in any way be penalized in either cost or efficiency, employ labourers, workmen and artisans who reside in the Municipality and purchase in the Municipality such materials as are required for the said construction work as are available in the Municipality. The Municipality acknowledges that the construction and installation of a gas distribution system is a specialized construction project calling for the services of

artisans and technicians with special skills and experience, and that in the performance by the Company of the covenant and agreement hereinbefore in this paragraph set out, the Company shall not be deemed to be in default in performance thereof by its employing artisans or technicians who reside elsewhere than in the Municipality for any work requiring specialized skill or experience, even although there may be artisans or technicians residing in the Municipality and available who might be able to do such specialized work satisfactorily. In the event that the said distribution system or any part or parts thereof, or any extension or extensions thereof, are constructed or installed by any contractor or contractors to the Company, then the Company covenants and agrees that it will endeavour to procure a similar covenant on the part of such contractor or contractors that any such contractor or contractors carry out and perform the covenant and agreement hereinbefore set out in this paragraph in the same manner and to the same extent as if the Company itself were carrying out the work.

27. This Agreement shall be assignable by the Company to a subsidiary without consent of the Municipality but otherwise shall only be assignable by the Company with the consent in writing of the Municipality first had and obtained, such consent not to be unreasonably withheld. Subject to the foregoing, this Agreement shall enure to the benefit of and be binding on the parties hereto and their respective successors and assigns.

28. It is further agreed that nothing contained or set forth in this agreement shall be taken or read as relieving the Company from its obligations to observe the terms and provisions of any and all By-laws of the Municipality, and any

order or regulation made or passed thereunder, where same are not in conflict with or inconsistent with the provisions of this agreement.

29. This agreement is subject to the approval of the British Columbia Energy Commission, and shall not be binding upon the Municipality until it has been authorized or adopted by By-law of the Municipality, which By-law shall before coming into force be subject to the approval of the Lieutenant-Governor in Council.

IN WITNESS WHEREOF the parties hereto have hereunto caused their respective corporate seals to be affixed, attested to by the signatures of their officers in that behalf, the day and year first above written.

The Corporate Seal of THE CORPORATION OF THE CITY OF KELOWNA was hereunto affixed in the presence of:

DEPUTY CITY CLERK

The Corporate Seal of INLAND NATURAL GAS CO. LTD. was hereunto affixed in the presence of:

DATED: _____

BETWEEN:

THE CORPORATION OF THE CITY
OF KELOWNA

(hereinafter called the
"Municipality")

OF THE FIRST PART

AND:

INLAND NATURAL GAS CO. LTD.

(hereinafter called the
"Company")

OF THE SECOND PART

FRANCHISE AGREEMENT

THIS FIFTH AMENDING AGREEMENT dated December 11, 2000.

BETWEEN:

THE CORPORATION OF THE CITY OF KELOWNA
1435 Water Street
Kelowna, B.C.
V1Y 1J4
(the "Municipality")

OF THE FIRST PART

AND

BC GAS UTILITY LTD.
1111 West Georgia Street
Vancouver, B.C.
V6E 4M4
(the "Company")

OF THE SECOND PART

WHEREAS:

A. The Municipality and the Company entered into a Franchise Agreement dated April 2, 1980 for the supply of gas to and within the Municipality (the "Franchise Agreement") the term of which was due to expire January 20, 1999.

B. The parties entered into an amending agreement dated December 24, 1998 (the "First Amending Agreement") to extend the then existing term of the Franchise Agreement until March 1, 1999, a second amending agreement dated February 11, 1999 (the "Second Amending Agreement") to extend the then existing term of the Franchise Agreement until July 31, 1999, a third amending agreement dated July 22, 1999 (the "Third Amending Agreement") to extend the then existing term of the Franchise Agreement until June 30, 2000, and a fourth amending agreement dated June 20, 2000 to extend the then existing term of the Franchise Agreement until December 31, 2000.

C. The parties have now agreed to extend the amended term of the Franchise Agreement until March 31, 2001 on the same terms and conditions.

NOW THEREFORE THIS INDENTURE WITNESSETH that in consideration of the premises and mutual covenants and agreements herein contained, the parties hereto agree as follows:

1. This Fifth Amending Agreement forms part of and shall henceforth be read together with the Franchise Agreement, First Amending Agreement, Second Amending Agreement, Third Amending Agreement and Fourth Amending Agreement (collectively "the Agreement").

2. In the event of any inconsistency between the terms of this Fifth Amending Agreement and the Agreement, the terms of this Fifth Amending Agreement shall prevail.

3. In this Fifth Amending Agreement, words and expressions used herein shall have the same meaning as are respectively assigned to them in the Agreement.

4. Clause 1 of the Agreement shall be amended by revising the paragraph at the end of the Clause to read:

> "Notwithstanding the foregoing, the parties hereto have agreed to extend the term of this Agreement for a further additional period (the "Fifth Additional Term") commencing January 1, 2001 and terminating March 31, 2001 (the "Fifth Revised Termination Date")."

5. Clause 3 shall be amended by deleting the phrase "the Second, Third and Fourth Additional Terms" in the third line between "Additional Term" and "as set out" and replacing it with ", the Second, Third, Fourth and Fifth Additional Terms".

6. Clause 11 shall be amended by deleting the phrase "the Second, Third and Fourth Additional Terms" in third line between "Additional Term" and "as set out" and replacing it with ", the Second, Third, Fourth and Fifth Additional Terms".

7. Clause 13 shall be amended by deleting the phrase "the Second, Third and Fourth Additional Terms" in the third line between "Additional Term" and "as set out" and replacing it with ", the Second, Third, Fourth and Fifth Additional Terms".

8. Clause 16 shall be amended by deleting the last sentence in the Clause and replacing it with the following:

> "In the event that the Municipality shall acquire and desire to exercise the said right to purchase it shall exercise the said right by notice in writing given to the Company not later than three (3) days after the Fifth Revised Termination Date, and a sale and purchase made under this Clause shall become, and be deemed to have become, effective at midnight on the Fifth Revised Termination Date."

9. Clause 22 shall be amended by deleting the phrase "Fourth Additional Term" located in the second line of the Clause and replacing it with "Fifth Additional Term".

10. Clause 23 shall be amended by:

(a) deleting the phrase "Fourth Revised Termination Date" located in lines 14 and 15 of the clause and replacing it with "Fifth Revised Termination Date"; and

(b) deleting the phrase "Fourth Additional Term" located in the third to last line of the Clause and replacing it with "Fifth Additional Term".

11. This Amending Agreement shall be governed by and construed in accordance with the laws of the Province of British Columbia and the parties agree to attorn to the jurisdiction of the courts of British Columbia.

12. Words importing the singular include the plural and vice versa; words importing the masculine gender include the feminine and neuter genders; and words importing persons include individuals, sole proprietors, corporations, partnerships and unincorporated associations.

13. This Amending Agreement may be executed in counterparts with the same effect as if all parties had signed the same document. All counterparts will be construed together and will constitute one agreement.

14. All unamended terms and conditions shall remain in full force and effect.

15. This Amending Agreement shall have effect as of December 31, 2000.

IN WITNESS WHEREOF the parties hereto have hereunto caused their respective corporate seals to be affixed, attested to by the signatures of their officers in that behalf, the day and year first above written.

The Municipal Seal of the **Corporation of the City of Kelowna** was hereto affixed in the presence of:

Authorized Signatory
Walter Gray, Mayor

Authorized Signatory
David L. Shipclark, City Clerk

The Common Seal of **BC Gas Utility Ltd.** was hereunto affixed in the presence of:

Authorized Signatory

Authorized Signatory

BC Gas Utility Ltd.
Legal Services
1111 West Georgia Street
Vancouver, British Columbia
Canada V6E 4M4

Tel (604) 443-6561
Fax (604) 443-6789

FILE COPY

BCGas™
Naturally Resourceful.

February 18, 2002

R.J. Pellatt
British Columbia Utilities Commission
6th Floor, 900 Howe Street
Vancouver, B.C.
V6Z 2N3

Dear Mr. Pellatt:

Re: Form of Franchise Amendment Agreement ("Agreement")
Between BC Gas Utility Ltd. and The City of Kelowna

Further to our correspondence dated January 14, 2002, wherein we enclosed an executed copy of the above noted agreement for a renewal term to October 31, 2018, BC Gas at this time seeks Commission approval of this Agreement pursuant to Section 45 of the Utilities Commission Act.

Should you have any questions regarding this matter, please contact Ron Baker at 250-558-3131.

Yours truly,

BC Gas Utility Ltd.

Marie-France Leroi
Senior Solicitor
MFL/ler
Encls.

cc: The City of Kelowna
Ron Baker, BC Gas – Vernon
Cal Johnson, Fasken Martineau

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BC Gas Utility Ltd.
Legal Services
1111 West Georgia Street
Vancouver, British Columbia
Canada V6E 4M4

Tel (604) 443-6561
Fax (604) 443-6789

BCGas™
Naturally Resourceful.

January 14, 2002

R.J. Pellatt
British Columbia Utilities Commission
6th Floor, 900 Howe Street
Vancouver, B.C.
V6Z 2N3

Dear Mr. Pellatt:

Re: Form of Franchise Amendment Agreement ("Agreement")
Between BC Gas Utility Ltd. and The City of Kelowna

Please find enclosed herewith an executed copy of the above noted agreement for a renewal term to October 31, 2018.

Should you have any questions regarding this matter, please contact Ron Baker at 250-558-3131.

Yours truly,

BC Gas Utility Ltd.

Marie-France Leroi
Senior Solicitor
MFL/ler
Encls.

cc: The City of Kelowna
Ron Baker, BC Gas - Vernon

FORM OF FRANCHISE AMENDMENT AGREEMENT

THIS AMENDMENT is made as of the 1st day of November, 2001.

BETWEEN:

CITY OF KELOWNA, a municipality having an office at 1435 Water Street, Kelowna, British Columbia, V1Y 1J4

("City")

AND:

BC GAS UTILITY LTD., a company having an office at 1111 West Georgia Street, Vancouver, British Columbia, V6E 4M4

("BCGU")

RECITALS

(A) City and BCGU (then known as Inland Natural Gas Co. Ltd.) entered into the Franchise Agreement (as defined below), dated April 2, 1980 permitting BCGU to operate a gas distribution system in Kelowna;

(B) City and BCGU have amended and renewed the Franchise Agreement from time to time;

(C) City and BCGU have further agreed to renew the Franchise Agreement on the terms of this Amendment.

TERMS OF AGREEMENT

NOW THEREFORE, in consideration of the mutual agreements set out in this Amendment, City and BCGU agree as follows:

1. DEFINITIONS AND APPENDICES

1.1 Definitions. In this Amendment (including the Recitals and Appendices), the capitalized terms defined shall have the following meaning:

"Amendment" means this agreement amending the Franchise Agreement.

"Franchise Agreement" means the agreement between the City and BCGU (then known as Inland Natural Gas Co. Ltd.) dated April 2, 1980, as amended and renewed.

2. EXTENSION

2.1 Expiry. The Franchise Agreement is hereby amended to renew the Franchise Agreement such that the expiry date is extended to October 31, 2018.

2.2 Purchase Option Terminated. The Purchase Option contained in sections 16, 17 and 18 of the Franchise Agreement is hereby terminated, by agreement of the parties.

2.3 Franchise Agreement Continues. Except as specifically altered by this Amendment, the Franchise Agreement continues in full force and effect.

3. GENERAL PROVISIONS

3.1 Enurement. This Amendment shall be binding upon and enure to the benefit of the parties to this Amendment and their respective successors and permitted assigns.

3.2 Other Agreements. The provisions of this Amendment shall not affect the rights of the parties which may subsist from time to time pursuant to any other agreements between them dated concurrently with or subsequently to this Amendment, nor relieve the parties of any obligations they may have pursuant to such agreements. There shall be no merger with this Amendment created or deemed to be created by virtue of any other agreement or agreements entered into between the parties hereto.

3.3 Office Consolidation. An office consolidation of the Franchise Agreement reflecting its state after this Amendment is attached to this Agreement. This office consolidation has been prepared for convenience and ease of reference only, including updating statutory references, and is not intended to amend, alter or supercede the terms of the Franchise Agreement.

3.4 Counterparts. This Agreement may be executed in one or more counterparts and such counterparts may be transmitted by electronic facsimile, and each such counterpart shall be deemed to be an original and together such counterparts shall constitute one document.

IN WITNESS WHEREOF the parties have caused this Amendment to be duly executed.

BC GAS UTILITY LTD.

Per: _____

Authorized Signatory

CITY OF KELOWNA

Per: _____

Authorized Signatory

Mayor

Per: _____

Authorized Signatory

City Clerk