

BELLINGHAM WATERFRONT DISTRICT ENERGY UTILITY
2023 and 2004 Revenue Requirements and Rates Application of
Corix Utility Systems (Washington), Inc.

Case No. 2023-01

Before Rates Review Panel

Fong Kwok, Chair
Chris Heimgartner
Jeffrey Goltz

DECISION APPROVING RATES
October 6, 2023

I. INTRODUCTION

A. Background and Procedural History

On July 27, 2023, Corix Utility Systems (Washington), Inc. (Corix or Applicant) filed on behalf of the Bellingham Waterfront District Energy Utility (BWDEU) its Revenue Requirements and Rates Application for 2023 and 2024 (Application) pursuant to the Bellingham Downtown Waterfront District Regulatory Framework for District Energy Utility (Framework). That Framework was the product of a negotiation between Corix and the Port of Bellingham (Port) and governs the work of the Rate Review Panel (Panel) in this matter.

In its application, as it had no historical operational costs, Corix uses a future test year of calendar year 2024. It seeks approval of rates for both 2024 and for the last two months of 2023 when it anticipates providing service to two customers (the only customers Corix anticipates during the period covered by this Application): Harcourt Bellingham, LLC (Harcourt) and Mercy Housing (Mercy). Of course, in the event other customers would connect during 2024, the approved rates would apply to them as well.

Consistent with section 7.2 of the Regulatory Framework, Corix provided both Harcourt and Mercy with a copy of its Application and indicated that pursuant to section 9.1 of the Framework any customer had 20 calendar days within which to file with the Panel a “written notice of its intention to participate as a Respondent.” Neither Harcourt nor Mercy filed such a notice.

Normally, when there are one or more Respondents, the Framework would provide for a 120-day timeline for the proceeding, including the issuance of information requests, responses to those requests, and, if needed, a hearing. Framework §10. However, given the fact that no customer sought to participate in the proceeding, section 9.4 of the Framework provides instead a 60-day period for the rate review, commencing on the date of the filing of the Application. That would mean that the Panel would have to issue its decision on September 25, 2023. Because this

is the inaugural rate review for this Panel under the Framework, and because of some scheduling conflicts, the Panel requested additional time. By letter dated August 23, Corix and the Port of Bellingham agreed to extend the date of September 25, 2023, to October 6, 2023.

B. Role of the Review Panel Under the Regulatory Framework

The Panel's "mandate" is contained in part 5 of the Framework. Section 5.1 states:

The Panel will be responsible for:

- (a) reviewing Corix's Annual Report and ensuring the proposed Monthly Rates outlined in the Annual Report for the upcoming calendar year are consistent with those outlined in the then-current Pro Forma Forecast;
- (b) conducting a Rate Review where Corix's Monthly Rates exceed what is otherwise permitted by this Framework;
- (c) hearing, deciding or otherwise resolving disputes that arise between Corix and a Customer in respect of the Terms and Conditions; and
- (d) issuing a final determination on matters within its cognizance hereunder.

Paragraph (b) refers to what is "permitted by this Framework." The Framework spells out what is permitted. For example:

- The rates must be "fair, just and reasonable" in light of "Prudent Utility Practice," which is defined to mean:
 - a) any of the practices, methods and acts, which, in the exercise of reasonable judgment in the light of the facts known, or facts which should reasonably have ought to be known, at the time the decision was made, including, but not limited to, the practices, methods and acts engaged in or approved by responsible and reputable owners and operators of district energy systems, having regard to size, age, location and intended use; and
 - (b) exercising that degree of skill, care, diligence, prudence and foresight that would reasonably and ordinarily be expected from a skilled and experienced district energy utility operator engaged in a similar type of undertaking under similar circumstances.
- The rates must be set to recover Corix's "prudently-incurred" costs. Framework §2.2(c).
- The rates must be sufficient to allow Corix the opportunity to earn a reasonable return on its investment. Framework §2.2(d).

- The rates must be sufficient to recover Corix’s annual revenue requirement. Framework §17.1.

The Framework envisions that rate proceedings be initiated by the filing by Corix of an “Annual Report” that is to contain information of expenses and capital expenditures for the prior year. Framework §7.3. Of course, in this initial filing, there is nothing to report on operations of the prior year, so this review must, of necessity, be based on a so-called “future test year” using estimated costs to determine the company’s revenue requirement and also its rate base. In future years, Corix will file its Annual Report that will include actual costs to justify its rates.¹ If those actual costs deviate in any material way from the estimated costs used in this rate proceeding, the future rates will be adjusted appropriately to take that into account.

The Framework states:

Corix has the burden of proof in Rate Reviews, which shall be by a preponderance of the evidence standard, to prove that the proposals in its Rate Application are fair, just and reasonable in light of Prudent Utility Practice, the objectives in Section 2.2, the principles in Sections 17 through 23, and any other provision of this Framework.

However, where, as here, there is no Respondent, section 11.1 of the Framework states that “[t]he Panel shall extend a presumption of reasonableness to any uncontested Rate Application made by Corix.” Accordingly, the Panel’s review in this proceeding necessarily gives deference to the justification of its proposed rates presented by Corix. Despite this presumption, the Framework recognizes that the Panel has the authority to determine the reasonableness of the proposed rates. However, in the event that the Panel finds the proposed rates unreasonable, section 11.1 of the Framework states that “the Panel shall support its Final Decision with a detailed record of decision, indicating its rationale including such items as the contractual terms and applicable principles relied upon to arrive at the alternative ruling.”

In a number of aspects, the Framework is very specific about how the Panel is to decide some aspects of a rate proceeding. For example, Framework is very prescriptive about the calculation of the appropriate rate of return on equity. See Framework §18. However, in other aspects, the Framework is less definitive. In such a case, section 14.2 of the Framework authorizes the panel to consult ratemaking principles applicable to Washington’s investor-owned utilities as governed by the Washington Utilities and Transportation Commission (WUTC).

¹ The Framework requires Corix to file its next Rate Application, with the filing of an Annual Report by May 15, 2024. Framework §7.1. It is to contain “at a minimum” actual expenses from the prior calendar year. Assuming that the customers come online in November 2023, that would mean that the Annual Report could only have two months of actual cost data. However, we would also expect to see actual cost data for at least the first quarter of 2024. If that is not in the Annual Report filed in May 2024, we anticipate asking for it in the Information Request process.

One regulatory item that is not precise in the Framework is whether the authority of the Panel in conducting a Rate Review includes the authority to disallow costs that the Panel deems unreasonable or imprudent. In Washington, the statute governing rate proceedings by the WUTC is very precise about the WUTC's authority to disallow costs and "fix" rates where the proposed rates are unreasonable or when some facilities are not "used and useful."² The standard practice is that when the WUTC disallows costs it requires the utility to recalculate its rates. Accordingly, given the language in section 14.2 of the Framework that directs the Panel to regulatory principles of the WUTC, we believe that the Panel has the authority under the Framework to disallow imprudent or unreasonable costs and direct the Applicant to recalculate the rates accordingly. However, as indicated below, in this proceeding, despite some concerns about some aspects of the rate calculation, the Panel is not taking that step.

The Panel also has some authority outside the confines of a rate review. For example, section 2.3 of the Framework authorizes the Panel to initiate a process to revise the Framework. It states:

To the extent that any of the processes, guidelines or procedures described in this Framework prove to be unworkable, unduly cumbersome or costly, or fail to provide sufficient detail, information or transparency, the Rate Review Panel may, outside the context of a particular Rate Review, facilitate negotiations between Corix, and Customers to develop a mutually acceptable alternative that aligns with the objectives in Section 2.2 above.

As discussed below, the Panel has some suggestions in this regard.

II. APPLICATION AND APPROVALS SOUGHT

In its Application, Corix seeks the following:

(1) Approval of the forecast annual revenue requirements for the 2024 test year, as shown in Table 20, in section 8 of the Application, and in Schedule 9.

(2) Approval of customer rates as follows:

- Heating basic charge (\$ per square foot per month): \$0.0862
- Heating energy charge (\$ per MMBTU): \$13.91
- Cooling basic charge (\$ per square foot per month): \$0.0395
- Cooling energy charge (\$ per MMBTU): \$3.95

² Rev. Code Wash. §80.28.020 allows the WUTC, after a hearing, to "fix" the rates of electric, gas, and water companies. Rev. Code Wash. §80.04.250 limits rate base to those facilities that are "used and useful" in the provision of utility service.

(3) Approval that the energy (variable) heating charge for Mercy Housing is equal to the above rates.

(4) Approval of a one-time connection fee for connections to each of the heating and cooling components of the DEU as follows:

- Heating connection fee (\$ per square foot): \$2.254 (2023), \$2.299 (2024)
- Cooling connection fee (\$ per square foot): \$2.254 (2023), \$2.299 (2024)

(5) Approval to adjust the connection fees annually, starting January 1, 2025, by the greater of (i) the general Consumer Price Index applicable to Whatcom County (or King County if data for Whatcom County are unavailable); or (ii) as otherwise agreed upon between Corix and the Developer.³

(6) Approval of the tariff including the rate schedules, applicable to all customers except Mercy Housing, as provided in Appendix A of the Application.

(7) Approval of the rate schedule applicable to Mercy Housing, as filed confidentially.

(8) If the Panel does not make a decision prior to November, approval that the rates applied for in 2 and 3 above be effective on November 1, 2023, on an interim basis and then subsequently adjusted.

Application §1.2.1.

These are all discussed below.

III. RATE REVIEW PROCESS

After receiving the Application and determining that there would be no Respondents, on August 28, 2023, the Panel issued 35 Information Requests (IRs), many with subparts, to Corix in order to clarify some aspects of the Application and the Applicant's position on a variety of potential issues. Corix responded on September 1, 2023.

In reviewing these and other issues, the Panel was constrained by the fact that no customer opted to participate as a Respondent in this proceeding. That limited the Panel in two ways. First, it triggered the provision in section 11.1 of the Framework which establishes a presumption of reasonableness of any uncontested rate application. While that does not make it impossible for the Panel to find any aspect of the Application unreasonable, it raises the bar. Second, with no Respondent, the Framework establishes an abbreviated schedule for the Panel's

³ The "Developer" is defined in the Framework to mean "Harcourt Bellingham, LLC or any other person or entity to whom the Port transfers or has transferred land or land rights with the Downtown Waterfront District for the purpose of development or other use."

review of the rates and imposes procedural limitations on the Panel. In a contested proceeding, section 10 of the Framework establishes a 120-day review period and permits two rounds of information requests (and in “extenuating circumstances,” more than two) and provides for a rate hearing if the Panel believes that necessary. However, where the Application is uncontested, section 9.4 requires a “Truncated Review Schedule” of 60 days from the date of filing of the Application. Given that time period, there is simply insufficient time for multiple rounds of information requests or the sort of give and take that a hearing would permit.

IV. SUMMARY OF DECISION

The Panel determines that, given the presumption of reasonableness required by the Regulatory Framework, the rates proposed in the Application should be approved. This is not to say that the Panel approves all the elements that led to those rates. As discussed below, we have numerous questions about several rate-setting approaches presented by Corix. While we did not disallow any expenses for this 2024 rate year, we request that for the filing for the 2025 rate year, which will be made in May 2024, Corix should provide additional information on several issues and offer alternatives to the approaches taken by Corix for 2024. These are discussed below.

V. DISCUSSION OF SELECTED ISSUES AND DECISION

A. Overview

Though we approve the rates as proposed for 2024, we highlight several issues that give us pause. We expect Corix to discuss these issues in further detail in the next Rate Review, if not before.

B. Specific Issues

1. Corporate Services Costs

In its application, under its discussion of operation and maintenance details, Corix forecasts “corporate services costs” of \$256,200 in the 2024 year. These include both direct costs attributable to the BWDEU and also an allocated portion of general company overhead costs. Corix states that this amount understates the actual dollar amount, resulting in an “under-recovery” for the benefit of consumers.⁴ Though Corix states that it “is not requesting to recover the forecast corporate services cost allocations” in this proceeding,⁵ going forward we have concerns about these cost numbers. For a company with two customers, this seems like an extraordinary amount. While the three-factor allocation methodology referenced in the Application may be appropriate, for the next rate application, we would like to see more “granular information” as suggested by Corix.⁶ This should include details about the application

⁴ Application, at 30.

⁵ Corix Response to IR 10.a.

⁶ Corix Response to IR 10.a.

of those factors, including the weighting of each factor and the calculation of the final allocation percentages, in addition to any narrative that would justify the magnitude of these costs. The Panel recognizes that a full response to the questions around corporate services allocation would include detailed information beyond the boundaries of the BWEDU and would be considered confidential.

2. Initial Maintenance Costs and Sustaining Capital Expenditures

While Corix rightfully does not include any maintenance costs for its 2024 year,⁷ it sets forth an estimated cost for future years based on a percentage of the capital cost of each facility. The percentages were “developed in dialogue with Corix’s external engineering advisors” but adds that it will develop a plan for maintenance in the future.⁸ So, the estimates contained in the Application for years 2025 and beyond (over \$90,000 per year) is tentative at best. We expect better estimates, and perhaps some actual data, for the next Application.

Corix also proposes to include in future years sustaining capital expenditures, which they estimate to be 10% of maintenance costs.⁹ These would become part of rate base.¹⁰ The distinction between maintenance costs and sustaining capital expenditures is important, but imprecise. Ordinarily, expenditures that ensure that a facility will operate throughout its useful life are maintenance, while expenditures that extend a facility’s useful live can be put into rate base. However, the principles have not been clearly defined to ensure the treatment of maintenance costs and capital sustainment costs are distinctive. Given the long service lives of BWDEU’s capitals assets between 30 to 65 years as well as potential warranties on new assets, the Panel would not expect to see any sustaining capital expenditures in a rate application for a number of years, perhaps at least five years. When Corix proposes to include such expenditures, the Panel would expect a more detailed rationale for them and a more precise distinction between maintenance costs and sustaining capital expenditures.

3. Treatment of Connection Fees and Contributions in Aid of Construction (CIAC)

Corix and Harcourt in their District Energy Service Agreement (DESA) Section 5.1, outlined that Harcourt’s preference was to pay a one-time connection fee in lieu of an otherwise higher monthly Basic charge for connected building. The DESA stated: “Corix will use the Connection Fee for the benefit of Customers in a manner it deems reasonable, which may include (among other things) treating it as revenue to offset the Cost of Service in the year the Connection Fee is collected or in a subsequent year, or to reduce the balance of any Energy Cost Reconciliation Account(s) or Rate Stabilization Account”

⁷ Application, at 28.

⁸ Application, at 28.

⁹ Application, at 26.

¹⁰ Corix Response to IR 19.c.

Corix has chosen to recognize the connection fee as revenue in the year received. However, Corix's choice of treatment of connection fees does not align with standard regulatory treatment. The appropriate treatment for Connection fees would be to recognize these payments as Contributions in Aid of Construction (CIAC) to offset or reduce the capital infrastructure costs associated with service connections. Connection fees represent a contribution towards the cost of labor, equipment, and materials necessary to connect a customer to its system with the associated assets having an expected service life of more than one year. This is a standard utility accounting practice whereby CIAC offsets rate base upon which the utility is allowed to earn a rate of return.

Corix further submits that any CIAC will be applied in full against Corix's debt component. The Panel deems that the treatment of CIAC is a reduction of rate base as noted above which would impact the company's capital structure, both in debt and equity and not solely a reduction of debt. This concept is consistent with a regulated utility's ratemaking treatment because rate base is generally determined net of CIAC received. Shareholders equity and debt comprise a company's long-range capitalization or, in the case of a utility, its rate base.

In the next rate filing, we expect to see a calculation of rates that is based on treatment of connection fees as CIAC.

4. Return on Equity (ROE), Deemed Interest Rate, and Weighted Average Cost of Capital (WACC)

Corix proposed a return on equity (ROE) of 10.4% and a deemed interest rate of 6.38%, taking into consideration the risk factors of being an independent, stand-alone small utility in comparison to the benchmark utility, Puget Sound Energy (PSE). The Panel has considered these risk factors in its determination on the reasonableness of these rates of return and has some concerns.

The Framework that Corix negotiated with the Port defined the (ROE) that Corix would be entitled, effectively taking that issue out of the purview of the Review Panel. The Framework sets the rate of return as "the greater of (a) 10 percent or (b) the sum of the approved return on equity amount then in place for the Benchmark Utility and 100 basis points."¹¹ Puget Sound Energy (PSE) is the Benchmark Utility and has a current authorized ROE of 9.4%, so adding the 100 basis points to that gives Corix an ROE of 10.4%. Presumably, this added 100 basis points is intended to compensate Corix for the risk it faces, which is greater than the risk faced by PSE. Since Corix currently has only two customers, and with the uncertainty of when other customers will be able to take service, Corix faces a riskier future than an established regulated utility like PSE. Given the nature of the customer risks along with a negotiated agreement with the Port Authority, the Panel deems the return on equity to be reasonable for a start-up utility but may review this matter when the utility is more established and mature in the near future.

¹¹ Framework §18.1.

We have greater concerns with the rationale for the deemed interest rate. The deemed interest rate proposed by Corix of 6.38% also takes into consideration the risk factors of being an independent, stand-alone small utility's ability to raise bond debt in comparison to the benchmark utility, PSE. However, BWDEU is 100% owned by Corix Utility Systems (Washington) Inc., and ultimately fully owned by Corix Infrastructure Inc. (CII), the risk factors of being a stand-alone independent utility appears hyperbolic as the risks of borrowing is somewhat mitigated.

Furthermore, there is no readily available index for a BBB- bond rating to which BWDEU has deemed to be its credit worthiness as compared to PSE's BBB rating, nor are there any comparable thermal energy facilities in Washington available for review, even though the Regulatory Framework requires that financing cost be determined by reference to a "comparable thermal energy utility."¹²

The use of the deemed interest rate by Corix impacts the weighted average cost of capital (WACC) used to determine overall rate of return and, ultimately, the rates. As noted in virtual presentation of August 24, the benchmark utility, PSE, has a WACC rate of 6.62% as January 31, 2023 while Corix calculated WACC is 7.67% with a differential of 1.05%.

Given the synthetic nature of the deemed interest rate, including the lack of comparison to a "comparable thermal energy utility" as required by the Framework, and the discrepancy between the WACC of Corix compared to that of PSE, the Panel believes that the support for the ultimate WACC is lacking. Though we accept it for purpose of calculating the rate in this current rate proceeding, we look forward to a more fulsome review of this issue in the next rate proceeding.

C. Discussion and Decision on Approvals Sought by Corix

Accordingly, we approve the requests by Corix as follows:

(1) We approve the forecast annual revenue requirements for the 2024 test year, as shown in Table 20, in section 8 of the Application, and in Schedule 9. However, this approval is based substantially on the presumption of reasonableness that the Framework imposes on this proceeding. Forecasted expenses are inherently inaccurate. Though necessary for this initial rate proceeding, we expect that in the future there will be more precision using, where possible, actual costs.

(2) We approve customer rates as follows:

- Heating basic charge (\$ per square foot per month): \$0.0862
- Heating energy charge (\$ per MMBTU): \$13.91
- Cooling basic charge (\$ per square foot per month): \$0.0395

¹² Framework, §19.1.

- Cooling energy charge (\$ per MMBTU): \$3.95

Again, this is derived from the revenue requirement that is based on forecasted costs, which can vary from the actual costs. However, Corix offered some reassurance on this point when it stated in response to information requests that other entities, including the customers, have reviewed certain costs. For example, the Port and City have reviewed plans and specifications for the project,¹³ and “Corix and Harcourt, in cooperation with the Port, set initial rates to align approximately with a business-as-usual estimated cost of owning and operating in-building heating and cooling equipment (i.e., air-source heat pumps and fluid coolers) that would provide low carbon energy equivalent to the district energy design solution.”¹⁴ Of course, had Harcourt participated as a Respondent in this proceeding, it would have been easier for the Panel to confirm Harcourt’s concurrence, or at least acquiescence, in the proposed rates.

(3) We approve the energy (variable) heating charge for Mercy Housing is equal to the above rates.

(4) We approve the one-time connection fee for 2024 for connections to each of the heating and cooling components of the DEU as follows:

- Heating connection fee (\$ per square foot): \$2.254 (2023), \$2.299 (2024)
- Cooling connection fee (\$ per square foot): \$2.254 (2023), \$2.299 (2024)

(5) We tentatively approve the Corix proposal to adjust the connection fees annually, starting January 1, 2025, by the greater of (i) the general Consumer Price Index applicable to Whatcom County (or King County if data for Whatcom County are unavailable); or (ii) as otherwise agreed upon between Corix and the Developer.¹⁵ We say “tentatively,” because we believe that the connection fee, and how it is treated, should be an open question for future rate proceedings.

(6) We approve the tariff including the rate schedules, applicable to all customers except Mercy Housing, as provided in Appendix A of the Application. This includes the non-rate provisions in the tariffs. This approval is based in substantial part on the assurance we received from Corix in the information request process that the customers were given the opportunity to review an earlier draft of the non-rate tariff language and subsequent revisions to that language was relatively minor.¹⁶ Again, it would have been easier for the

¹³ Corix Response to IR 6.

¹⁴ Corix Response to IR 9.b.

¹⁵ The “Developer” is defined in the Framework to mean “Harcourt Bellingham, LLC or any other person or entity to whom the Port transfers or has transferred land or land rights with the Downtown Waterfront District for the purpose of development or other use.”

¹⁶ Corix Response to IRs 28 and 29.

Panel to determine whether this non-rate tariff language was acceptable to the customers if the customers had they been Respondents in this proceeding.

(7) We approve the rate schedule applicable to Mercy Housing, as filed confidentially.

(8) Because we have made a final rate decision in this proceeding, there is no need for interim rates, which was an alternative request of Corix.

VI. SUGGESTIONS FOR DISCUSSIONS ABOUT REVISIONS TO THE REGULATORY FRAMEWORK AND OTHER MATTERS

Section 2.3 of the Framework authorizes the Panel to initiate a process to revise the “to the extent that any of the processes, guidelines or procedures described in this Framework prove to be unworkable, unduly cumbersome or costly, or fail to provide sufficient detail, information or transparency” Such a process is to take place “outside the context of a particular Rate Review” In the course of working on this Rate Review, the Panel did find some of the processes, guidelines, and procedures to be “unworkable and cumbersome.” Accordingly, in the future, most likely in late Fall 2023 or early Winter 2024, the Panel intends to initiate such a process to include Corix and the customers (as specified in section 2.3), and also the Port which negotiated the initial Framework with Corix.

Dated, October 6, 2023

Fong Kwok, Chair
Chris Heimgartner
Jeffrey Goltz

Rate Review Panel Members