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IN THE MATTER OF
the Utilities Commission Act,
S.B.C. 1980, c. 60, as amended

and

IN THE MATTER OF
an Application for Rate Relief
by Vancouver Island Gas Company Ltd.

DECISION

July 29, 1983

Before:

J.D.V. Newlands, Deputy Chairman
and Chairman of the Division
D.B. Kilpatrick, Commissioner
N. Martin, Commissioner

The Application of Vancouver Island Gas Company Ltd. dated March 24, 1983 for interim and permanent rate relief was heard on June 21, 1983 in Nanaimo, British Columbia.

The Division of the Commission comprised J.D.V. Newlands, Deputy Chairman; D.B. Kilpatrick, Commissioner; and N. Martin, Commissioner.

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ORDER NO. G-55-83

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APPENDIX A Operating, Maintenance and Administration Expenses

APPEARANCES

K.E. GUSTAFSON	Commission Counsel
R.B. WALLACE	Counsel for Vancouver Island Gas Company Ltd.
PAUL ALVANO	Pacific Linen Supply Ltd.

R.J. FLETCHER J.A. GREINER J.A. HODSON D.D. MacINNIS	Commission Staff
W.R. HARPER	Hearing Officer
W.B. AUDIOTRON LTD.	Court Reporters

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INTRODUCTION

This Decision deals with the Application by Vancouver Island Gas Company Ltd. (hereinafter referred to as "VIGAS" or "the Applicant") dated March 24, 1983 for both interim and permanent rate relief. The Applicant requested rate increases of 16.85% for Residential and 16.37% for Commercial customers, leaving Interruptible customer rates unchanged, to enable it to earn 14.8% on rate base and 16.9% on common equity, deemed to be 42% of rate base. To enable it to attain the revenue level necessary to protect its financial integrity the Applicant requested full interim relief.

By Order No. G-32-83 dated April 26, 1983, the British Columbia Utilities Commission ("the Commission") granted the full interim relief requested, effective May 1, 1983 and subject to refund with interest at the average prime rate of the Applicant's bank. By Order No. G-36-83 dated May 12, 1983, the Commission set down the Application for public hearing commencing at 10:00 a.m. on June 21, 1983 in Nanaimo, British Columbia.

The Applicant was incorporated in 1955 as a gas distribution company. In 1956, a franchise agreement was negotiated with the City of Nanaimo, enabling the Company to operate a butane-air system within the city boundaries. This agreement was renewed for a further 20 years in 1974. In 1980, a propane-air mix was substituted for the butane-air mix, as approved by the Commission.

VIGAS is owned as to 92.7% by Fort St. John Petroleums Ltd., with ultimate control vested in Inter-City Gas Corporation Ltd. of Winnipeg. Major financing is by way of loans and advances from the Applicant's parent and affiliated companies, and a bank line of credit secured by a general assignment of book debts and a first floating charge against the assets of the company.

The Applicant in presenting its case was represented by D.G. Olsen, General Manager and R.A. Shelley, Office Manager and Accountant; and supported by G.M. Hoffman, Vice President - Rate Administration of ICG Utilities Ltd., Winnipeg, Manitoba, with regard to capital structure and rate of return.

In addition, the Applicant was represented by L.M. Heikkinen, Manager - Administration and Accounting of ICG Utilities (Plains-Western) Ltd., in Leduc, Alberta, who gave evidence as to the new computerized management information and customer service systems provided to VIGAS by ICG Utilities Ltd., and related inter-company charges.

The Commission acknowledges the very useful contribution to the proceedings made by the sole intervenor, Mr. Paul Alvano of Pacific Linen Supply, and commends Mr. Alvano for his time and effort at the hearing.

At the outset, the Commission stresses that, while this Decision has necessarily been determined in the context of the Applicant's present operations and circumstances, in the event that proposed natural gas supply to Vancouver Island is implemented the size, financial, marketing and indeed overall circumstances of VIGAS can be expected to change very markedly.

As an indication of the order of magnitude of the impact on the Applicant attributable to the availability of natural gas, testimony by ICG management at the hearing suggests that the VIGAS rate base serving the existing Nanaimo franchise area alone could expand by a factor of as much as fifteen times to a level of $30 to $40 million, while the number of customers served might rise to as many as 15,000 from the present 1,300 to 1,400.

The implications for the Applicant from such a major expansion, in such matters as future capital structure and potential sources of the necessary funds, are clearly very significant. The Commission recognizes, however, that these are matters currently under study by the Applicant's parent company and are clearly premature and not appropriate for consideration in this Decision. The Commission's conclusions with respect to issues deemed pertinent to the present circumstances follow.

THE TEST YEAR

The Commission accepts the forecast test year selected by the Applicant, being the fiscal year ending December 31, 1983.

RATE BASE

The Rutherford Plant

While there was some discussion on the expenditures made on the Rutherford plant, the Commission concludes that allowance in full of these expenditures in the rate base is reasonable in the circumstances.

System Development Costs

The Commission accepts the inclusion in rate base, and amortization over seven years, of the $35,000 of development costs relating to the Management Information and Customer Service systems. In future, however, the Commission will expect to be advised of any significant expenditures planned by the parent or related subsidiaries, the costs of which will be allocated in whole or in part to VIGAS.

Past Rate Hearing Costs

In the present Application the Applicant raised for reconsideration past rate hearing costs excluded from rate base in the Commission's Decision of February 19, 1982. The Commission has carefully considered the reasons for exclusion of these costs in the last Decision and the four tests applied to them on page 8 of that Decision, and concludes that those costs should remain excluded from rate base. The Commission will, however, allow the utility to recover Rate Administration Department costs over a three year period rather than the ten years specified in that Decision. These costs will then be fully recovered by year-end 1985.

REVENUES AND EXPENSES

Revenues

The Commission accepts the sales volume forecast by the Applicant and the related forecast of revenues.

Expenses

The Commission recognizes and commends the management of VIGAS for its effective restraint and control of costs during a very difficult inflationary period coupled with recession. These achievements are summarized in Appendix A.

The Commission accepts the projected operating costs of the computerized Management Information and Customer Service systems allocated to VIGAS by ICG Utilities Ltd., which reflect a saving as compared to the less sophisticated systems and services in place.

CAPITAL STRUCTURE AND COST OF CAPITAL

Capital Structure

The Commission accepts the notional capital structure proposed by the Applicant, comprising 58% debt and 42% common equity. This was the capital structure accepted by the Commission in its Februrary 19, 1982 Decision and the Commission concludes that there has been no significant change in the business or financial risks to the Applicant that would justify a change from that structure.

The Commission, however, is concerned about the implications of such a notional capital structure for the Applicant's financial welfare in the future. At the hearing Mr. Hoffman testified that the parent company was in process of reviewing the capital structure of VIGAS with a view to replacing the deemed capital with an appropriate combination of actual debt and common equity. He further indicated that when permanent capital is injected, the Applicant would receive the benefit of the parent company's long-term borrowing capacity and that this would be available to VIGAS without additional cost, except that related to the cost of issue.

The Commission recognizes the potential value to the Applicant of such support from the parent company with respect to the debt element in any new capital structure but would stress the even greater importance of an early injection of additional equity if the future capital structure of the Applicant is to achieve reasonable balance in real terms. The Commission notes that an opportunity to achieve this promptly would be the conversion of an appropriate portion of existing inter-company loans or advances into equity. The Commission therefore looks forward to the early achievement of these objectives and if possible before the Applicant's next application for general rate relief. In any event, on that occasion the Commission will regulate on the basis of the Applicant's actual capital structure.

Embedded Cost of Debt

The Commission concludes that a 20 year term remains appropriate for purposes of computing the Applicant's embedded cost of debt. Accordingly, the Commission accepts the 12.84% cost cited on page 95 and, after adjusting for financing costs, concludes that the appropriate embedded cost of debt in this instance is 13.09%.

Return on Equity

The Commission has considered the evidence of Mr. G.M. Hoffman and Mr. D.R. Bolster, the business and financial risks of the Applicant, the approved capital structure and equity component and concludes that a fair and reasonable rate of return on the Applicant's deemed common equity lies in the range of 15.0% to 16.0%. Accordingly, for purposes of determining the Applicant's revenue requirement a rate of return on common equity of 15.5% has been used.

DISPOSITION OF INCOME TAX BENEFITS

The Applicant has proposed that the tariff rates should include recovery of a deemed income tax expense of $80,187. This amount represents the income tax expense deemed to be payable in the test year after applying the maximum deemed capital cost allowance. During cross-examination the Applicant acknowledged that, while included as a projected 1983 expense, the $80,187 would in fact not be paid by reason of the application of prior years' losses.

The company's audited financial statement (Exhibit 4, Tab 14) for the year ended December 31, 1982 records prior years' losses of $269,000 (Note 6) available to carry forward to reduce taxable income in future years. The Applicant's position on the matter of whether the customers or its shareholders should realize the resulting tax saving is clear; namely, that customers who benefitted from lower rates during loss years, when rates should have been higher to provide adequate return to shareholders, should not now benefit again from the lower rates which will result by applying the subsequent savings in income tax to reducing the revenue requirement.

The Commission has considered this matter in terms of its position with respect to the Applicant's capital structure (ref. page 5) and concludes that it is inappropriate to apply actual prior years' losses to reduce the deemed income tax expense in the forecast test year. Accordingly, in the present circumstances the Commission will allow an adjusted income tax expense of $74,259 in the cost of service.

TARIFF MATTERS

Terms and Conditions for Gas Service

The Commission has examined the VIGAS tariff marked Gas Tariff BCUC No. 1 which was filed at the hearing as Exhibit 13.

With respect to item (f) on page 6 of the tariff dealing with billing, the Commission will require that the provision that the consumer shall pay rendered accounts within fourteen days from the date of mailing of bills by the Company, be changed to read twenty-one days from the date of mailing.

The Commission accepts as reasonable the Applicant's request for change in the provisions of item (g) on page 6 of the tariff, to increase the guarantee deposit from the prevailing two months' billings to a maximum of three months' billings, which for existing customers will be based on average monthly billings in the preceeding year and for new customers on 25% of estimated annual consumption.

The Commission concludes and the Applicant agreed that the 5 year period cited in paragraph (b) of page 11 of the tariff pertaining to the mains extension policy, be incorporated in paragraph (a) of page 11 with respect to customer contributions to construction costs.

Modified as above, the Commission will accept for filing the Applicant's gas tariff filed at the hearing as Exhibit 13.

Modification to Notice of Future Rate Changes

Concern was expressed at the hearing with respect to the form of notice of increases in rates currently provided to its customers by the Applicant. It was suggested and the Commission concurs, that in future when practicable, the notice should display the prevailing rate, the proposed new rate and the percentage change.

PRICING POLICY

The Applicant is exposed to an unusual level of inter-fuel price competition from both oil and electricity in the Nanaimo franchise area. Despite a currently significant price disadvantage in comparison to both oil and electricity (Reference Exhibit 11), in the past two years VIGAS has managed to achieve an increase in the number of customers served of some 5% and, despite the impact of conservation, has achieved an increase in sales per customer of some 8.5%. Management is to be commended for this achievement since this sales growth has minimized the magnitude of the rate relief required.

Complaint by Pacific Linen Supply

To make the use of its product more attractive to potential commercial customers whose higher volumes would benefit all customers on the system, and to avoid the loss of these customers to oil, the Commission approved the introduction by the Applicant of special contract rates for interruptible service. This has given rise to a significant differential in the rates payable by the Applicant's firm commercial customers and those commercial customers able to take advantage of interruptible service. Interruptible service is attractive to those customers equipped to make periodic use of alternative fuels when the price of those fuels is advantageous. It follows that the interruptible rates for gas must be maintained at or close to the fluctuating market price of the competing fuels.

The resulting two price system gave rise to a complaint by the sole intervenor at the hearing, Mr. Paul Alvano of Pacific Linen Supply, of price discrimination by VIGAS. Pacific Linen Supply is a commercial customer on firm rates while Nelson Laundry is a commercial customer on both firm and interruptible rates, both companies being in the commercial laundry business in the Nanaimo market area.

The Commission recognizes that under presently prevailing prices, and with both Pacific and Nelson laundries burning gas, there is a cost advantage to Nelson. On the other hand it is clear that Nelson, by reason of its ability to burn oil whenever oil is cheaper than gas, would have a cost advantage in any case. Were higher volume interruptible customers such as Nelson to abandon the use of gas entirely, the Applicant's total cost of service would have to be borne by the firm customers. The end result would be even higher rates to Mr. Alvano with no change for Nelson when burning oil, so that the cost advantage to Nelson would simply increase.

The Commission concludes that although at present rates interruptible sales are making a negligible contribution to the Applicant's operating income, the maintenance of such sales is in the public interest and is justified by the prospect of higher rates in the future. The Commission further concludes that the maintenance of interruptible rates in the present circumstances does not constitute undue discrimination against the Applicant's firm customers not equipped to take advantage of them by reason of ability to burn both oil and/or gas.

Range Rates

To increase its pricing flexibility and ability to compete with alternative fuels, particularly with the fluctuating price of fuel oil, the Applicant is seeking approval by the Commission of Range Rates applicable to its interruptible customers. The Applicant proposes that the rates to its interruptible customers should be permitted to range from a low of cost of gas plus 5 cents per Ccf to a high of the prevailing commercial rate to firm customers.

The Applicant testified that a 5 cent per Ccf margin would allow for recovery of its costs and some profit or contribution to the operating income of the system, while permitting it to be more competitive with fuel oil. The Commission concludes that the range rate concept as proposed by the Applicant is practical and reasonable in the circumstances, and accordingly will approve interruptible rates on that basis. The Commission further concludes, however, that the upper limit of the range should be no higher than 90% of the prevailing firm commercial rate.

Deferral Accounting for Interruptible Sales

In conjunction with its proposed range rates the Applicant seeks Commission approval to operate a deferral account to accrue the margin on interruptible sales achieved either above or below the forecast or projected level of such sales. In granting the range rates the Commission has enhanced the competitive capabilities of the Applicant thereby reducing the risk to the shareholders. To further reduce that risk by permitting the proposed deferral accounting, in the opinion of the Commission is unjustified, and would remove the incentive and obligation of the Applicant to forecast interruptible sales as accurately as possible. This could have an adverse effect on the rates required to be paid by the firm customers. Accordingly, the request for deferral accounting on range rate sales is denied.

RATES

The Commission confirms the interim rates authorized by Commission Order G-32-83 and will accept for filing effective with consumption on and after August 1, 1983 Tariff Rate Schedules based on Schedule II of this Decision adjusted for the May 1, 1983 reduction in the cost of gas. The Commission further will accept for filing interruptible tariff rate schedules reflecting the approved Range Rates.

DATED at the City of Vancouver, in the Province of British Columbia, this 29th day of July, 1983.

J.D.V. Newlands, Deputy Chairman

D.B. Kilpatrick

D.B. Kilpatrick, Commissioner

N. Martin, Commissioner

BRITISH COLUMBIA UTILITIES COMMISSION

ORDER NUMBER G-55-83

PROVINCE OF BRITISH COLUMBIA

BRITISH COLUMBIA UTILITIES COMMISSION

IN THE MATTER OF the Utilities Commission Act, S.B.C. 1980, c. 60, as amended

and

IN THE MATTER OF Applications by Vancouver Island Gas Company Ltd.

BEFORE:	J.D.V. Newlands, Deputy Chairman; D.B. Kilpatrick, Commissioner; and N. Martin, Commissioner	July 29, 1983

O R D E R

WHEREAS a public hearing pertaining to Vancouver Island Gas Company Ltd. ("Vigas") was held before this Commission at Nanaimo, B.C. on Tuesday, June 21, 1983 to hear Vigas' Application dated March 24, 1983 for interim and permanent rate relief; and

WHEREAS the Commission by Order No. G-32-83 dated April 26, 1983 authorized an interim rate increase effective May 1, 1983, subject to refund with interest at the average prime rate of the bank with which Vigas conducts its business; and

WHEREAS the Commission by Order No. G-36-83 established Tuesday, June 21, 1983 as the date of commencement of a public hearing of the Application; and

WHEREAS the Commission has considered the Applications and the evidence adduced thereon, all as set forth in a Decision issued concurrently with this Order.

.../2

NOW THEREFORE the Commission hereby orders Vancouver Island Gas Company Ltd. as follows:

1. The interim rates currently in effect as authorized by Commission Order No. G-32-83 effective May 1, 1983 are hereby confirmed as permanent increases.

2. The Rate Base for the Test Year ending December 31, 1983 is approximately $2,970,000.

3. The Total Revenue Requirement for the Test Year ending December 31, 1983 is approximately $2,870,000 based upon the cost of gas as presented in the Application.

4. The Commission will accept for filing effective with consumption on and after August 1, 1983 amended Tariff Rate Schedules as outlined on page 11 of the Decision issued concurrently with this Order.

5. The amended Tariff Rate Schedules will allow Vigas an opportunity to earn a rate of return of 15.5% on the deemed common share equity.

6. The Commission will accept for filing, subject to the timely action concerning the required modifications contained on pages 7 and 8 of the Decision issued concurrently with this Order, the Gas Tariff B.C.U.C. No. 1 filed at the hearing as Exhibit 13.

DATED at the City of Vancouver, in the Province of British Columbia, this 29th day of July, 1983.

BY ORDER

Deputy Chairman

SCHEDULE I

VANCOUVER ISLAND GAS COMPANY LTD.

Rate Base
1983 Forecast

	Per Application Exhibits 3, 5 & 6	Commission Adjustments	Final Adjusted Balance
Gross Plant in Service, January 1, 1983	$3,455,550	$ -	$3,455,550
Accumulated Depreciation, January 1, 1983	(750,404)	-	(750,404)
Net Plant in Service, January 1, 1983	$2,705,146	-	$2,705,146
Gross Plant in Service, December 31, 1983	$3,547,695	-	$3,547,695
Accumulated Depreciation, December 31, 1983	(820,977)	-	(820,977)
Net Plant in Service, December 31, 1983	$2,726,718	-	$2,726,718
Net Plant in Service (mid-yr.)	$2,715,932	-	$2,715,932
Deduct: Customer Contributions	(78,418)	-	(78,418)
Total	2,637,514	-	2,637,514
Working Capital			
Cash Expenses	137,681	45,489 (a)	183,170
Inventory, Materials	61,017	-	61,017
Inventory, Gas	96,286	-	96,286
Unamortized Rate Hearing Costs, Mid-year	49,587	(31,191) (b)	18,396
Deferred System Development Costs, Mid-year	17,500	-	17,500
Customer Deposits, Mid-year	(110,064)	-	(110,064)
Organization Costs, Mid-year	32,761	-	32,761
Leak Investigation & Repair Costs, Mid-year	5,600	-	5,600
Prepaid Expenses	27,958		27,958
Total Working Capital	318,326	14,298	332,624
Total Rate Base	$2,955,840	$ 14,298	$2,970,138

VANCOUVER ISLAND GAS COMPANY LTD.

Notes to Schedule I

(a) Adjustment to working capital to reflect the change in customer payment term per Decision.

(b) Adjustment to exclude rate hearing costs previously disallowed.

Balance at December 31, 1982	$17,061
Balance at December 31, 1983	19,731
Allowed 1983 mid-year balance	$18,396

SCHEDULE II

VANCOUVER ISLAND GAS COMPANY LTD.

Utility Income and Earned Return

1983 Forecast

	Per Application Exhibits 3, 5 & 6	Commission Adjustments	Final Adjusted Balance
Sales Volume (Ccf)	2,036,420	-	2,036,420
Sales Revenue	$2,879,869	$(6,145) (a)	$2,873,724
Other Revenue	75,744	-	75,744
Total Revenue	2,955,613	(6,145)	2,949,468
Cost of Gas	1,625,523	-	1,625,523
Gross Margin	1,330,090	(6,145)	1,323,945
Operating & Maintenance Expense	569,028	6,931 (b)	575,959
Amortization Expense	420	-	420
Property & Other Taxes	165,945	-	165,945
Depreciation	88,573	-	88,573
Total Utility Operating Expenses	823,966	6,931	830,897
Utility Operating Income	506,124	(13,076)	493,048
Income Taxes (Sch. III)	80,187	(5,928)	74,259
Earned Return	$ 425,937	$(7,148)	$ 418,789
Rate Base (Sch. I)	$2,955,840	$ 14,298	$2,970,138
Rate of Return on Rate Base	14.41%		14.1%

VANCOUVER ISLAND GAS COMPANY LTD.

Notes to Schedule II

(a) Net adjustment as a result of Decision.

(b) Adjustment to reflect the recovery of Rate Administration costs over 3 years, per Decision page 4.

SCHEDULE III

VANCOUVER ISLAND GAS COMPANY LTD.

Income Tax

1983 Forecast

	Per Application Exhibits 3, 5 & 6	Commission Adjustments		Final Adjusted Balance
Utility Income (Sch. II)	$ 506,124	$(13,076)		$493,048
Less: Interest	(227,304)	1,871	(a)	(225,433)
	278,820	(11,205)		267,615
Add:				
- Depreciation	88,573	-		88,573
- Amortization of Organization Costs	420	-		420
- Amortization of Rate Hearing Costs	23,889	-		23,889
	112,882	-		112,882
Deduct:				
- Capital Cost Allowance	213,131	-		213,131
- Inventory Allowance - 3%	3,100	-		3,100
- Rate Hearing Costs	23,889	-		23,889
	240,120	-		240,120
Taxable Income (Loss)	151,582	(11,205)		140,377
Income Tax Expense (52.9%)	$ 80,187	$(5,928)		$ 74,259

Note:

(a) Interest Expense:

$2,970,138 (rate base) x 7.59% (cost of debt component)

= $225,433

SCHEDULE IV

VANCOUVER ISLAND GAS COMPANY LTD.

Return on Capital

1983 Forecast

Per Application, Exhibits 3 and 5

	Percentage	Cost Rate	Product
Debt	58	13.25%	7.69
Common Equity	42	16.0%	6.72
Total	100%		14.41

Final Adjusted Balance

	Percentage	Cost Rate	Product
Debt	58	13.09%	7.59
Common Equity	42	15.5%	6.51
Total	100%		14.10

VANCOUVER ISLAND GAS COMPANY LTD.

Operating Maintenance and Administrative Expenses

	1981 Actual	1982 Actual	1983 Forecast	Increase 1981-1982		Increase 1982-1983	
				$	%	$	%
Exhibit 4, Tab 9, Page 2.1 Total Operating Expenses	$166,345	$209,405	$194,295	$ 43,060	26%	$-15,110	- 7%
Cost per Customer	$ 150.81	$ 185.15	$ 166.92	$ 34.34	23%	$ -18.23	-10%
Exhibit 4, Tab 9, Page 4.1 Total Maintenance Expenses	$ 68,229	$ 71,307	$ 76,090	$ 3,078	5%	$ 4,783	7%
Cost per Customer	$ 61.86	$ 63.05	$ 65.37	$ 1.19	2%	$ 2.32	4%
Exhibit 4, Tab 9, Page 6.1 Total Administrative Expenses	$311,322	$285,512	$298,643	$-25,810	- 8%	$ 13,131	5%
Cost per Customer	$ 282.25	$ 252.44	$ 256.57	$ -29.81	-11%	$ 4.13	2%
Total Expenses	$545,896	$566,224	$569,028	$ 20,328	4%	$ 2,804	0%
Cost per Customer	$ 494.92	$ 500.64	$ 488.86	$ 5.72	1%	$ -11.78	- 2%