1.0 BACKGROUND

The City of Fort St. John, with a population of approximately 12,900 is located in northeastern British Columbia. The economic base of the community is dependent primarily on a combination of oil and gas, forest products and agriculture. Centra Gas British Columbia Inc. - Fort St. John District ("Centra-FSJ", "the Company", "the Applicant") provides natural gas service to the City of Fort St. John, the District of Taylor, the community of Charlie Lake and an extensive rural service area surrounding Fort St. John which is approximately 2,500 square miles (T. 589). The rural distribution system was expanded significantly in the last few years with the assistance of government financing under the provincial Power and Gas Extension Program ("PGEP").

Natural gas service to this area commenced in 1953 and was provided on a divisional basis by Plains-Western Gas and Electric Co. Ltd. In 1978, Plains-Western Gas and Electric Co. Ltd. was acquired by Inter-City Gas Corporation of Winnipeg, Manitoba.

In 1984 ICG Utilities (British Columbia) Ltd. ["ICG (B.C.)"] which was providing piped propane service to Port Alice, located on northern Vancouver Island, acquired the British Columbia utility assets of ICG Utilities (Plains-Western) Ltd. pursuant to Commission Order No. G-2-84 dated January 9, 1984 which provided natural gas service to Fort St. John and its environs.

Pursuant to Commission Order No. G-84-86, dated December 15, 1986, ICG (B.C.) acquired the assets of the Vancouver Island Gas Company Ltd. ("Vigas"), a related gas distribution company, which distributed piped propane gas in Nanaimo, British Columbia.

Pursuant to Commission Order No. C-3-87 dated November 23, 1987, ICG (B.C.) acquired the propane gas distribution system owned by ICG Liquid Gas Ltd., within the Resort Municipality of Whistler. Concurrently with this Order No. C-3-87, ICG (B.C.) received a Certificate of Public Convenience and Necessity ("CPCN") to provide gas service by underground distribution to commercial and residential customers within the boundaries of the Resort Municipality of Whistler. This system supplies propane since natural gas is not currently available in this area of British Columbia.

In February of 1989, Inter-City Gas Corporation's wholly-owned subsidiary, Vigas, purchased the Victoria Gas Company Limited from the British Columbia Hydro and Power Authority and in addition acquired the franchise rights to distribute gas in the area north of the Malahat on Vancouver Island and the Mainland adjacent thereto (Sunshine Coast and Powell River). The Victoria Gas Company (1988) Limited service area is set forth as those areas of lands in the Capital

Regional District other than those lands in the Outer Gulf Islands Electoral Area, the Saltspring Island Electoral Area and the Sooke Electoral Area. Vigas' service area included the following municipalities and their environs: Campbell River, Chemainus, Comox, Courtenay, Crofton, Cumberland, Duncan/Cowichan, Gibsons, Ladysmith, Laslo/Little River, Parksville, Port Alberni, Powell River, Qualicum Beach, Royston and Sechelt. ICG (B.C.) would continue to provide service to Nanaimo except that it would now be natural gas service. With regard to ICG (B.C.) and Vigas, the service area specifically excluded any existing pulp and paper mills on Vancouver Island and the coastal Mainland. As a requirement of obtaining the franchise rights to provide natural gas service to Vancouver Island and the Sunshine Coast, the Province entered into Rate Stabilization Agreements with Victoria Gas Company (1988) Limited and Vigas for their service areas and ICG (B.C.) for the Nanaimo service area. These are commonly referred to as the RSA areas.

In April of 1990, Westcoast Energy Inc. ("Westcoast") acquired ICG Canada Inc. which included ICG (B.C.), the Victoria Gas Company (1988) Limited and Vigas. In November of 1990, ICG (B.C.) became Centra Gas British Columbia Inc. ["Centra Gas (B.C.)"]; Vancouver Island Gas Company Ltd. became Centra Gas Vancouver Island Inc.; and Victoria Gas Company (1988) Limited became Centra Gas Victoria Inc. The latter two companies are wholly-owned subsidiaries of Centra Gas (B.C.) (Exhibit 25). Westcoast is also the controlling shareholder of Pacific Northern Gas Ltd. which transmits and distributes natural gas in northwestern British Columbia. Generally speaking, this group of companies provide "mainline" transmission service in British Columbia and distributes natural gas on Vancouver Island and coastal British Columbia with the exception of the Lower Fraser Valley and Squamish.

With regard to Fort St. John, this Division last appeared before the Commission at a public hearing held in Fort St. John, British Columbia on March 26-28, 1985 at which time it was a "Ltd." company providing service in Fort St. John and Port Alice. The Decision on that proceeding was made pursuant to Commission Order No. G-42-85 dated May 8, 1985. That Decision, as well as the 1985 Application, was referred to repeatedly during the course of this hearing, emphasising the importance of prior instructions, Orders, and Reasons for Decision contained in those documents. This Decision contains a number of quotations from the 1985 Decision because of their importance.

Since 1985 several rate adjustments have taken place, and these are listed as follows:

	Reason for Change
August 1, 1985	Final Decision on General Rate Application incorporated a cost of gas increase not included in the General Rate Application. Commission Orders No. G-42-85, G-45-85, G-61-85 and G-68-85
December 1, 1985	Conversion from imperial to metric measurement. Commission Order No. G-92-85
January 1, 1986	Interim increase of 3.8 percent, final Decision granted interim rates as permanent. Commission Orders No. G-101-85 and G-29-86
November 1, 1986	Introduction of a two-tier gas supply based on load factor for Small General Service ("SGS"), Large General Service ("LGS") and Small Industrial Service ("SIS") which decreased cost of gas PLUS Westcoast/National Energy Board ("NEB") hearing cost recovery. Commission Order No. G-65-86
December 1, 1988 January 1, 1989	New contracts with Canadian Forest Products Ltd. ("CanFor") and Balfour Forest Products Inc. ("Balfour") resulting in lost margin deferral account established to capture loss. Commission Orders No. G-103-88 and G-110-88
May 1, 1989	Permanent increase in rates as result of lost margin re: Balfour and CanFor. Commission Order No. G-19-89
July 1, 1989	New customer - Westcoast Stoddart Compressor.
November1, 1989	Increased cost of gas for SGS/LGS customers PLUS removal of Westcoast/NEB hearing cost recovery. Commission Order No. G-59-89
November1, 1990	Increased cost of gas for SIS customers; does not affect those with negotiated rates. Commission Order No. G-85-90

The Company had received approval by Commission Orders No. G-103-88, G-110-88 and G-19-89 to recover the lost revenue of $137,647 due to lower negotiated rates for CanFor and Balfour by the addition of a $0.05/GJ rider to the rates of residential and commercial customers effective May 1, 1989. By Centra-FSJ's calculation, the recovery would have been completed by the end of January, 1991 but the rider was not removed and the October 31, 1991 Application showed that an over-collection of $38,470 had occurred. Rather than refunding the amount, the Company requested that the over-collection be applied against the Scurry Rainbow Oil Limited ("Scurry Rainbow") lost margin which was an unrelated account. This request was denied by Order No. G-112-91 and the money returned to the customers who had been billed improperly.

2.0 THE APPLICATION

Centra-FSJ applied October 31, 1991, pursuant to Section 67(4) of the Utilities Commission Act ("the Act"), for approval to pass-through certain cost changes effective November 1, 1991. The changes in cost which the Applicant sought to adjust were as follows:

- a decrease in the cost of gas of $208,000 ($0.078/GJ) for residential/commercial customers and $0.132/GJ for industrial customers.
- a general decrease in industrial sales volumes and related margin and certain increases in Operating, Maintenance and General ("O&M") expenses inclusive of municipal taxes totalling $408,038 ($0.174/GJ).
- a deficiency rider to recover the pro-rated lost margin of $70,080 due to Scurry Rainbow no longer being on the system from the expiration date of its contract on April 16, 1991 to the end of October, 1991.

The net impact of the Application was to propose an increase in rates to residential and commercial customers of $0.096/GJ, and industrial customers of $0.042/GJ. In addition, the Applicant proposed a net deficiency rider of $0.013/GJ to all customers for the loss of Scurry Rainbow. In calculating the net deficiency rider, the Company requested that its over-collection of approximately $38,000 on the CanFor and Balfour rider be offset against the Scurry Rainbow lost margin.

Commission Staff review of the Application determined that there was a request for a double-recovery of the lost margin on Scurry Rainbow through an adjustment to reflect a decrease in industrial sales as well as the deficiency rider. The Applicant, on being advised, reduced the cost increase it was seeking to recover, exclusive of the cost of gas, from approximately $0.174/GJ to $0.14/GJ with a minimal adjustment to the industrial cost of gas. As a consequence of the above, by letter dated November 5, 1991 the Applicant sought reduced relief of approximately 18 percent and requested an adjusted net increase in residential and commercial rates of $0.062/GJ and industrial rates of $0.007/GJ. The request with regard to the net deficiency rider remained unchanged.

The pass-through of costs requested was denied pursuant to Commission Order No. G-112-91 dated November 15, 1991, and Centra-FSJ was directed to file a 1992 General Revenue Requirements Application by December 10, 1991 and provide a detailed review of intercompany charges. In that Order the Commission approved a cost of gas decrease of $0.078/GJ for the residential and commercial customers and $0.133/GJ for industrial customers effective November 1, 1991. The Company was directed to maintain the deferral account for the loss of margin from Scurry Rainbow, but to refund the over-collection of the CanFor/Balfour rider (estimated to be $62,057) including interest by January 1992. This money was refunded to customers from whom it was improperly collected.

The above-mentioned Application was received on December 16, 1991 and sought interim and permanent relief, the interim relief to be effective January 1, 1992 subject to refund with interest, if required, after a public hearing. The Applicant sought an increase in revenue of approximately 11.1 percent ($0.34/GJ). The Applicant attributed the projected revenue shortfall of $830,000 to the following factors:

- increased earned return requirements and depreciation expense resulting from increased plant additions since 1985.
- increased municipal taxes on the plant additions.
- increased O&M expenses resulting from additions to personnel and salary and wage levels since 1985.
- the loss of margin in 1991 from Scurry Rainbow leaving the system.
- the change from a straight 30-year to a weighted 30-year (5 and 25 year) degree day average for weather normalization.

After reviewing the Application, Commission Order No. G-119-91 dated December 20, 1991 denied the request for an interim increase and ordered a public hearing to commence in Fort St. John, British Columbia on February 17, 1992 subject to the pre-filing of the intercompany charges study by Centra-FSJ. The interim increase in large measure was denied due to the continued "fluidity" of the Applicant's estimates. In Commission Order No. G-112-91 the directions for the refunds and cost of gas decrease were to be followed and a reconciliation of the refunds was required before January 31, 1992. Following a review of the over-collection calculation by the Commission it was determined that interest was incorrectly being deducted from the refund balance for the months of March through to December, 1991. Centra-FSJ concurred and revised the calculation on January 29, 1992 to a total of $94,898 (originally calculated by the Applicant to be $62,057) including interest as of December 31, 1991. The refund for the cost of gas decrease and the over-collection was included in the March, 1992 customer bills.

Centra-FSJ applied on January 7, 1992 under Section 114 of the Act for reconsideration and variation to Commission Order No. G-119-91 and requested:

- a delay in the public hearing until the latter half of April, 1992.

- an extension of time in which to file supplementary information from January 20 to March 2, 1992.
- Commission approval for an interim rate increase effective February 1, 1992.

The Commission reviewed the Application and the filings made and, on the basis of the material filed and the delay proposed by the Applicant, determined that approval of an interim, refundable increase of 11.1 percent effective February 1, 1992 was appropriate. Commission Order No. G-8-92 approved the request and set a public hearing for May 25, 1992 with direct and supplementary evidence to be provided by March 2, 1992. The Company was to inform the customers of the interim increase by way of a Customer Notice and an Information Notice in the local newspapers of the service area. Commission Order No. G-34-92 dated April 13, 1992, confirmed the location for the hearing and established the deadlines for filings by intervenors and interested parties. Mr. Brent Rogers representing the United Brotherhood of Carpenters and Joiners, Local 1237, made a presentation and cross-examined the Company.

CanFor, an industrial customer of the Applicant, retained counsel and intervened on May 5, 1992 but withdrew its intervention when the Applicant agreed that its rate had been adjusted in error. A similar error occurred with Balfour and this was also corrected. Exhibit 12 which was filed at the beginning of the hearing indicated that the rates for CanFor and Balfour had been incorrectly increased by 2.1 percent and 2.6 percent respectively.

Centra-FSJ, as directed, on March 2, 1992 filed the Direct Testimony of Company Witnesses ("Testimony"), the Common Services Allocation Study ("Allocation Study") and the Plant Additions Study. These filings amended the Application dated December 16, 1991 with the result that the relief sought was reduced by approximately 37 percent. No adjustment was made to the outstanding 11.1 percent interim approved on January 8, 1992 by Commission Order No. G-8-92 due to the proximity of the hearing.

At the commencement of the hearing on May 25, 1992 the Application was further amended by increasing the revenue deficiency by 34 percent. These adjustments effectively increased the revenue deficiency to approximately 85 percent of that claimed on December 16, 1991 albeit the cost composition was significantly different. This upward adjustment was primarily the result of the Applicant changing its cost of capital calculation. Additional amendments took place during the hearing. At the conclusion of the hearing, the Applicant provided exhibits setting forth what it was finally seeking (Exhibit 12A). A summary of the December 16, 1991 Application and the revisions on March 2, 1992, May 25, 1992 and May 28, 1992 are shown in Appendix A.

The Applicant's final position sought an increase of 9.7 percent which if granted in full would result in a refund of the original interim applied for by the Company and granted by the Commission. The interim relief sought and granted was 11.1 percent.

During the course of this hearing, the Commission specifically related its concerns over the many significant changes that had occurred from the original Application and generally its concern over the quality of the Application in total. When many ad hoc revisions must be made to an Application when it is in the hearing stage, this tends to discredit the integrity of the Application as a whole.

The Applicant's chief policy witness in his closing statement said:

> ". . . On behalf of the company I'd like to thank you for your assistance and understanding with reviewing our hearing. When we come to visit you again we certainly will provide evidence which makes our hearing smoother than this one has been. . ." (T. 627-628)

The Commission would encourage the Applicant to achieve its objective.

3.0 ISSUES

3.1 Rate Base

The Applicant's rate base has grown significantly, from approximately $7.1 million at December 31, 1985 to an estimated $11.4 million at December 31, 1991. In recent years major capital expenditures of $2.1 million in 1986 and $1.1 million in 1990 have been made under the PGEP program wherein financial assistance of $1.2 million and $670,000 has been provided by the Provincial Government for those respective years in order that natural gas can be made available in rural areas. These expenditures represent approximately three-quarters of the rate base growth.

Centra-FSJ stated that due to time constraints 16.1 kilometres of 2-inch aluminum transmission pipe was used to provide service in the North Pine area and 12.5 kilometres of 1.25-inch aluminum transmission pipe was installed for the Cecil Lake system as part of 1986 PGEP program (Exhibit 6, Tab 4, pages 4 and 5). Currently, significant problems are being experienced with this pipe due, amongst other matters, to the close proximity of high voltage electrical lines. Initiatives will be required to correct this problem or premature replacement may be required. The Application estimated the direct cost of replacement at $912,000 (T. 578).

The Applicant is directed to report annually to the Commission, in conjunction with its Annual Report, on the status of these facilities until such time as the problem is resolved or the facilities replaced. The incremental cost incurred with regard to these facilities should be recorded in a separate plant sub-account in order that the appropriate disposition can be made by further Order of the Commission.

3.1.1 Plant Additions

Prior to considering the forecast plant additions for 1992, two additional matters must be considered from prior years: the cost overruns incurred on the new office building; and the apparent disregard of the minimum rule with regard to capitalization of repairs and replacements in favour of what the Applicant described as its "program" approach.

New Office Building

The Commission stated on page 4, of the May 8, 1985 Decision as follows:

> "With regard to the proposed new office building, the site for which the Commission viewed with the Applicant and intervenors, the Commission believes that the benefits to the employees of the Company and purported efficiency to be gained by the Applicant, are not commensurate with the burden which is to be borne by the ratepayers at this time. Accordingly, the Commission has adjusted the rate base downward to reflect the removal of this proposed capital addition exclusive of the property already purchased, and the furniture and fixtures associated therewith have been deleted. The Commission is prepared, however, to approve early construction of this project if the Applicant can find sufficient savings in the estimated costs, or wishes to absorb any additional costs at this time. If this proves impossible, the Applicant can elect early construction but the resulting new assets must be kept out of the rate base until such time as the Commission deems it appropriate to include them."

As a result of the above, the Company reviewed its plans and sought the approval of the Commission to construct the building, inclusive of furniture, for approximately $200,000. The original estimated cost was approximately $276,000, as opposed to the Company's revised Application (of approximately $200,000) which was approved pursuant to Commission Order No. G-61-85. No amendment or revision to that Order has been sought by the Applicant. The issue at this time is the appropriate treatment of the cost overrun which has occurred ($70,876).

The matter of costs exceeding those which have been approved was addressed by the Commission in the 1987 Inland Natural Gas Co. Ltd. Decision (Chase-Sorrento). In that Decision, the Commission considered the matter of cost overruns in relationship to a CPCN. The Commission was of the view that the Applicant should seek revision to the CPCN, if appropriate. The Commission determined that a 20 percent overrun was reasonable and accordingly disallowed the balance. The Commission continues to believe this is an appropriate principle; however, in the circumstances of this proceeding, bearing in mind the materiality of the figures involved, the entire amount is allowed in the rate base.

Minimum Capitalization

The second issue which relates to prior years requires consideration of the "minimum" rule with regard to the capitalization of repairs or replacements as set forth in the Uniform System of

Accounts for Gas Utilities in British Columbia. This rule, which has been in place since December, 1961, states as follows:

> "The Minimum rule is intended for accounting convenience to provide a dollar limit on the charging of costs of minor items of plant to the plant accounts. When costs of items are less than $500, or such other amount as the Commission may approve, such costs shall be charged to the expense account."

The Company's policy and procedures regarding capitalization was included in the response to a Commission Staff Information Request and stated as follows:

> ". . . Costs incurred in acquiring or constructing the addition or replacement of an item which will be included in the following plant categories, shall be capitalized if the cost of the item exceeds $500. . ." (Exhibit 9, Tab 2, Question 2.13)

When the Applicant was asked if the $500 minimum was invariably followed, Mr. Olsen stated that it would be difficult to pick up a $500 pay item and normally the items range from $1,000 and beyond. The Applicant also confirmed that the costs of one or two items are lumped together (T. 71).

Without considering the current appropriateness of the $500, the Applicant in this proceeding adopted, as described by the Applicant, the "program" approach. The Applicant described this as follows (T. 70):

> "MR. HAINES: A: We have a capitalization policy that we apply and in the event that it becomes a capital item we record them as systems betterment type work.
>
> MR. OLSEN: A: If I might speak for the field, when we came across an item such as this we'll identify it with a special account number, which will collect those costs of doing that specific -- for instance, if we discover that we have a valve that's leaking, it's a dresser end valve, then rather than try and repair it because it's outdated and maybe not required, we will just take a special number, which will accumulate those costs go in and eliminate the valve and capitalize that particular section because the main has been upgraded."

Accordingly and consistent with this interpretation, the Applicant considered individual meter moves as part of the larger programs and hence even though the costs of the individual move fell under the minimum rule, the Applicant, under the program, accumulated the costs and capitalized these items (T. 147-149).

In the Plant Additions Study, Exhibit 7, meter relocations from the inside to the outside of customers' premises occurred in 1985 at a cost of $87,054 and in 1986 at a cost of $57,719. The Applicant stated that 1986 was the end of a five-year system betterment program with the cost per meter moved averaging $283 in 1986 (T. 145-147).

The Commission believes in these circumstances that the minimum rule was appropriate and these items should have been expensed as opposed to capitalized. In such circumstances where an Applicant believes the minimum rule is inappropriate, the appropriate modification should be requested from the Commission as is contemplated in the rule itself. However the Commission recognizes that the "program" approach has been applied for a number of years by this Company and possibly by other utilities under the Commission's jurisdiction. Rather than making an adjustment at this time, this matter should be reviewed by the Commission on a generic basis with all the utilities.

<u>1992 Rate Base Additions</u>

The Applicant in this proceeding prepared a five year forecast which estimated capital expenditures of approximately $900,000 in 1993 declining to approximately $650,000 in 1994. The $900,000 is composed of approximately $157,000 for new business, $640,000 for system betterment, and $103,000 for general plant. Throughout the five-year forecast, both the anticipated expenditures for new business and the expenditure for new plant increase generally at the rate of inflation assumed by the Applicant (2.8 percent in 1993 and 3.5 percent thereafter). With regard to system betterment this expenditure decreases from the anticipated $640,000 in 1993 to a low of approximately $291,000 in 1995. Over the five years system betterment averages $418,500 per year (Exhibit 9, Tab 4, Question 4.1, page 2).

The total plant additions for 1992 included in the Application are approximately $942,000 with a major portion of the capital program ($403,000) directed to "Station Upgrades and Modifications". The Applicant in its direct evidence described these as follows:

> "a) <u>Town Border and Station 1A</u>
>
> The existing Town Border Station has passive monitor regulators, no pressure relief, no liquid separation, no filter and no line heater. For safety and security of supply it is necessary that the station be upgraded as this station supplies the majority of gas to the community.

The existing Station 1A has no line heater and a large pressure reduction. Frost heaving is severe consequently piping and equipment misalignment are oncoming problems. Coupled with work at the Town Border Station, the pressure reduction at Station 1A will be halved with minor station modifications.

b) Taylor Purchase Station

A new instrument will be purchased to affix to the purchase meter to provide a signal to the odourization equipment to ensure effective odourant levels are introduced to the main supply to Taylor and Fort St. John. This modification is necessary now to ensure effective odourant levels exist in the supply gas. The existing station will be fenced and made secure. Minor site improvements are included.

c) Station Alarms

Elementary alarm systems are present at only one site. It will have to be upgraded to adapt to the proposed new Communications Centre planned for Victoria.

It is proposed that station alarms be extended to include a total of six to eight sites. These alarms will feed into the overall provincial communications/emergency network based in Victoria.

d) Baldonnel

Odourization is an important safety issue for the public and the company, consequently $10,000 has been placed in the 1992 budget to provide effective odourization for this area.

e) Petro Canada Station

Two nearby farm taps (Alcan & Ross) will be consolidated into the Petro Canada Station thus eliminating operation and maintenance costs associated with these two farm taps.

Installation of a Metrotech instrument on the meter will allow remote reading of the daily volumes and permit a review of daily allocations without visiting the site.

A considerable savings in operation expenses will be achieved by this expenditure by eliminating daily visits by a Meter Reader."

(Exhibit 6, Tab 3, pages 5 and 6)

In addition, the Applicant forecasts an expenditure of approximately $234,000 for general plant of which the acquisition of additional property adjacent to the Centra-FSJ office ($60,000) and the purchase of additional vehicles ($82,300) represent approximately 60 percent (Exhibit 7, Tab 9, pages 2-4).

The Commission has considered the proposed expenditures inclusive of items of distribution plant not discussed above and concurs that the expenditures are prudent. The Commission in reaching this conclusion recognizes that even though the additional land is not urgently required at this time, it is adjacent to the existing property and should be acquired when it is available.

3.1.2 Customer Service System

Since the early 1980's, Centra-FSJ has been using a computerized, customer service system ("CSS") originating with Centra Gas Manitoba Inc. Prior to 1984, the customers in Fort St. John, Port Alice and Nanaimo were billed on a manual system from Leduc, Alberta (T. 81).

During 1983-84 (T. 79), Inter-City Gas Corporation decided that it should develop a then, "State of the Art" computerized customer billing system. The thinking at that time was that a central system, resident on a large mainframe computer, was the correct approach. This system would be custom designed and it would serve all of the Inter-City companies from Quebec to British Columbia and the state of Minnesota, in the United States of America.

From 1985-1990 (Exhibit 22) the Fort St. John office received two 'dumb' terminals and two first-generation personal computers, a printer and some telecommunications equipment in order to access the billing system being run in Manitoba. There was also some limited ability with the equipment to create and use spreadsheets. In 1990 the decision was made to change from 'dumb' terminals, only accessing the mainframe, to intelligent workstations - personal computers which allowed communication between all similar workstations within an office and between other offices.

In 1991 a new Information Technology strategy was completed at a cost $1,200,000. This cost is recorded as general plant in the Victoria Head Office and raised the 1991 year end Head Office investment in computer equipment and systems to $1,357,000. A further investment of $234,000 in this system is expected in 1992 (Exhibit 1, page 5.6.1). The Fort St. John office acquired seven personal computer workstations, a laser printer and communication equipment to connect it with Victoria. With the added intelligence of the local work stations, Centra-FSJ has access to a number of extensive systems that were developed by the corporate data processing groups. Centra-FSJ can perform "spreadsheet" printouts, word processing, and access Head Office financial systems with their direct accounting and budgeting function. Centra-FSJ can also access the Mains and Services Tracking System which reports the progress of new service installations from the initial application up until the actual flowing of gas to the customer, and the Contractor Charges Reporting System which captures and reports on all of the costs involved with independent contractor usage. The Vehicle Costing System, Shared Files and Electronic Mail functions were also made available to the Fort St. John office.

For access to these applications, Centra-FSJ proposed a shared cost allocation of $108,610 (T. 124) in capital and an annual operating fee of $42,848 which includes an annual charge of $15,798 for the dedicated line and all telecommunication charges (Exhibit 10, Tab 1, Question 1.1, page 5, Cost Centre 0260).

The Applicant testified that Centra-FSJ will continue to receive access to the existing systems and in addition will receive access to even newer data processing programs and systems now being developed by Centra's Head Office group. For example, a Geographic and Facilities Information System is being implemented in the RSA areas that will be available to Centra-FSJ in the 1993-94 time period. The Inventory Control system now being used in the RSA, will be applied to Centra-FSJ in 1993. Updating and system enhancements are forecast in the human resources system, the Electronic Mail, Groupware and other office automation tools.

In 1983-84 Centra-FSJ had approximately 6,100 customers. By 1985 there were 6,211 (Exhibit 9, Tab 2, Question 2.1) and now there are approximately 7,000 customers. The number of employees has increased from 12 in 1985 to 16 in 1992 (Exhibit 6, Tab 4, page 2 and Tab 3, pages 2-3). The current computer system was developed almost ten years ago and as the witnesses noted, the Manitoba company is reviewing its use of the mainframe used by the CSS (T. 84).

Centra-FSJ currently utilizes what appears to be a very convoluted process to produce its customers bills. The meters are read in Fort St. John, the readings are couriered to Nanaimo (T. 102) where the data is entered and transmitted electronically to Winnipeg, processed there and then transmitted again, this time to Leduc, Alberta where the customer statements are printed and mailed out (T. 93). This process is brought about by the utilization of the Winnipeg mainframe and the Leduc specialized printer. In its review of the CSS, the Commission expects the B company to greatly reduce the movement of data and more importantly reduce the cost of the system in total by simplifying all aspects of the process. The Applicant stated that 60 percent of its accounts are paid at the Applicant's office in Fort St. John.

In its 1985 Decision, the Commission was concerned with the anticipated costs of the computer systems for the Fort St. John company. The anticipated cost as presented in the 1985 Application was to have been $221,000 but in its Decision (page 6), the Commission restricted the Company to a total cost for development of computer operating systems not to exceed $200,000. In Exhibit 21, the Company presented evidence that the CSS costs have increased from $222,600 in 1984 to $400,437 at December 31, 1992. No approval was sought or received from the Commission for the increase. The CSS is the major portion of the total computer investment of $476,340 at Centra-FSJ with the other items representing local computer hardware and software. The Applicant submitted Exhibit 12A, Page 5.4.3R which showed that the depreciation expense of $75,721 charged for 1992 was comprised of software depreciation ($194,713 x 14.3% = $27,844) and computer hardware depreciation (($476,340 - $194,713) x 17% = $47,877). By the end of 1992, the accumulated depreciation on computer hardware and software will be $431,295.

The Commission is still concerned with the total cost of this system as well as the amounts being charged to the customers of this relatively small and mature utility especially since the efficiency, usefulness and the future life of the system was brought into question during the hearing. Rather than disallowing the prior expense overruns, the Commission orders that all depreciation charges associated with the CSS, should be suspended at this time while the Company assesses its course of action on this system. Once the Company reaches a decision and advises the Commission on its proposed action, then at that time the Commission will order the appropriate action to be taken by the Company on the depreciation amount to be charged.

In the future, if Centra Gas (B.C.) finalizes its plans to replace its participation in the Winnipeg mainframe and the Leduc printing operations, the Company is instructed to advise the Commission of its plans before starting on any phases of implementation. While the Commission does not want to be included in the selection process, it is concerned about the total costs and the allocation of charges to the Fort St. John customers and looks forward to the Company's ability to minimize those costs in the future.

3.1.3 Capitalized Overhead

A detailed discussion of this topic can be found in Section 3.2(c).

3.1.4 Allocated Net Mid-Year Plant - Regional

A detailed discussion of this topic can be found in Section 3.2(b).

3.1.5 Working Capital

The working capital is comprised of cash working capital, O&M inventory, and deferred balances. The cash working capital is derived from a lead/lag calculation while the O&M inventory is based on the 1991 average monthly inventory balances plus inflation for 1992. The Commission accepts the amounts shown for these two categories.

In the Application, the deferred charges were comprised of a cost of gas decrease from November 1, 1991, the lost margin on Scurry Rainbow and the projected hearing costs. The cost of gas decrease was refunded to the customers on their March, 1992 bills in accordance with Commission Order No. G-112-91.

(a) Scurry Rainbow

The Company requested, on May 24, 1991, a deferral account for the recovery of the lost margin from Scurry Rainbow leaving the system at the end of its 10-year contract on April 16, 1991 (Exhibit 19). The customer had been on a take-or-pay contract which provided a gross margin of approximately $300,000 to the Company (Exhibit 1, page 8.3.1). The Commission granted approval in principle, by letter dated June 28, 1991, up to a maximum of $300,000 with the determination of the appropriate amount and its disposition to occur by a future Order and direction of the Commission (Exhibit 20). The Company witness testified that the take-or-pay contract guaranteed a gross margin of about $300,000 regardless of the volume sold (T. 175).

The amount of the lost margin requested was reduced by the Applicant in the October and December 1991 Applications to recognize that the loss of the customer also results in the reduction of related expenses. The incremental expenses of $173,000 resulted in a lost net margin of $129,187. The Company further reduced the claim in the December Application by pro-rating the annual lost net margin from April 17 to December 31, 1991. (The October Application requested a net deficiency rider as discussed in Section 2.0 of this Decision.) The amount requested in the December Application was $94,516, including interest. This amount was set up as a rate base item to be amortized over a two-year period although Centra-FSJ would not object to a longer period (T. 479-482). The Company considers that interest is an appropriate component of the deferral amount to recognize the delay in receiving the loss recovery even though it did not explicitly seek this in the initial Application (T. 171-173).

The amount of the incremental expenses was questioned because the contract was originally negotiated on a cost-recovery basis using expenses of $200,400 (Exhibit 9, Tab 2, Question 2.16, page 1). This Application removed O&M costs since they were considered to be fixed in the short-term (T. 176-179). The municipal taxes were also reduced to remove the portion that was dependent on revenue (T. 179-181).

The Commission considers that the incremental expenses should be $200,400 to recognize the costs that were being recovered in the sales rate which results in an allowed annual lost net margin of $101,787 ($302,187 - $200,400). A pro-rating of the annual lost net margin is appropriate and reduces the allowed amount to $72,230 which should be recovered as a rate base item over a period of three years. By including the net lost margin in rate base, the 1991 accrued interest is inappropriate and has been removed.

(b) Regulatory Expenses

The Applicant has made a provision for regulatory expenses of $120,000 to be amortized over a two year period commencing in 1992. Subsequent to the filing of the Application on October 31, 1991 the Applicant was directed, pursuant to Commission Order No. G-112-91, to undertake an Allocation Study. The cost of Ernst & Young Utility Consulting Group ("Ernst & Young") preparing the Allocation Study, responding to data requests and Mr. Tibbetts appearing to answer questions about the Allocation Study is estimated to cost $65,000 to $70,000 (T. 425-426). These costs were estimated to be 10 percent higher that they would have been if more time had been available (T. 427) to prepare the study. The Commission notes that the 1985 Decision (page 10) directed the Applicant to undertake such a study. The Applicant stated that these costs have been allocated between the districts with Centra-FSJ receiving one-third thereof (T. 265).

The Applicant, by letter dated July 3, 1992, advised that the actual hearing cost incurred was $128,422 and provided the following detailed support:

	Actual $
Material costs including binders, tabs and assembly	$700
Travel, accommodation and meals (7 people)	9,234
Consultant Fees:	
Ernst & Young	42,862
Energy Industry Consulting	12,854
Foster & Associates	8,013
Consultants	5,623
Legal Fees:	
Bull, Housser & Tupper	42,729
Miscellaneous:	
Work room at Pioneer Inn	521
Witness Training	354
"Notice of Public Hearing" design and placement	3,697
Transcripts	1,715
Total Centra-FSJ	$128,302

On July 7, 1992 the Commission requested additional information and the answers were received on July 8 and are attached as Appendix B.

The Commission for its part incurred costs of approximately $30,000 of which approximately $25,000 was incurred for legal counsel and court reporters. The remaining amount of $5,000 represents staff travel, accommodation and the rental of hearing facilities.

With regard specifically to the consultant, Ernst & Young, and putting aside the need for the incurrence of consulting charges from Energy Industry Consulting, W. Gajda, R. Krieger and J.S. Computers, the Commission notes that rather than using the one-third allocation to Centra-FSJ, the Applicant in Appendix B adopted a different methodology which allocated $32,171 to Centra-FSJ for one-half the study costs and 100 percent of the cost of responding to information requests and appearing at the hearing ($10,691).

With regard to legal fees incurred inclusive of expenses of approximately $43,000, the Commission is concerned not only with the magnitude but also with the justification therefor. The

Commission appreciates that differences do occur between counsel and as dictated to some extent by the different responsibilities (eg. Applicant Counsel, etc.). However, in these circumstances the Commission believes considerably more information is required before a determination can be made that these expenses are, in fact, just and reasonable costs to be incurred.

Similar concerns arise with regard to other costs incurred as shown in Appendix B.

The matter of prudency in this instance is further complicated when consideration is given to the results sought as opposed to those achieved.

The Commission believes significant additional information is required and accordingly is removing the regulatory expenses and amortization thereof from the rate base and cost of service portions inclusive of income tax. However, to ensure fairness exists the entire amount inclusive of the Commission costs will be placed in a deferred account which will attract a carrying cost equal to the weighted cost of capital until a final determination and the appropriate disposition of the amount inclusive of the carrying cost is made. It is the Commission's objective to have this outstanding matter resolved as soon as possible.

3.2 Allocation of Shared Expenses, Plant and Capitalized Overhead

(a) <u>Allocation of Shared Expenses</u>

The customers in the Fort St. John district receive services that are provided by the local office and various other offices in Alberta, Manitoba and recently from British Columbia. Centra-FSJ is charged for the services provided by the other offices and by an allocation of shared costs. Questions surrounding these allocations centre on whether the services are necessary, are provided in a cost effective manner, and, if benefits to the district can be clearly shown.

In the 1985 Rate Application, the utility expected that the actual allocation of shared costs to Fort St. John and Port Alice in 1984 would be $596,300 to serve approximately 6,400 customers and projected a 1985 cost of $581,100. The Applicant was unable to support the increases in allocated shared costs and, as a result, the 1985 Decision reduced the provision for allocated shared costs to $495,400 which was the level approved in the 1984 Decision. Page 10 of the 1985 Decision, contained the following direction regarding shared costs:

> "In addition to the reduction in shared cost allocations the Commission, for the next rate application, will require specific evidence, as distinct from unsupported testimony, that the projected intercompany charges are reasonable and justified, without which further adjustments may be required."

In his opening statement, Mr. Burke stated that for the period from 1985 to 1989, the operations of Centra Gas (B.C.) and its predecessor company remained similar in size and management staff because operations were essentially unchanged. During that time period, services for engineering, accounting, reporting, benefits and salaries were not available in British Columbia but were provided from Winnipeg, Manitoba and Leduc, Alberta. In the latter part of 1990, the Company expanded as a result of the new natural gas distribution system on Vancouver Island and the Sunshine Coast which allowed a more specialized level of services to Centra-FSJ. These services were identified as accounting, budgeting, information systems, regulatory affairs, customer accounting, treasury, pension and benefits, union negotiations, purchases, insurance, land management, construction and engineering, marketing and sales and customer service (T. 24-26). The total number of customers for all districts is projected to increase from about 25,000 at the end of 1992 to 70,000 at the end of 1996 with the majority of the growth occurring in the RSA areas of Vancouver Island/Sunshine Coast (Exhibit 8, page I-1). According to Exhibit 32, page 3, by 1996 the total number of customers forecasted in Centra-FSJ is about 7,236.

In the initial 1992 Application, the shared expense charge was set at the 1985 level of $495,400 (Exhibit 1, Tab 12, page 12.1.1) pending the outcome of an allocation study. The Allocation Study, Exhibit 8, was filed on March 2, 1992 which reduced the shared expense allocation for Centra-FSJ to $384,600 (Exhibit 6, Tab 2, page 12.2.1R). The Allocation Study also provided an allocation of the shared general plant and capitalized costs, which are discussed in Sections 3.2(b) and 3.2(c) of this Decision. In reviewing the Allocation Study the Commission Staff considered that the information was provided at a highly summarized level which was further complicated by the lack of any supporting working papers. The Testimony was filed on the same date as the Allocation Study but the Testimony only incorporated the final allocations to Centra-FSJ of shared expenses and plant and did not provide any supporting information. The Commission considers that the working papers form an integral part of the study and the rate application and they must be included in future rate applications to support the conclusions reached and achieve a cost effective hearing. To do otherwise, significantly increases the costs especially to intervenors and to the Commission.

In producing the Allocation Study, Ernst & Young applied the following steps:

> "The first step was to reallocate human resource and fringe benefit costs. The second step, to strip out costs that were charged directly to single activities or geographic areas, less the portion that was capitalized.
>
> The third step was to reallocate administrative shared costs to three basic functions, and we considered those to be the three forces that are driving Centra B Capital expenditures, marketing, and operations. The operating costs we then allocated to the geographic areas, just to try and give you a step by step as to the approach that we used in performing the study." (T. 192)

Obtaining a distinction between a directly charged expense and a shared expense occupied a great deal of time in cross examination due to the lack of precision in references to shared costs in the Allocation Study and evidence by Company Witnesses. Page I-2 of the Allocation Study indicated that the total budgeted shared service costs for Centra Gas (B.C.) in 1992 was $7.3 million, after removing the deferred marketing costs and capitalized expenses. The marketing costs are 100 percent related to the RSA areas and accordingly do not have an impact on the shared expense allocation.

The Centra Gas (B.C.) budgeted cost of $7.3 million includes the charges for services from other affiliated companies. Westcoast provides Centra Gas (B.C.) with corporate services of treasury, legal and internal audit for a charge of $144,500 annually whilst Centra Gas Manitoba Inc. and Centra Gas Alberta Inc. charge approximately $230,000 for bill preparation and customer service support (Exhibit 8, page II-1). The $7.3 million cost was redefined on page III-1 of the Allocation Study to show $3.3 million of the costs that are directly traceable to a specific district while $4.1 million of shared costs require an allocation. In testimony, Mr. Tibbetts (Ernst & Young) and Mr. Haines explained that the $3.3 million relates to a single jurisdiction utility and that the costs are incurred by an individual office in accordance with its own budget (T. 201-202).

A review of the Allocation Study requires an examination of the costs and the various bases of the allocation. Mr. Wallace recognized that examining only one district in a four district utility places limitations on the Commission's review of the costs. He made the following suggestion:

> "We recognize that you cannot, in the course of this hearing, test the prudence of all of the costs incurred by Centra as a corporate entity which go to make up the allocation study. It's simply beyond the scope of this hearing to look at the entire RSA and determine whether all of those costs are prudent.
>
> We ask, I guess, that you look at the methodology, is it reasonable and that you look at the result of the methodology, the $384,000 and does Fort St. John get

> good value for that allocation and make your determination on the basis of that. We do not ask that you go back through the whole Centra RSA cost." (T. 223-224)

Of the $4.1 million of shared costs, of which $384,608 is allocated to Centra-FSJ, the Allocation Study determined that about two-thirds of the expenses were incurred on specific bases (such as hours, sales volumes, number of customers, inventory turnover or capital additions) (Page III-1). The remaining expenses were allocated using a composite weighting of 10.25 percent which represents a 50 percent weighting on capital additions, 25 percent for payroll and 25 percent on sales volume. In selecting the weightings, the Allocation Study considered the 1992 projections of Centra Gas (B.C.). Mr. Tibbetts acknowledged that the weightings were based on judgement (T. 215) and stated that the following was the basis of the judgement and the degree to which it could vary:

> "MR. TIBBETTS: A: It was very clear to us in looking at the budgets and plans over the next five years, that there was a very large emphasis on marketing, a very large emphasis on the capital programs for the company as a whole, but that that was not the emphasis for Fort St. John or some of the other areas. The emphasis is all on RSA.
>
> The weighting of 50 percent on capital, 25 percent on payroll, 25 percent on sales volume, is really a reflection of that emphasis on the capital program. At the end of three years or five years, if I'm here in front of you again, I'll probably say that that weighting is inappropriate, that the weighting more likely should be a third, a third, a third, but there isn't any question that for the next several years the capital program is going to be very, very important and should be considered in the weighting of the allocations." (T. 216)

The witness stated that normally in this three factor allocator, the net plant investment would be used as one factor rather than the capital additions. However, with the relatively low capital base of the RSA area and the importance of capital additions, the change was considered appropriate (T. 217).

Commission counsel asked if it would be appropriate for the allocation methodology to use the 1992 costs but apply the factors after 1996 when the growth period would have stabilized. Mr. Tibbetts considered that if weightings of one-third for each of the three factors were used, most of the costs would have gone to Centra-FSJ (T. 217-218).

As another perspective on using the 1996 factors to allocate the shared costs, Commission counsel asked if the allocation to Centra-FSJ of $384,608 would change if the 1996 factors for capital additions, payroll and sales volumes were used but the weightings of 50/25/25 were applied

(T. 229). On this point, the following exchange occurred between the witnesses and Commission counsel:

> "MR. TIBBETTS: A: We looked at the numbers. The numbers aren't a lot different than what we ended up with, but honestly, we didn't believe -- I didn't believe that I could convince a regulatory body that we should do cost allocation today on what a system is going to look like five years from now. I just didn't see you buying it, even though conceptually I think it makes some sense.
>
> MR. DUNLOP: Q: You appreciated that conceptually it made some sense in the sense that that would be your normal or levelized off operation after this period of growth. Are you saying that there wouldn't be much of a difference in the allocation factors?
>
> MR. TIBBETTS: A: I'm saying that in terms of allocations to Fort St. John that's right.
>
> MR. HAINES: A: If I might add on that, we did have an information request number 3 1.1 where we were asked to consider the 1996 position of the company, allocate the expenses projected for that time out on the existing methodology. We found there to be, in the Fort St. John area the result would be $340,000 as opposed to 386, which proves to us that the methodology was sound and that Fort St. John was not picking up any undue portion of the activities for the Vancouver Island expansion." (T. 229-230)

The witness was referring to Exhibit 11, Tab 1, page 2 which showed an allocation in 1996 for Centra-FSJ of $342,077. This, in the witnesses' opinion, confirmed the 1992 allocation of $384,608 proposed by the Company.

Subsequently, the original estimate for 1996 ($342,077) was reduced by approximately $100,000 to $240,275 due to what the Applicant's witness initially testified to be a typographical error (T. 232-234) which would not require adjustments of the schedules. Upon further review it was determined that this was not a typographical error and the schedules had to be recalculated using the correct estimate of customers (eg. 70,000 instead of 25,000). Exhibit 32 incorporates this correction.

When the Company was asked to accept a revision to the shared expense allocation to Centra-FSJ from $386,000 down to $240,275 Mr. Haines stated that the reduction was for 1996 (T. 433) and Mr. Wallace in final argument only referred to the shared expense of about $380,000 (T. 580).

The Commission at this time and in these circumstances accepts the allocation bases used in the Allocation Study except for the costs that have been assigned to Centra-FSJ for customer accounting of $204,888 (Exhibit 10, Tab 1, Question 1.1, page 2). As noted in Section 3.1.2 of this Decision, the processing of meter reading and customer billings is a convoluted process, at best, which leads to inefficiency. The Commission concern about the shared expenses was expressed at transcript page 218 wherein the growth of the RSA areas requires levels of skills such as marketing, engineering and general management that are not required by Centra-FSJ. Mr. Tibbetts had the following comments about the possible benefits and increased costs that can occur through rapid growth:

> "I mean, it's not only skills in terms of people skills. It's infrastructure, management infrastructure and systems. . . That you need to run a gas company with 70,000 customers that you don't need to run a gas company with 7,000 customers . . . the way that I,,, as an analyst, deal with that is to not just look at today but to look out five years. . . Organizationally and management-wise, there is normally an expectation that there are some economies of scale associated with serving 70,000 customers as opposed to 7,000. . . On the other hand, the increased sophistication required for 70,000 customers may cost an increased cost. The right thing to do is to get the right balance to go through figure out the areas where corporate support and centralization provides some economies of scale but not burden a remote operation with costs from which they receive no benefit. I happen to think that's what the company is trying to do." (T. 219-221)

In its determination of the appropriate level of shared expenses for Centra-FSJ, the Commission agrees with Mr. Wallace that an examination of the entire RSA area and the other districts is beyond the scope of this hearing. However, a comprehensive study must be undertaken within the Westcoast family both with regard to allocation methods and costs. Centra Gas (B.C.) is directed to file an outline of the proposed methodology and timing with the Commission by December 31, 1992 for its review. Due to the assumed complexity of this matter the Commission would suggest that the "consultative process" be considered in the interests of fairness, time and money. In view of the "fluidity" of the Applicant's forecast the Commission has significant concerns with regard to the reliability of the gross input numbers. However, in view of the magnitude of the change required in the input numbers to have a significant impact on the expense allocation, the Commission will accept the input numbers in this instance.

The Commission has considered the proposed shared expense allocation to Centra-FSJ of $384,600 using the 1992 factors and the allocation of $240,275 resulting from 1996 factors to determine which basis is more appropriate. The Company stated on pages 5.1.4 and 5.1.5 of its Application that the Head Office infrastructure was designed to serve the anticipated growth in its service areas. The Commission considers that the shared expense allocation to Centra-FSJ shown on Exhibit 32 of $240,275 is appropriate since it would normalize costs incurred in anticipation of growth, recognize economies of scale and minimize the transfer of start-up cost incurred in RSA areas.

(b) Allocation of Shared General Plant

The methodology used to allocate the shared general plant differed significantly from the Allocation Study. Page 5.1.4 of the Application stated:

> "The Fort St. John district is administered from Centra Gas British Columbia Inc.'s Head Office in Victoria and Regional Office in Nanaimo. . . The Regional Operations office in Nanaimo provides general operating, maintenance and construction supervision."

Page 4.1.1 of the Application states that assets in the Nanaimo Regional Office and the Victoria Head Office were purchased for the joint administration of the Fort St. John district and the balance of the Centra Gas (B.C.) operations. In determining the amount of the Head Office general plant that should be allocated, almost all of the capital costs related to the marketing function were excluded since this was considered to apply exclusively to the expanding RSA areas (Exhibit 1, page 5.1.4). The Application stated that the shared general plant should be allocated using the following approach:

> "A ratio of customers in Fort St. John and the company in total was used as a basis for allocating common general plant. Currently the customers in the rest of the service areas of the company, especially the Rate Stabilization areas, represent only a small proportion of the future. However, in the next five years significant customer growth will take place in the Rate Stabilization areas. In anticipation, the Head Office infrastructure has been designed to service this growth, which is expected to begin to stabilize in 1996." (Exhibit 1, page 5.1.4)
>
> "Having in mind the foregoing events the Company felt it was reasonable to select a ratio for allocation based on forecast customer relationships in 1996. The use of the future ratio yields a reasonable and realistic percentage of 8.9% instead of the current 50%." (Exhibit 1, page 5.1.5)

The Applicant calculated, based on a 1992 mid-year net book value of about $2.2 million for Victoria and $306,000 for Nanaimo, that an allocation to Centra-FSJ of $222,250 was appropriate. A depreciation expense allocation of $29,341 was determined by applying the prescribed rates to the plant in service.

The Allocation Study did not use customer ratios or include any 1996 factors in its allocation of general plant. As stated on Page I-4 of the Allocation Study (Exhibit 8), the shared general plant was allocated based upon the effective expense allocation of the Shared Costs of Service (Exhibit 8, page IV-2). The ratio obtained was 9.5 percent which was based on Centra-FSJ's allocation of $384,608 from the total shared costs of approximately $4.1 million.

The Allocation Study also differed, for this proposed allocation, in its identification of offices that were providing service to Centra-FSJ. It stated on Page III-6 that:

> "The Nanaimo Regional Office has historically provided support to all cost regions in the organization. In November, 1991, all support functions provided by Nanaimo to Fort St. John were transferred to the Victoria head office in an effort to consolidate functions. Therefore no costs from the office will be allocated to Fort St. John in 1992."

Page II-1 of the Allocation Study indicated that Centra-FSJ received services from the Head Office located at Tolmie Avenue and a single Victoria District office. Page IV-1 identified total shared general plant of approximately $3.3 million which resulted in a 9.5 percent allocation to Centra-FSJ of $317,331. A breakdown was obtained on Exhibit 10, Tab 2, Question 1.2 which showed that the general plant represented the 1992 year end values of Victoria Head Office, Nanaimo, Quadra and Discovery offices rather than as given in the evidence on Page II-1 of the Allocation Study.

The allocation of general plant to Centra-FSJ appeared to be overstated since only the assets of Head Office and a Victoria District Office, which would be either Quadra or Discovery, should be involved. Commission counsel asked Mr. Tibbetts and Mr. Haines which location represented the Victoria District Office and received these replies:

> "MR. DUNLOP: Q:. . . Now which of the two district offices, maybe you or Mr. Haines can tell us, Discovery, as I understand one is named or Quadra, provide that service? This is when we talked about Victoria District Office.
>
> MR. HAINES: A: We have five offices in Victoria. . . . Discovery, Pembroke, McKenzie, Tolmie and Quadra. . . During the study added the Discovery and Quadra offices to -- we already had the Tolmie, McKenzie offices in there.
>
> COMMISSIONER PAGE: These names presumably are the streets on which the offices are located?
>
> MR. HAINES: A: Yes, that's correct, they'd be address names. The Victoria District Office is the Pembroke location, where Mr. Maxwell resides.

> MR. TIBBETTS: A: Which, as I recall, was the source, the main source of costs that were allocable.
>
> MR. DUNLOP: Q: Pembroke?
>
> MR. TIBBETTS: A: to Fort St. John.
>
> MR. DUNLOP: Q: How have you got the Victoria District Office broken up for the purposes of comparing, as you have set it out in Question 1.2, because there -- you see where my confusion is is that you refer there in the allocated plant schedule behind that information request, if you look at it, for net book value, you refer to areas Tolmie, Nanaimo, Quadra and Discovery, and I'm using the Discovery and Quadra trying to understand what part of the Victoria District Office that two percent of the time and costs are spent allocated to Fort St. John. Can you help me?
>
> MR. HAINES: A: That is the Pembroke operation
>
> MR. DUNLOP: Q: And is Pembroke part of Quadra or Discovery?
>
> MR. HAINES: A: No. We have not allocated any plant for that." (T. 236-238)

The Allocation Study (Page III-3) indicated that the Victoria District office spent 2 percent of its time on activities attributable to Centra-FSJ which was further clarified by Mr. Tibbetts (T. 238):

> "What I would suggest in that particular case is that two percent was really the result of interviews that focussed on particular individuals, and my recollection is that what we're really talking about is not two percent of the total, but it was 15 percent of the costs associated with an individual."

Mr. Tibbetts confirmed that if an office did not provide a service to Centra-FSJ then the plant and costs of that plant should not be allocated to Centra-FSJ (T. 242). When Commission counsel suggested that Nanaimo, Quadra and Discovery should be excluded from the allocation of general plant to Centra-FSJ (T. 243), Mr. Haines modified the previous evidence explaining the services are provided from more than one office:

> ". . . Our Quadra office is principally our engineering office. Our Tolmie office, which I'm including our McKenzie office in, is our accounting and management office. Quadra I've mentioned. Discovery is our sales office. Pembroke has some inspection and engineering done from it as well." (T. 244)

Commission counsel questioned the relationship between Nanaimo shared costs to Centra-FSJ and the allocation of its general plant:

> "MR. DUNLOP: Q: I'm just wondering, sir, if Nanaimo does not provide any services to Fort St. John why the net book value as shown on this schedule should be allocated to Fort St. John. Why would it be part of the shared general plant when these offices don't have anything to do with Fort St. John. Should it come out?
>
> MR. HAINES: A: Perhaps I can build on that. As we've discussed yesterday, our customer accounting services provided from Fort St. John where we take our meter reads, send them to Fort St. John* where they're entered. The cost of that individual are included within our customer accounting costs and the equipment basically that we're seeing in the Nanaimo costs are the costs of the computer equipment and some related other costs associated with that function.
>
> MR. DUNLOP: Q: I understand. But this is for the purposes of the study. The purposes of the study assumed that Nanaimo was providing no service at all and I'm just wondering, Mr. Tibbetts, if it's inconsistent to include it in your total of net book value allocated when you're coming up with a percentage value for Fort St. John.
>
> MR. HAINES: A: I think what we have going on here is a difference between terminologies of Nanaimo operations and an individual sitting in Nanaimo doing some customer accounting work. The individual who is in Nanaimo doing some customer accounting work whose costs are under customer accounting and have in fact been allocated to Fort St. John, so there is an operation cost coming out of the Nanaimo office under customer accounting, and there is a fixed asset cost out of Nanaimo being allocated to Fort St. John." (T. 251-252)
>
> (*the witness subsequently confirmed that he meant to say Nanaimo.)

The witnesses were asked to verify that the shared general plant of $3.3 million was a 1992 year end amount rather than a mid-year value upon which the balance of the plant accounts are predicated (T. 259). Mr. Tibbetts confirmed his original calculation and replied:

> "Yes I have and I found that we mistakenly used a year end number for general plant. The effect of that--the use of a mid-year would reduce the allocable general plant balance from 3,340,324 to 3,178,067, or the impact on rate base would be a reduction of 162,257." (T. 423)

This adjustment has been incorporated by the Applicant in Exhibit 12A.

The witnesses reviewed their information about Nanaimo's services and Mr. Wallace provided the following redirect:

> "Q: Mr. Haines, as I understand it there are two types of services that could be considered to be provided by the Nanaimo office. The first is customer accounting, that there are customer accounting people there who do work with respect to Fort St. John bills?

MR. HAINES: A: Yes.

MR. WALLACE: Q: And the reason -- and I understand that they are not included as part of the Nanaimo office for the study done by Mr. Tibbetts because their costs are accumulated under customer accounting, which is basically in Victoria, and accordingly they do not show up as part of Nanaimo because if they did it would be duplication?

MR. HAINES: A: Yes.

MR. WALLACE: Q: The only other form of services that is provided with respect to Fort St. John are the services of Mr. Olsen, who has assisted in the preparation of this hearing?

MR. HAINES: A: Yes.

MR. WALLACE: Q: And essentially his role with respect to Fort St. John for 1992 has been reduced to that of providing historical information to Mr. Maxwell when required, being at the end of a telephone to give a call, but is not considered to be a major element of his time commitment?

MR. HAINES: A: Yes.

MR. WALLACE: Q: Thank you. And it's because of that limited commitment that no costs associated with the Nanaimo office were passed through?

MR. HAINES: A: The operations, yes.

MR. WALLACE: Q: Operations. Now, there were some capital costs, and it is my understanding that those are not part of the Nanaimo office building costs, but rather relate to the computers and related general plant, rather than buildings used by the customer accounting people?

MR. HAINES: A: Yes." (T. 434-436)

The Commission believes that if an office provides a service to a district then it is appropriate to allocate a portion of that office's general plant to that district. However the proposal to use the effective expense allocation of 9.5 percent of 1992 Shared Costs of Service does not consider the statement on page 5.1.4 of Exhibit 1, wherein it was stated that the Head Office infrastructure was designed to service the growth to 1996. The Commission accepts that various offices provide some services to Centra-FSJ but believes that to a large extent this investment was undertaken in anticipation of growth in the RSA areas. The more appropriate relationship is when growth in the RSA area has stabilized and therefore, the 1996 factors as shown in Exhibit 32 should be used to allocate shared expenses. The resulting effective expense allocation to Centra-FSJ is 5.9 percent ($240,275/$4,065,017). When the 5.9 percent is applied to the $3,178,067 the allocated general plant for Centra-FSJ is $187,506. An adjustment to the allocated shared depreciation expense has been made in the attached schedules. With regard to the gross amount of ($4,065,017) the Commission would reiterate its statement in Section 3.2(a).

(c) Allocation of Shared Capitalized Overhead

The Allocation Study showed 1992 budgeted plant additions for Centra-FSJ of approximately $910,000. The total plant additions budgeted for Centra Gas (B.C.) were $35.4 million inclusive of $8.3 million of capitalized overhead (23.44 percent). Using this percentage the capitalized overhead allocated to Centra-FSJ is $278,000 (Page IV-2 of the Allocation Study).

The Plant Additions Study, which was filed at the same time as the Allocation Study, included revisions to the budgeted 1992 additions. The revised capital additions were approximately $942,200 including capitalized overhead of about 23.44 percent or $220,000 (Exhibit 9, Tab 2, Question 2.19, pages 1 and 2).

The amount of total capitalized overhead was revised (T. 193), to remove the $1.1 million of marketing costs that were being deferred for the purposes of the Allocation Study and not capitalized. The effect of the adjustment was a $65,000 reduction in the plant additions which was reflected on Exhibit 12A.

3.3 Sales

The Applicant used several estimates, which varied within a range of 10 percent, for the projected 1992 average number of customers. The Commission considered that natural gas and transportation service would be provided to an average of 7,012 customers during 1992. An approximate breakdown would be 6,000 Residential-Small General Service customers, 999 Commercial-Small General Service customers, 3 Commercial-Large General Service I customers, 1 Commercial-Large General Service II customer and 8 Industrial customers, some of which receive only transportation service. Transportation service is not available to other classes of service.

The Applicant in its direct evidence and further in its cross-examination recommended that the Environment Canada normal 30-year degree day weighted average be replaced with a revised normal with equal weight being given to the average of the last 5 years and the previous 25 years.

In support of this the Applicant provided the following table (Exhibit 1, page 10.1.2):

"Comparison of Normal Degree Day Alternatives

		Normal Degree Days
1.	30 year average (1951-1980)	6,122.4[2]
2.	30 year average (1961-1990)	5,998.1
3.	30 year weighted average (1986-1990) + (1961-1985)[1]	5,810.0[3]
4.	10 year average (1981-1990)	5,751.6
5.	5 year average (1986-1990)	5,527.8

1 Both periods weighted @ 50%.
2 Existing method.
3 Proposed method."

On the basis of the above statistical review which indicates a recent warming trend, the Commission concurs that a revised normal should be used and for this purpose adopts a 10-year average as appropriate. However, if this were a larger utility the Commission believes meteorological evidence should be considered in addition to the statistical material considered herein.

In addition to the above, the Commission has also reviewed the method whereby the Applicant developed its normalized temperature adjustment. In essence, the Applicant determined the base load by assuming no heating load in July and August for the residential and commercial customers. However, in making this adjustment it then proceeded to make a degree day adjustment to its non-heat sensitive base load in July and August. The Applicant (T. 503) confirmed the error.

The Applicant should also carefully review its commercial base load calculation to ensure "gas chillers" have been removed from its base load calculation in future Applications as these incorporate a heat sensitive element. The evidence indicates (T. 504) that at least three of these "chillers" exist which have not been removed from the calculation of the base load which was then deducted from the total load to determine the heat sensitive portion to be normalized. The

Applicant reviewed its data and corrections have been made on Exhibit 12A which was filed at the end of the hearing.

3.4 Gas Purchases

The cost of gas as of October 31, 1991 was \$1.867/GJ for General Service customers and \$1.55/GJ for Industrial customers. For the period from November 1, 1991 to December 31, 1992 the rate decreases to \$1.79/GJ for General Service and \$1.42/GJ for Industrial (Exhibit 1, Page 11.1.1). As mentioned in Section 2.0 of this Decision, a cost of gas refund was made to the customers on their March, 1992 bills.

The Centra-FSJ gas supply was described in the Testimony, Tab 5 and Exhibit 9, Tab 6, Questions 6.1, 6.2 and 6.3. The Company's gas supply is comprised of a 10-year contract signed in 1986 which provides a firm reserves dedicated supply ("the Firm Contract") through back to back contracts between Centra Gas (B.C.)/Canadian Hydrocarbons Marketing Inc. ("CHMI"), an affiliated Westcoast company, and CHMI/Conoco Canada Limited ("Conoco") up to a maximum daily volume ("MDV") of 340 10^3m^3/day which is delivered on CHMI's equivalent Westcoast Transportation Service - Northern. For volumes in excess of the MDV, Conoco has the contracted first right but no obligation to supply at contracted prices.

The use of CHMI allows access to that company's larger gas pool and provides a backstop to the Conoco contract. A firm Offline Sales Agreement with Westcoast is also in place which provides for Centra-FSJ's full requirements, not limited by a set contract demand, for an indefinite period.

Centra Gas (B.C.), through CHMI, is negotiating with Conoco for an extension to the Firm Contract but to reduce the MDV at the end of the current contract to allow another supplier to share in the Centra-FSJ market. The proposal also requests Conoco retract its first supply option for volumes in excess of the MDV in favour of other suppliers. Due to Westcoast's desire to end offline sales it is expected that the Westcoast Offline Sales Agreement will be converted to a Service Agreement. These negotiations should result in a conventional 10-15 year supply with multiple plants and multiple suppliers in conformance with the Commission's rules under Section 85.3 of the Act.

3.5 Operating Costs

The Application requested an increase in allowed expenses for operations of 28.9 percent, maintenance expense of 79.4 percent and general expense of 10.6 percent over 1991 costs (Exhibit 1, page 12.2.1). The Applicant provided additional information on the cost increases in Exhibit 10, Staff Information Questions 2.1, 2.2 and 2.3 which were summarized and submitted as Exhibit 37.

3.5.1 Inflation

The Application used an inflation factor for 1992 of 4 percent for materials and supplies but the forecast of inflation for 1992 was 2.2 percent according to the Applicant's response in Exhibit 9, Tab 11, Question 11.12 filed in May, 1992. During cross-examination, the Applicant agreed that the lower rate was more appropriate and accordingly revised the expenditures on Exhibit 12A filed at the conclusion at the hearing on May 28, 1992.

3.5.2 Operating Expense

Distribution-Supervision in the test year 1992 is projected to increase 29.23 percent over 1991. The Commission recognizes that a small increase in the number of employees translates into a relatively large change in the costs. The Company adequately explained the changes in this area so no adjustment was made.

Distribution-Meters & Regulators (customer meters and house regulators - account 673) are expected to increase by $78,100 or 119 percent over 1991. A backlog of 1,500 meter recalls has resulted over the last five or six years due to time spent on other projects such as PGEP, meter relocations and valve maintenance (T. 536). The Company expects to remove the backlog in 1992 with the costs recorded in the test year.

The Commission considers that the costs for Distribution-Meters & Regulators, in excess of 1991 costs represent a buildup of costs from prior years which should be set up as a rate base account and amortized over a period of two years.

3.5.3 Maintenance Expense

The Distribution-Meters & Regulators (Company-owned equipment on customer's premises - account 874) category is projected to increase by $41,400 over 1991 actual. The cost increases are due to a full time measurement technician and the inspection, testing and repair of the commercial installations and the associated parts and supplies (T. 542).

Distribution-Mains & Services is forecast to increase by $44,400 or 76 percent over 1991 due to leak repairs resulting from the ongoing system survey (T. 542).

The Commission considers that the increase in costs for Distribution-Meters & Regulators and Distribution-Mains & Services over 1991 should be set up as a rate base account and amortized over a period of two years.

3.5.4 General Expense

Sales Promotion is forecasted to increase from $30,000 in 1991 to $55,000 in 1992 to encourage infill on the PGEP expansion, additional appliances sales and natural gas for vehicles sales (T. 543). Customer accounting-meter reading is forecast to increase due to the addition of one-half a meter reader (T. 544).

The Commission accepts the increase in general expense for these two categories.

The Applicant significantly reduced the cost of customer accounting in Exhibit 12 to remove approximately $148,000 of direct expense which was duplicated as these were included in the allocation of shared expenses (T. 39-41).

The Commission is concerned that this error was not discovered prior to the March 2, 1992 filing of the Allocation Study especially since a special effort was to have been made by the Applicant to eliminate obvious errors.

3.6 Income Taxes

The deduction for capital cost allowance ("CCA") decreased by approximately $278,000 on Exhibit 12, which was filed at the start of the hearing. The Application and the revisions in the

Testimony did not incorporate income tax records on a segmented basis (T. 41). The calculation had been performed on a company-wide basis and was pro-rated to Centra-FSJ using its rate base. Exhibit 12 corrected this error.

The deduction for overheads began as $75,000 in the Application, rose to $182,700 on the March 2, 1992 revisions, decreased to $75,000 on May 25, 1992 (Exhibit 12) and decreased to $32,700 at the conclusion of the hearing on the May 28, 1992 filing (Exhibit 12A). The variation relates to the capitalized overhead costs of $219,500 on Exhibit 9, Tab 2, Question 2.14 which is comprised of inspection costs, shared service costs and district costs and whether these amounts should be capitalized for CCA purposes or expensed. The revisions, made to conform to Company policy, were explained when Exhibit 12 was filed:

> ". . . in our original application we wrote off the entire portion of the overhead allocation for the year. This is not consistent with our Company's policy. We should have -- the overhead components for engineering and inspection should have in fact gone into the capital cost allowance and only that portion of administrative overhead is deducted in the year specific." (T. 42)

The witnesses were asked, regardless of the Company policy of capitalizing engineering and inspection costs, if these overhead costs could also be expensed for tax purposes (T. 548). The Company reviewed their policy and the Revenue Canada publications then provided the following reply:

> "MR. BURKE: A: Yes, engineering costs and inspection costs which relate directly to capital, you know, things like maps, the distribution mains and services, are to be capitalized and this is dealt with under Interpretation Bulletin IT-174R, which I would like to offer as an exhibit.
>
> The treatment is consistent with prior years and has been approved by Revenue Canada in their review of the company's returns." (T. 577)

The Commission accepts the Company's method of expensing capitalized overhead for tax purposes. However, if the Company should obtain approval from Revenue Canada to increase the expensing of capitalized overhead then the Commission must be informed and an accounting direction requested.

4.0 CAPITAL STRUCTURE AND RETURN ON EQUITY

4.1 Introduction

Centra-FSJ applied for the following capital structure and costs of capital.

Original Proposed Capital Structure and Costs of Capital - 1992

	Capitalization	Cost
Short-Term Debt	4.59	8.08
Long-Term Debt	18.48	13.89
Deemed Long-Term Debt	40.55	9.34
Preferred Shares	0.67	6.48
Common Equity	35.71	14.25
Total	100.00	11.86

(Application, page 14.2.1)

During the hearing, this was revised as follows:

Revised Proposed Capital Structure and Cost of Capital - 1992

	Capitalization	Cost
Short-Term Debt	5.29	7.97
Long-Term Debt	19.85	13.89
Deemed Long-Term Debt	38.47	10.76
Preferred Shares	0.68	6.48
Common Equity	35.71	14.25
Total	100.00	12.45

(Exhibit 12A)

The request with respect to the appropriate rate of return on equity was supported by written testimony from Ms. Kathleen McShane, an expert witness. Even though Ms. McShane did not attend due to cost considerations, she was contacted by Company witnesses who answered questions and adopted her evidence. Company witnesses (primarily Messrs. R. Burke and J.A. Walker) spoke to the entire capital structure and associated costs. The written evidence given by Ms. McShane was in essence identical to that given and subject to cross-examination in the recent Pacific Northern Gas Ltd. Revenue Requirement hearing. The Division of the Commission was the same in both proceedings.

4.2 Capital Structure and Costs

4.2.1 Involvement of Westcoast Energy Inc.

Centra-FSJ does not have a capital structure in the conventional sense as it is a division of Centra Gas (B.C.), which is in turn part of Centra Gas Inc., a member of the Westcoast family of companies.

Westcoast undertakes the treasury functions for Centra Gas Inc. and its related companies. These services include provision of short-term capital, the investment of short-term surpluses that any member of the group might have as well as the inter-corporate flow of funds among the Centra Gas Inc. group of companies across Canada (T. 272).

The inter-corporate flow of short-term funds among the Centra Gas Inc. companies is managed through 14 separate accounts, with accounts being credited or debited depending on the balance in the individual accounts. On a monthly basis, the treasury department charges the individual accounts either the bank prime or bankers acceptance rate plus a stamp fee (currently approximately 75 basis points) depending on which is lower and advises the bank accordingly. The bank for its part will then use the selected rate to allocate the interest received or cost incurred to each of the individual accounts. An exception to the above is that if the group on a consolidated basis is in a deficit position they will borrow on an overdraft basis. The commercial paper market, an alternative source of funds, is not available to Centra Gas Inc. as it has not been rated by the rating service.

Westcoast also provides corporate finance services, such as access to long-term capital markets and private placements of indebtedness, long bonds and common equity where required (T. 272). Consistent with current corporate policy (T. 299) each of the Centra companies issues its own long-term capital on its own merits. In this regard Centra Gas (B.C.) has placed a high priority on raising approximately $80,000,000.

With respect to this financing, the following exchange took place:

> "THE CHAIRMAN: I suppose from the Commission's perspective, we're not trying to put any undue pressure on this financing, but to the extent it was delayed and a more advantageous rate was achieved, I certainly don't have any driving desire to have it done by June. Other members of the Commission may, I can't speak for them, but I think the objective has to be a balance between security for the shareholder due to fluctuating prices and to some extent we're compensating for this in deferred accounts, and having an advantageous timing into that bond market. I wouldn't think with the Olympia and York going on and a triple B credit, the interest rate forecasts are unsettled. If one was forced into a market one may not come out with as good a rate as one would come out if they went to that perhaps a slightly different market six months or a year from now.
>
> MR. WALKER: A: That is very correct, sir. I couldn't have said it better myself. That is the reality of the situation we face. There is the O and Y and there is the Japan scenario in there."

The timing and rate achieved on this proposed issue is particularly important for the Fort St. John division since the Applicant has financed a large portion of long-term assets with short-term debt since 1985.

4.2.2 <u>Short-Term Debt</u>

Centra-FSJ has applied for a revised cost of 7.97 percent on a short-term debt component of 5.29 percent of its capital structure. This component is equal to the amount required to fund 75 percent of the working capital requirement. In the original Application, the cost of short-term debt was forecast to be equal to bank prime less 50 basis points. However after consultation with Westcoast the Application was revised so that the cost of short-term debt is now forecast to equal bank prime without any discount. The Company has applied for a deferral account into which any deviations from the forecast short-term debt costs would be accrued.

The Applicant was asked at transcript page 617 whether or not from an income tax perspective, it mattered if the Commission's estimated cost of short-term debt was higher or lower than the actual cost incurred. The Applicant advised by letter dated July 16, 1992 that it would be more advantageous for the estimated cost to be lower (Appendix C).

4.2.3 Long-Term Debt

The Company's capital structure includes 19.85 percent of actual long-term debt at an average embedded cost of 13.89 percent. This debt was issued by a predecessor company to Centra Gas (B.C.) in 1984 and is clearly associated with the Fort St. John utility assets.

4.2.4 Deemed Long-Term Debt

The Company's capital structure, as set out in the Application, includes 38.47 percent of deemed long-term debt at a revised forecast cost of 10.76 percent (original forecast cost of 9.50 percent). Originally, this debt was expected to have been issued by the time of the hearing (Exhibit 6, Tab 1, page 5). However, the Company testified an unreceptive market environment for lower quality investment grade credits has resulted in delaying the issue of the long-term debt (T. 298-299). Currently, this portion of the capital structure is actually financed by unfunded or short-term debt borrowed from the ultimate parent company, i.e. Westcoast, at a rate equal to the lower of the prime rate or the bankers acceptance rate plus 75 basis points (T. 308 and Exhibit 25, Note 6).

The Company witness stated that new long-term debt for this division will be issued as part of a larger package to be issued by Centra Gas (B.C.) (T. 295) and will be used to replace the deemed long-term debt. Although this debt was not expected to be issued by the end of June (T. 297), the witness stated that it is a very high priority item since it involves the capital expenditure plans of other Centra group members (T. 299). The Company expects to issue the long-term debt at approximately 150 basis points over the long-term Government of Canada bond rate which it anticipate will result in a rate of approximately 10.76 percent. The Company witness agreed that to the extent that the deemed long-term debt is actually funded with lower cost short-term debt, shareholders would receive a benefit. The Company suggested that a deferral account be instituted into which the difference between the requested deemed long-term debt cost and the actual costs, if different, would be accrued (T. 616). Since the legal entity, as opposed to this division, will be issuing this debt, the divisional cost will reflect the financial markets' assessment of the legal entity.

4.3 Capital Structure and Costs - Equity

4.3.1 Preferred Shares

As indicated in the Section 1.0 of this Decision, in 1984 ICG (B.C.) acquired the British Columbia utility assets of ICG Utilities (Plains-Western) Ltd., which served the Fort St. John area. As part of the consideration for the sale, ICG (B.C.) issued preferred shares to ICG Utilities (Plains-Western) Ltd. Currently, $75,700 of preferred shares remain outstanding, which comprises approximately 0.68 percent of the utility's capital structure. The cost associated with these shares is 6.48 percent.

4.3.2 Common Equity

Centra-FSJ has applied for a rate of return on common equity of 14.25 percent on a deemed common equity base equal to 35.71 percent of the capital structure. The requested common equity component was supported initially on the grounds that it "remains unchanged from the level approved in the last decision" (Exhibit 6, Tab 1, page 5).

Indeed, in response to cross-examination, the Company witness stated that:

> "Common equity is, as depicted in the application, is a deemed structure. It is a deemed level of equity which would be sufficient to support the indebtedness, the financial risk and the business risk of that utility. It's not represented that it in fact physically exists to the quantum dollar that the Board established back in that Decision in 1985." (T. 335)

However, during the course of the hearing, the Company witness stated that the equity component of Centra Gas (B.C.) was approximately 25 percent as shown in the consolidated legal statements (Exhibit 25). This equity supports the Centra-FSJ operations, operations in Whistler and Port Alice, and the companies serving Vancouver Island/Coastal Mainland (the RSA companies). The Company proposed to allocate this equity amongst the divisions of Centra Gas (B.C.) in such a way that the RSA companies would have a 22.9 percent equity component, the Whistler and Port Alice operations would have 40 percent equity component and the Centra-FSJ utility would be assigned an equity component of 35.71 percent (Exhibit 31) consistent with the amount that had resulted from the 1985 revenue requirements hearing. In argument, Counsel for the Company stated:

> "We see the RSA at 22.9, which is consistent with what the RSA requires and with what the company has undertaken there in support of the project that is very beneficial to the whole of the province.
>
> The company is accepting a lesser return for a limited period from what it normally would in order to facilitate the project and it's also accepting a lower equity ratio, but that does grade up over time, and Mr. Burke and Mr. Walker, I think, have indicated that further equity will be going into the company." (T. 621)

The RSA agreements specifies an equity component of 20 percent increasing to 30 percent in year five of the agreements between the Company and the Provincial Government.

With respect to the rate of return to be earned on common equity, the applied for rate of 14.25 percent was supported by written evidence from Ms. McShane. Ms. McShane stated that the financial and business risks of the Fort St. John operations were higher than those of the typical Canadian utility resulting in a required risk premium above the lowest risk utilities of approximately 100 basis points. Further, Ms. McShane stated that the fair rate of return for the lowest risk Canadian utilities, based on the comparable earnings, discounted cash flow and risk premium tests, was in the range of 13.5 percent to 13.75 percent. Therefore, Ms. McShane found that an appropriate rate of return on common equity for Fort St. John would be in the range of 14.5 percent to 14.75 percent (Exhibit 6, Attachment to Tab 1, page 2), some 25 to 50 basis points more than the Company requested. Ms. McShane's recommendations with respect to Centra-FSJ were consistent with her recommendations in the earlier Pacific Northern Gas Ltd. hearing.

4.4 Commission Determination

4.4.1 Introduction

As indicated in Section 1.0 of this Decision, Centra-FSJ exists as a division of the larger legal entity Centra B As a division, the Company has no separate legal financial statements on which to determine its capital structure. Given this situation, the Commission would anticipate that the Company's ordinary course of action would be to apply for a capital structure based on the legal capital structure of the parent entity. In this case, Centra has not chosen to do so but instead has applied for a capital structure in which many of the elements may be said to be deemed rather than actual. This fact appears to be recognized by the Company witness when he stated:

> "The capital structure, I suppose one could say, and I'm telling you this without having thought through this fully and certainly not researched it, but I would suggest to you that probably a lot of the, apart from the real long-term (debt) that we have there, the remainder of it would be some form of bank borrowing and probably support from Westcoast.
>
> In the books of Centra B and up the line to Fort St. John, we could term these items as we have done here, deemed long-term debt, and perhaps the term "deemed equity" would also be appropriate." (T. 321)

In assessing the appropriate capital structure for Centra-FSJ, the Commission has tried to be cognizant of the difference between that portion of the capital structure which can be ascertained with some degree of certainty to apply to Centra-FSJ and that which may be said to be fictional. In this instance, the Commission believes that the actual long-term debt and preferred share components shown in the Applicant's capital structure do, in fact, exist and support the utility operations. Further, the Commission is satisfied that the costs associated with these components, shown in the revised Application, reflect the actual historical costs associated with these components. Therefore, the Commission accepts the proportions and costs of actual long-term debt and preferred shares shown in the revised Application.

4.4.2 Short-Term Debt

Centra-FSJ has applied for a revised forecast short-term debt cost of 7.97 percent on a short-term debt component of 5.29 percent of the capital structure. As indicated earlier, this cost estimate reflects the Company's forecast of bank prime rate for the test year and is a reduction from that originally filed. The Commission believes that the decline in short-term interest rates which triggered this revision may continue causing the Company's estimate of short-term debt costs to be excessive. Further, the Commission is sensitive to the Company's concern that setting too high a short-term rate may result in adverse tax impacts.

With respect to the amount of short-term debt to allow in the capital structure, the Commission rejects the concept that short-term debt should be calculated as a percentage of working capital, since working capital is supported by the capital structure as a whole and may be considered a long-term asset.

Therefore, the Commission approves an annual average cost of short-term debt of 7.25 percent on a short-term debt component of 10.85 percent. Any differences from the forecast cost are to be accrued in a deferral account.

A short-term interest rate deferral account was also an issue in the 1985 Decision. Pages 17 and 18 of that Decision directed that a fund be established with a benchmark rate of 11 percent to "insulate" the customers and the shareholders from short-term rate fluctuations. The balance in the fund would be reviewed and adjusted, if required, when the appropriate long-term financing was determined.

In response to Exhibit 10, Question 3.1, page 1 regarding the balance of the fund, the Company stated that the account was not established as directed and could not explain the oversight. The Applicant prepared a calculation of the fund on a retrospective basis using annual short-term debt balances and interest rates from 1985 to 1992. As requested, the Company filed Exhibit 38 which showed the yearly breakdown of the fund and its components which resulted in a debit balance of approximately $42,700 by December 31, 1991. The Company considered that the fund should apply to the actual short-term debt financing and the $556,000 of long-term debt that was reclassified to short-term debt in the 1985 Decision. The Applicant requested that the balance of the fund be fully recovered in the 1992 rates. (T. 579)

The Commission accepts the fund balance of approximately $42,700 for 1991 but directs the balance be maintained in accordance with Section 4.4.3 of this Decision.

4.4.3 Deemed Long-Term Debt

As was demonstrated at the hearing, the deemed long-term debt is in fact debt borrowed from an affiliated company, namely Westcoast, at short-term rates and without fixed repayment terms (Exhibit 25, Note 6). To allow the utility to earn a long-term debt rate on this portion of the capital structure results in the utility customers paying for the security of long-term debt but bearing the risk of short-term rates without any offsetting benefit.

Therefore, the Commission determines that the deemed long-term debt should earn a return equal to the short-term cost of debt while it is actually funded in that manner. To the extent the cost of the deemed long-term debt while funded at short-term rates, differs from the allowed short-term cost of debt, the difference shall be placed in a deferral account similar to that outlined above with respect to short-term debt.

Once the needed long-term debt has been placed by the Company and Commission approval received on the financing, the Commission will act to adjust the utility rates to allow the increased cost of the long-term debt, if any, to be passed through to customers via the utility's rates.

The Commission accepts a deemed long-term debt component of 38.47 percent as shown in Exhibit 12A, page 14.2.1.R.

4.4.4 Common Equity

The Centra Gas (B.C.) legal financial statements for year end 1991 show an equity component of 24.4 percent (Exhibit 25) which is forecast to increase to 24.7 percent for mid-year 1992 (Exhibit 31). Although Exhibit 31 shows an arithmetical example of a possible allocation of equity which would give rise to a 35.7 percent common equity component for Centra-FSJ, the Commission does not find this Exhibit sufficient to deem this level of equity in the capital structure of the utility. Instead, the Commission agrees with the Company witness when he agreed that the equity component of the legal company was all that could be known for sure (T. 335).

However, as Counsel for the Applicant stated, equity in the RSA companies is expected to increase over time. Indeed, the Commission is aware that under the terms of the agreement between the Provincial Government and Centra Gas (B.C.), the equity component of the capital structure for the RSA companies is expected to be 30 percent at the end of five years. The Commission expects that this would result in the equity component of the legal company also increasing to something in the order of 30 percent. Therefore, the Commission sets the equity component of the Centra-FSJ utility at 30 percent, which reflects the legal entity's expected capital structure at the end of five years.

With respect to the rate of return to be earned on equity by Centra-FSJ, the Commission recognizes that similar evidence was presented to it by the expert witness at an earlier hearing. The Commission was not persuaded by the evidence at the earlier hearing and is no more persuaded, after the passage of three months and further data showing that interest rates are declining, that a rate of return of 14.5 to 14.75 percent is required by utilities which have the risk characteristics of Centra-FSJ. Given the decline in long-term interest rates, and a reasonable expectation that a further decline is possible, the Commission determines a rate of return on common equity of 13 percent within the range of 12.50 percent to 13.25 percent is appropriate. Given that the actual equity component of Centra Gas (B.C.) is 24.7 percent, the 13 percent for the Fort St.

John division becomes a return on equity for the shareholder of the Fort St. John division of approximately 14.94 percent due to the effect of leverage (Appendix D).

5.0 INTERVENORS

Several letters were received from customers of the Company who were opposed to the rate increase. Mr. Brent Rogers, the business representative of Local 1237 of the United Brotherhood of Carpenters and Joiners was present throughout the hearing, cross-examined witnesses and made a presentation.

In his opening remarks (T. 440), Mr. Rogers stated on behalf of his local that:

> ". . . It is our feeling that it is absolutely critical to the public that the pipeline transportation function regulated by the National Energy Board and the natural gas distribution system regulated by the B Utilities Commission, not be used as a conduit to channel non-utility, non-regulated costs into the cost of the pipeline service and distribution".

Mr. Rogers enquired as to whether Centra Gas (B.C.) was going to be the supplier of natural gas to the McMahon cogeneration project in Taylor, an adjacent community to Fort St. John.

The chief policy witness for Centra Gas (B.C.) advised that he was unfamiliar with the details of the project and he did not know whether or not Centra Gas (B.C.) had attempted to supply the load. Mr. Burke stated:

> ". . . this is an issue which has been, I think, dealt with at the Westcoast corporate level. We at BC Centra Gas have not been consulted on this issue directly. There maybe have been -- there may have been discussions with our president and the people at corporate Westcoast, but at this stage the people here on this panel are not very familiar with the details of the questions you are asking". (T. 443)

The panel consisted of Mr. R.R. Burke (Vice President, Finance), Mr. A.M. Haines (Manager, Budget Planning and Regulatory Affairs), Mr. D.J. Maxwell (Director of Operations) and Mr. D.G. Olsen (Operations Manager).

Mr. Burke advised the following day that Centra Gas (B.C.) was considered by Westcoast management as a supplier of natural gas to the cogeneration plant at Taylor but because the plant was right adjacent to the McMahon processing plants, on the same property, it was decided it just wasn't practicable to include Centra Gas (B.C.) as a supplier. A similar circumstance had occurred after the Applicant had applied to supply Fibreco.

Mr. Rogers also inquired into the qualifications of contractors and their employees, specifically whether or not they met B Trade qualification requirements and whether or not Centra Gas (B.C.) tender requirements have a local hiring provision. Mr. Rogers summarized his position (T. 455):

> ". . . And the bottom line, that's a great theory and everything, but if you have people from the area and you make sure that they're people, that they're local people that are qualified to do the job, then you end up with a reciprocating effect, where the money keeps moving around in the community and your gains far exceeds any losses by not possibly taking the lowest tender".

Mr. Burke advised that:

> ". . . To be candid with you, I don't know of any of the policies of this similarly in British Columbia." (T. 456)

However, as an officer of the Company, he undertook to bring up the points that Mr. Rogers raised at the senior management level and that all things being equal, one of which is price, the Company will take the direction that it is the appropriate thing to use local labour. Mr. Burke undertook:

> ". . . to ensure that there is that policy that whenever possible local labour will be used." (T. 456)

The Applicant's policy in this regard was filed on June 17, 1992 as Exhibit Number 44 and included herein as Appendix E.

The Commission encourages the Applicant to maximize the use of local material, supplies and labour to the extent reasonable. The Commission concurs with Mr. Rogers wherein he stated that a multiplying impact takes place at the local level.

6.0 OTHER MATTERS

6.1 Corporate Alignment

The Commission, at transcript page 417 and following, raised with the Applicant the question of whether or not Westcoast gave consideration to the corporate alignment of its related companies and in this particular instance, the relationship between Pacific Northern Gas Ltd. and Centra-FSJ.

Mr. Walker, a witness for the Applicant stated (T. 418):

> "We do look for resolutions to this kind of issue. We too are aware of those as issues. You know, I personally, I'm concerned with that because of the fact that this Fort St. John is so small compared to the relative growth of Centra B that is before it, and you know, there are possible scenarios."

And Mr. Burke, further stated (T. 421):

> "Could I just react to that very quickly and tell you that last year, last April, a year ago, we were involved in a strategic planning meeting. One of the issues was the combination of similar kinds of utilities such as PNG with the Fort St. John and Port Alice.
>
> Yes, we have different management. The culture of Inter-City Gas Corporation and the culture of Westcoast were broader, farther apart. Now they're closer together and yes, we're looking at those things."

The Commission would encourage further study in corporate alignments to the possible improvement of the current situation and would look forward to being advised in due course.

6.2 British Columbia Government's Budget Changes

The Application calculated income taxes incorporating the recent changes in the British Columbia Government's Budget. The tax calculations were allowed to stand and, subsequent to the hearing, Royal Assent was given on June 5, 1992 to the tax changes and the appropriate adjustments have been made on the schedules attached hereto.

7.0 COMMISSION DECISION

The Commission considered that the 11.1 percent interim increase on total revenue approved by Commission Order No. G-8-92 effective February 1, 1992 was not required. The Commission determines that Centra-FSJ requires the opportunity to earn a return on common equity of approximately 13 percent, within the range of 12.50 percent to 13.25 percent. The rates prior to the approval of the interim are determined to be just and reasonable. The Commission finds that Centra-FSJ requires an annual revenue requirement of approximately $7.488 million which is provided by the permanent rates. Accordingly, Centra-FSJ is to refund, to its customers the interim rate increase inclusive of interest. A reconciliation of the refund should be provided to the Commission. Centra-FSJ is to file, by September 1, 1992, or such earlier date that is reasonable, new rate schedules that reflect the permanent rates.

DATED at the City of Vancouver, in the Province of British Columbia, this day of July, 1992.

J.D.V. Newlands, Deputy Chairman

N. Martin, Commissioner

H.J. Page, Commissioner

APPENDIX A

Centra Gas British Columbia Inc.
Fort St. John District
Summary of Revisions to Application

	Dec. 16/91	Increases (Decreases)	March 2/92	Increases (Decreases)	May 25/92	Increases (Decreases)	May 28/92
Rate Base ($)	11,875,146	(785,704)	11,089,442	30,130	11,119,572	(61,298)	11,058,274
Earned Return at Present Rates ($)	752,394	91,411	843,805	124,810	968,615	(13,461)	955,154
Rate of Return on Rate Base (%)	6.34	1.27	7.61	1.10	8.71	-0.07	8.64
Proposed Rate of Return on Rate Base (%)	11.86	0.06	11.92	0.52	12.44	0.01	12.45
Proposed Earned Return ($)	1,408,392	(86,533)	1,321,859	61,415	1,383,274	(6,519)	1,376,755
Revenue Deficiency After Tax ($)	655,998	(177,939)	478,059	(63,400)	414,659	6,942	421,601
Income Tax on Revenue Deficiency ($)	173,582	(125,360)	48,222	243,855	292,077	2,892	294,969
Revenue Deficiency Before Tax ($)	829,580	(303,299)	526,281	180,455	706,736	9,834	716,570

Source: Exhibit 12A, page 2.2.1R

APPENDIX D

Centra Gas British Columbia Inc.
Fort St. John District
Illustrative Impact on Shareholders' Return on Increased Equity

Common Equity as per recommended award: 13.0% return on 30% common equity	= 3.90
Adjusted for Taxes 44.8% tax rate	= 3.17
Before Tax	= 7.07
Adjusted for Common Equity of 24.7% as per legal entity, 7.25% on additional 5.3% of rate base debt financed	= 0.38
Available before Taxes	= 6.69
Taxes .448 (6.69)	= 3.00
After Tax	= 3.69
Effective Rate of Return to Shareholder 3.69/24.7	**= 14.94%**

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APPEARANCES

S.S. DUNLOP	Commission Counsel
R.B. WALLACE	Counsel for Centra Gas British Columbia Inc.
B. ROGERS	United Brotherhood of Carpenters and Joiners, Local 1237

COMMISSION STAFF

P.W. NAKONESHNY	Senior Financial Analyst - Petroleum
D.W. EMES	Senior Economist
ALLWEST COURT REPORTERS LTD.	Court Reporters & Hearing Officer

LIST OF EXHIBITS

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