IN THE MATTER OF

Kanelk Transmission Company Limited

1995 Revenue Requirements Application

DECISION

October 17, 1995

BEFORE:

K.L. Hall, P. Eng., Chairperson
F.C. Leighton, P. Eng., Commissioner

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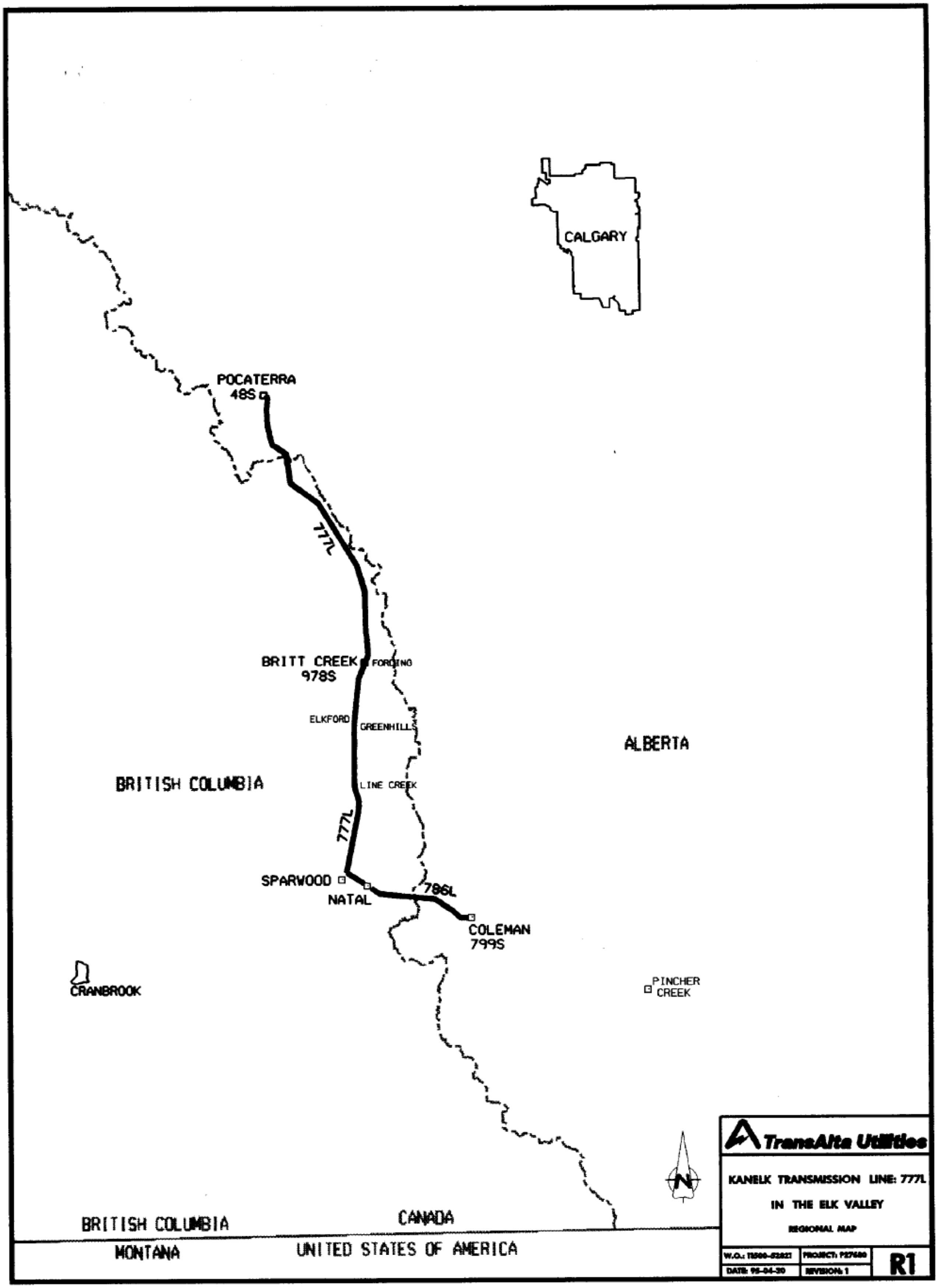
1.0 APPLICATION AND HEARING

Kanelk Transmission Company Limited ("Kanelk") is a wholly-owned subsidiary of TransAlta Utilities Corporation ("TransAlta"). Kanelk owns and operates a 138 kV transmission line and associated facilities in British Columbia, pursuant to a Certificate of Public Convenience and Necessity ("CPCN") issued by the British Columbia Public Utilities Commission on October 24, 1949. The facilities are connected to TransAlta's grid in Alberta at Pocaterra and Coleman and to the grid of the British Columbia Hydro and Power Authority ("B.C. Hydro") at Natal, B.C. (See map)

On April 28, 1995, Kanelk applied to the British Columbia Utilities Commission ("the Commission") for approval of rates on an interim basis, pursuant to Section 106 of the Utilities Commission Act ("the Act"), and on a permanent basis, pursuant to Section 64 of the Act, for transmission and other services provided by or through Kanelk to B.C. Hydro, effective June 1, 1995 ("the Application"). The proposed rate increase is substantial, with costs increasing from $104,000 per year, under a letter agreement which dates back to 1978, to $2,116,600 in 1996. These rates, however, do not result in a corresponding increase in the rates of the B.C. Hydro customers who receive services that are dependent upon the Kanelk facilities. Instead, B.C. Hydro will continue to charge customers its postage-stamp rates for the B.C. Hydro integrated system. The increased costs from Kanelk would be reflected in the overall costs of B.C. Hydro.

By Order No. G-45-95, the Commission approved the requested interim rates effective June 1, 1995, subject to refund with interest at the average prime rate of Kanelk's principal bank. Order No. G-45-95 also set down a pre-hearing conference and a public hearing into the Application. In accordance with this Order, two workshops and a number of meetings between the parties were held during the summer to identify the principal issues and review the completeness of the Application. On September 5, 1995, the Commission heard argument by the parties as to whether it had jurisdiction to hear and decide Kanelk's Application. The Commission issued its Decision (the "Jurisdiction Decision") on September 12, 1995, concluding that the Kanelk service to B.C. Hydro is not an interprovincial undertaking and that the Application falls within the Commission's jurisdiction. In accordance with the arrangements set out in the Jurisdiction Decision, the hearing into the merits of the Kanelk Application commenced on September 18, 1995 and concluded with final argument on September 20, 1995.


CALGARY
POCATERRA
48S
777L
BRITT CREEK
978S
FORDING
ELKFORD
GREENHILLS
ALBERTA
BRITISH COLUMBIA
LINE CREEK
777L
SPARWOOD
NATAL
786L
COLEMAN
799S
CRANBROOK
PINCHER
CREEK
TransAlta Utilities
KANELK TRANSMISSION LINE: 777L
IN THE ELK VALLEY
REGIONAL MAP
R1
BRITISH COLUMBIA
CANADA
MONTANA
UNITED STATES OF AMERICA

2.0 THE KANELK SYSTEM

2.1 Physical Facilities

The present Kanelk facilities consist of two 138 kV transmission lines. The first line, designated as Line 777L, connects the Pocaterra substation in Alberta and the Britt Creek switching station at the site of the line tap to Fording River Coal Mine in British Columbia. This line also connects the Britt Creek station to B.C. Hydro's Natal substation in British Columbia. The second Kanelk 138 kV transmission line is designated as Line 786L and it connects the Natal substation to the Coleman substation in Alberta. Line 777L is 116.2 km in length and Line 786L is 40.5 km in length.

B.C. Hydro also has facilities in this area, consisting of several 138 kV transmission lines between Kanelk Line 777L and various B.C. Hydro customers, plus a 138 kV/25 kV substation feeding the Town of Elkford and a 240 kV/138 kV/69 kV substation at Natal. (See Kanelk Application Schedule F)

2.2 Present Use of the Kanelk Facilities

B.C. Hydro makes use of Kanelk Line 777L from Natal to Britt Creek in order to supply power to B.C. Hydro customers in the Elk Valley. The present loads served are (Exhibit 8):

B.C. Hydro Customers	Peak Load (kVA)	Annual Energy (MW.h)
Fording Coal - Fording River	19,991	109,264
Fording Coal - Greenhills	13,075	85,365
Line Creek Resources	10,246	65,559
Elkford Municipal Area	3,820	14,668
Total	47,132	274,856

The remainder of Line 777L from Britt Creek to Pocaterra is required for the delivery of system support from Alberta in order to provide adequate quality of service to the Elk Valley customers. B.C. Hydro suggested in argument that, under certain conditions, this line could also provide backup to the Coleman area of southern Alberta (T. 509). However, in testimony, Kanelk explained that, if the line was needed for this purpose in an emergency situation, it would be inadequate to backup the load in southern Alberta. (T. 157, 188)

Based on the evidence presented at the hearing, especially that regarding the absence of second contingency backup in planning criteria, the Commission determines that the present use of Line 777L is solely for B.C. Hydro's supply to its customers in the Elk Valley.

In addition, the evidence also indicates that the Natal to Coleman section of the Kanelk facilities (Line 786L) supplies a mutual benefit to B.C. Hydro and TransAlta in the form of approximately 40 MW of mutual backup. (BCH-KAN.15 and Kanelk Application p. 11) Although TransAlta could supply all of the fault level capacity required by B.C. Hydro for its Elk Valley loads from the Pocaterra connection with the Coleman section open, this would result in a greater amount of voltage flicker. To that extent, Kanelk Line 786L provides some additional benefit to B.C. Hydro.

2.3 System Support

System support is currently supplied to Kanelk through its interconnection with the TransAlta system at Pocaterra, Alberta, near the Alberta-British Columbia border. The system support delivered by B.C. Hydro at Natal is insufficient by itself to ensure adequate power quality due to the nature of the loads imposed by the coal mines. From studies done for Kanelk by Optima Engineering and from various load flow analyses, it has been demonstrated that the power delivery to the Elk Valley suffers from unacceptable voltage flicker and voltage instability if it is unsupported by connection to the TransAlta grid. The TransAlta grid provides reactive power, short circuit capacity, load following, and frequency and voltage control, and B.C. Hydro has acknowledged that it needs these attributes for delivering adequate power quality to its customers. Because of the transitory nature of the demand for support, it is necessary that the interconnection switch at Pocaterra remain closed at all times to assure the quality of Kanelk's transmission.

B.C. Hydro could continue to make use of Kanelk Line 777L without the system support provided from Alberta but this would entail significant additional costs for B.C. Hydro. The alternatives to B.C. Hydro would be for B.C. Hydro to construct another 230 kV line from Cranbrook to Natal, to install high speed voltage regulators such as a static var compensator, or to install another source of generation in the Elk Valley. With the exception of additional generation, these options could not duplicate the additional benefits of having system support from the TransAlta grid. From Kanelk's perspective, the only alternative that it would have to obtaining these services from TransAlta would be for Kanelk to construct its own generation facilities.

3.0 HISTORICAL CONTEXT

Before Kanelk was built, southwest Alberta was fed radially from a 69 kV line into the Lethbridge area, which also tied into the system of the East Kootenay Power Company Limited ("East Kootenay") to the west. (BCH-KAN.2) East Kootenay later became a wholly-owned subsidiary of B.C. Hydro.

The Kanelk facilities were originally constructed in 1951 for the purpose of supplying customers in southwest Alberta with power generated in the Bow River area of Alberta and not for the purpose of serving any customers in British Columbia. In accordance with a 1967 amendment to the CPCN, TransAlta (then Calgary Power) bought the Alberta assets of East Kootenay and Kanelk's charter was amended to allow wheeling of energy to and from British Columbia. Letters of agreement signed between 1972 and 1982 enabled B.C. Hydro to take advantage of the Kanelk line by using it to wheel B.C. Hydro power to B.C. Hydro customers in the Elk Valley.

The maps in Schedule F of the Application show that, by 1970, after TransAlta had built its 911L transmission line into Peigan and B.C. Hydro had constructed its 230 kV extension from Cranbrook to Natal, Kanelk's Line 786L from Natal to Coleman became a backup to southwest Alberta and TransAlta's need for Line 777L "substantially diminished". It is noteworthy that the letter dated February 15, 1978 in Schedule D of the Application viewed the flow of B.C. Hydro electricity northward from Natal to its customers in the Elk Valley as "additive flow" rather than "subtractive flow".

By 1985, the Greenhills and Line Creek coal mines were connected to Kanelk's Line 777L and the 500 kV B.C. Hydro/TransAlta Phillips Pass Intertie was completed. The Application notes that there were no other significant changes from that date but that:

> "Following the initial years of operation of the intertie, it became apparent that the Kanelk line no longer had an economic role in electricity supply to Alberta and discussions for revised rates reflecting B.C. Hydro's use of the Kanelk Facilities were initiated in 1989." (Application, p. 6)

4.0 RATES

The original letter agreements established a rate for the wheeling service provided by Kanelk on Line 777L, which B.C. Hydro paid in order to move B.C. Hydro power to B.C. Hydro customers in British Columbia. As was consistent with the practices in place when the letter agreements were signed, the agreements did not break down this rate into its various components. In recent years, with the development of self-generation or co-generation plants by large industrial customers, the nature of the electricity market is changing. Utilities now recognize the value of system support services and are seeking compensation when these are provided. As a result, the rates for services are being unbundled in many jurisdictions. The Kanelk Application separates the charges for wheeling into two components; namely, a charge for the system support provided by TransAlta, and a separate charge to recover the costs for services and facilities directly related to Kanelk.

4.1 Network Services Charge

As noted in Chapter 3, Kanelk does not itself own any means by which it could provide the system support required by B.C. Hydro. Now that the TransAlta support services are unbundled, and charged for separately, Kanelk proposes to purchase network services from TransAlta and to pass the charge through to B.C. Hydro. According to Kanelk witnesses, there are no formal tariffs in Alberta for any inter-utility services at this time and the parent and subsidiary are free to charge whatever is mutually agreed upon. (T. 147, 172) The current network services charge by TransAlta to Kanelk is based on the system support portion of TransAlta's Network Services Rate 820, as approved by the Alberta Energy and Utilities Board ("AEUB"), for services similar to those provided to Kanelk. However, the TransAlta witnesses at the AEUB hearing, at which Rate 820 was approved, stated that:

> ". . . these rates are in response to customer ambitions to take advantage of export markets and customers desiring to pursue their own choice in a provision, at least, of a portion of their own electric services." (AEUB Decision E94076, p. 11)

The network services included in Rate 820 represent a collection of benefits received by being interconnected to an integrated system. B.C. Hydro asserts that it doesn't require all the services in that Rate (Exhibit 8, Q. 5). However, according to Kanelk, it is technically unrealistic to unbundle one of these benefits from the others and to substantiate this for billing purposes, so the services are provided on an "all or nothing" basis. (Exhibit 6, Q.11)

When the AEUB established Rate 820 in its Decision E94076, it approved the grandfathering of existing service so as to protect the investments made by customers on the basis of previously existing rates. In the AEUB Decision, it is noted that TransAlta gave evidence to the effect that:

> ". . . the revenues it was expecting from its proposed new services was small:
>
> | | |
> |---|---|
> | 1995 | ($0.1 million) |
> | 1996 | ($0.1 million) |
> | 1997 | 0.2 million |
> | 1998 | 1.5 million |
>
> Furthermore, customers presently receiving supplementary or 'humalong' service would be grandfathered. Therefore no extra revenue could be expected from existing customers." (Decision E94076, p. 112)

In contrast to this, Kanelk's Application shows that the proposed charge to Kanelk is $595,000 for 1995 (from June 1, 1995) and $1,021,000 in each of 1996 and 1997. Kanelk proposes to pass-through these charges to B.C. Hydro.

Kanelk agreed that there is no change in the nature of the service traditionally provided to B.C. Hydro and that the total increase in Kanelk's rates is in the order of 2000%. Kanelk's witnesses agreed that rate stability is a recognized rate design criteria but said that Kanelk must recover its revenue requirement to avoid significant earning shock on Kanelk shareholders. (T. 152) Later, Kanelk agreed with B.C. Hydro counsel that TransAlta has always recovered its revenue requirement and that the issue is one of equitable rate design between B.C. Hydro and the Alberta ratepayers. (T. 170)

Kanelk also testified that, if the AEUB were to order a rate hearing for TransAlta for 1995 and if the Commission, in this Decision, did not approve pass-through by Kanelk of the 1995 network services charge, Kanelk would appear at the AEUB proceeding to oppose the imposition of such a charge from TransAlta. (T. 325)

The Commission concludes that the application of TransAlta's Rate 820 for 1995 for services to B.C. Hydro is insufficiently justified by Kanelk and it is, therefore, denied.

TransAlta's Network Services Rate 820 applies to TransAlta customers in Alberta where interconnection is necessary for the sustained operation of the customer's system. However, B.C. Hydro contends that this service between TransAlta and B.C. Hydro forms part of the function of the intertie connection and is covered under the terms of the Interconnection and Coordination Agreement (the "ICA") entered into between TransAlta and B.C. Hydro in January, 1993. Specifically, B.C. Hydro asserts that the ICA requires mutual system support at no charge. (Exhibit 8.1, Q.2) B.C. Hydro indicated that it was pursuing arbitration to resolve the interpretation of this part of the ICA.

Commencing January 1, 1996, pursuant to the recently passed Alberta Electric Utilities Act, an entity called the Transmission Administrator will be created which will take into account all transmission support costs, including the transmission support costs of Kanelk, and design a rate to recover those costs from all the distribution utilities and from Kanelk. (T. 195) This rate design work is not yet complete and the filing has not yet been made but Kanelk proposes that any fluctuations in that rate from those forecast in the Application should be passed through to B.C. Hydro. (T. 148)

Subsequent arbitration or court proceedings may determine that the proposed network services rate is covered by the ICA. If this is not the case, and the 1996 rate is approved for recovery in Alberta, the Commission will consider the matter of a pass-through charge to B.C. Hydro. Therefore, the Commission considers that it is not necessary to approve the 1996 network services charge at this time.

4.2 Facilities Charge

According to the Application, the Kanelk facilities costs are derived using normal regulatory accounting principles and reflect:

- depreciated cost of the existing lines;
- additional capital expenditure requirements forecast for the test period;
- a return on rate base of 10.56 % and a return on equity of 12.5%; and
- ongoing operation and maintenance charges and administration costs.

(Application, p. 16)

Kanelk contends that B.C. Hydro is being heavily subsidized by Alberta ratepayers who bear all costs of Kanelk not covered by the small existing revenues derived from the letter agreements with B.C. Hydro. It states that "the unreasonableness of current rates is clearly demonstrated by the fact that, in 1995, they amount to less than 13% of Kanelk's direct cost of service excluding TransAlta Network Services, and 7% of the total cost of service inclusive of TransAlta Network Services." (Application p. 2) However, Kanelk agreed that, when TransAlta last forecast its revenue requirement, it assumed that only $100,000 would be received from B.C. Hydro. If B.C. Hydro is ordered by this Commission to pay more than that

$100,000, Kanelk agrees it is not going to be rebated to TransAlta's ratepayers in Alberta, but rather will become a benefit to TransAlta's shareholders, assuming that there is no TransAlta rate hearing in 1995. (T. 341)

The proposed Kanelk facilities charge is based on the revenue requirement in the statements provided in Schedule B of the Application, as amended by Exhibit 25. These statements are in the usual regulatory form, consisting of schedules of utility rate base, earnings, income taxes, and return on capital. However, they reflect only B.C. Hydro's share of the total revenue requirement, as presented by Kanelk, being 100% of the Pocaterra to Natal section and 50% of the Natal to Coleman section.

Both B.C. Hydro and Kanelk agree that the mutual use of the Natal to Coleman line is split approximately 50/50 (T. 564). B.C. Hydro does not dispute that the Natal to Britt Creek section of Line 777L is now being maintained solely for its purposes and the Commission agrees. B.C. Hydro argued that the costs of the Pocaterra to Britt Creek section should not be fully allocated to it. However, Kanelk proposes to continue to obtain the network services, which B.C. Hydro needs, from TransAlta at the Alberta-British Columbia border near Pocaterra and, regardless of the validity of the network services charge, this requires the continued use of the Kanelk line between Pocaterra and Britt Creek for support of the B.C. Hydro loads.

Therefore, in the absence of economic alternatives, the Commission believes that 100% of the approved costs of the Pocaterra to Natal facilities and 50% of the approved costs of the Natal to Coleman facilities should be charged to B.C. Hydro.

5.0 RATE BASE

5.1 Plant in Service

This is the first time that Kanelk has come before the Commission with a rate application. Consequently, the approved rate base has not yet been determined. Kanelk contends that the rate base should consist of the capital expenditures since the system was built, net of depreciation. Kanelk also asserts that Alberta ratepayers have been subsidizing the operations for years. (Application p. 2, T. 462) However, as discussed in Chapter 3, the system was originally built for TransAlta and continued to be maintained to serve operations in Alberta at least until 1970. By 1970, grid development in Alberta had diminished TransAlta's need for Kanelk's Line 777L.

TransAlta did not acknowledge that Line 777L was no longer useful to it until the period between 1985 and 1989, after the Phillips Pass Intertie was in operation. Even then, TransAlta continued to pay Kanelk a sufficient rental for the Kanelk facilities so as to allow Kanelk to earn a reasonable return on its assets. The notes to Kanelk's financial statements presented in Exhibit 6 consistently state, from 1989 to 1994, that:

> "[Kanelk] . . . charges its parent company, TransAlta Utilities Corporation, a line rental which is sufficient to recover its operating expenses, including depreciation, and provide an after tax rate of return . . . on the average net book value of its non-current assets during the year."

Kanelk acknowledges that the historical financial statements were not intended for rate-making purposes and actually had to be restated to correct for errors in recording the net plant. (T. 251) However, Kanelk now characterizes the revenues from TransAlta, as shown in the Kanelk Application, as "Past Deficiencies", purporting to demonstrate that the charges for service under the letter agreements were not sufficient. (Application p. 7) The Application, in Schedule C, refers to the TransAlta line rental revenue reported in Kanelk's financial statements as a "TransAlta Subsidy to Meet Deficiency". However, the financial statements were separately audited until 1992, and the auditor's report stated that the financial statements present fairly, in all material respects, the financial position and results of operations. As well, according to Kanelk, the auditors continued to monitor the annual results after 1992. (Exhibit 10) The financial statements were also filed with Revenue Canada as the basis for determining Kanelk's income taxes. At a time when the wheeling revenue from B.C. Hydro would not have covered out-of-pocket expenses, the TransAlta payment to Kanelk was always reported as line rental in the financial statements and the return on Kanelk's net assets was never less than 10%.

The value of any plant is reflected by its earning power. The letter agreements with B.C. Hydro presumably were signed with the understanding that the revenues provided to Kanelk by both parties reflected a fair share of the benefits at that time. The B.C. Hydro/Kanelk operating relationship has essentially remained unchanged over the years. What has changed is TransAlta's apparent realization that the Kanelk system is no longer "used and useful" to it. Given this, the Commission would have expected that TransAlta would have requested a reduction in the size of its line rental payments somewhere between 1970 and 1989. In response, Kanelk would have written down the value of its plant to reflect its reduced earning power. This did not happen, and the Kanelk financial statements continued to reflect that the primary purpose of the Kanelk facilities was to provide a service to TransAlta.

Despite the fact that the Kanelk financial statements to 1994 continued to report line rental from TransAlta sufficient to provide an after-tax return of 10.1%, the Commission will accept that the negotiations initiated in 1989 by TransAlta and Kanelk with B.C. Hydro indicated the reduced value of the system to TransAlta and a corresponding increase in value to B.C. Hydro. Kanelk continued to maintain the system and the Commission will recognize this by accepting the capital expenditures made since 1989 as a proper component of approved rate base for the purpose of determining the proper facilities charge to B.C. Hydro.

Therefore, for the purpose of establishing the rates which shall now be paid by B.C. Hydro, the Commission finds that, as at January 1, 1995, the beginning of the first test period in the Application, the approved value of the plant for rate-making purposes is $883,774, being the recorded plant additions from January 1, 1990.

As well, the parties to the hearing did not dispute that the planned capital expenditures in 1995-1997 were needed to preserve the existing capacity of the system, and the Commission accepts these as valid items for inclusion in rate base.

5.2 Depreciation

The depreciation recorded by Kanelk was the subject of numerous Information Requests and much cross-examination. Kanelk acknowledged that the accumulated depreciation had been recorded in error in the financial statements and attempted to reconstruct the Application schedules and prepare results using different depreciation methodologies. (T. 148) Kanelk argued that the biggest difference between Kanelk's depreciation rates and others is that Kanelk's depreciation rates include a salvage component. Kanelk did not prepare a separate depreciation or life study but applied TransAlta's rates to the Kanelk system. (T. 223) Kanelk's counsel suggested that this approach was appropriate and that the rates should be:

> ". . . collected going forward, particularly in the case of Kanelk where the evidence is that it is nearing the end of its original life, that there will be significant salvage and replacement over the next few years and ongoing into the future. It's my submission that the Commission should accept the findings of the Alberta review, that it should accept the depreciation rates as put forward, and until there is a good reason to do otherwise. If you take any action with respect to depreciation rates, I would suggest that it should be to request a specific depreciation study for Kanelk but not to change the rate that is there and has been generated or created in a normal regulatory manner." (T. 474)

As the Commission is only accepting the capital expenditures made since 1989 as approved rate base, it is not necessary to determine whether the depreciation methods used in the past were appropriate.

In future, Kanelk should use the Commission's Uniform System of Accounts Prescribed for Electric Utilities to determine the appropriate methodology. Section 10 of the Commission's Uniform System of Accounts states:

> "There shall be charged monthly to account No. 403, "Depreciation", or other appropriate accounts with concurrent credits to the accounts for accumulated depreciation amounts which will allocate the service value of the plant over its estimated service life in a systematic and rational manner. The service value of the assets, for depreciation purposes, shall be their cost less their estimated net salvage value. Net salvage value means the salvage value less removal costs. In determining the amount of the allocation, consideration may properly be given to pertinent factors such as variations in use, increasing obsolescence or inadequacy. The charges for depreciation shall be computed in conformity with the group system under the straight line method at rates approved by the Commission."

For the purposes of this Application, the Commission will use a composite depreciation rate of 2.5%, starting in the fiscal period following the plant in-service date, as is done in the Commission's treatment of the transmission assets of West Kootenay Power Ltd. (WKP 1994/95 Application, Volume 1, Tab 4, page 3 - Transmission Rate). If Kanelk wishes to undertake a depreciation study specific to the Kanelk assets, it may request a change in the depreciation rate in any future application.

5.3 AFUDC

The forecast capital expenditures in the Application originally included an Allowance for Funds Used During Construction ("AFUDC"), although the projects were forecast to start and complete in the same fiscal period. Normal regulatory practice is to remove the AFUDC to avoid double-recovery on the rate base item. After questioning by Commission counsel, Kanelk agreed that this was TransAlta's practice and removed the AFUDC component in Exhibit 25.

The Commission agrees with the amendment to AFUDC in Exhibit 25.

5.4 Working Capital

Kanelk has included a component for working capital in the rate base, consisting of the unamortized portion of the Application costs and the results of lead-lag studies used in TransAlta's rate applications. Kanelk chose to write-off the Application costs over two years. Both B.C. Hydro and Fording Coal argued that many of the Application costs represent one-time startup expenditures which could be written-off over a longer period. (T. 529)

The Commission recognizes that the Application costs are high for such a small utility, as this is the first time it has brought forth a rate application and does not anticipate seeing such levels in any future application. However, it would be unreasonable to extend the amortization period and attract a longer return on this rate base item. The Commission accepts that the costs should be written-off over a two year period as requested in the Application.

6.0 RETURN ON CAPITAL

6.1 Capital Structure

As Kanelk is a wholly-owned subsidiary and does not participate in capital markets, the capital structure in the Application (Schedule B, page 3) is based on TransAlta's mid-year cost of capital which consists of 40.8% common shareholder's equity, 12.3% preferred shares and 46.9% debt financing. In accordance with normal practice in Alberta, the capital structure proportions remain the same in all three test years. (T. 320)

B.C. Hydro argued that:

> ". . . the approach for B.C. is to look at B.C., weigh it against the factors that this Commission has determined are appropriate and proper to apply to a utility, and determine both a capital structure, which has to be deemed because it's a fully owned company, and you've had the circumstances to deal with lots of times and you've made it clear that you were quite willing to deem what's called an efficient capital structure in those circumstances; and second, to determine the riskiness of the company in making that assessment, and also what the appropriate rate of return is." (T. 531)

The common equity proportions deemed acceptable for other utilities under the Commission's jurisdiction have been in the order of 33-37% (June 10, 1994 Joint Return on Equity Decision). In addition, the high proportion of preferred shares in the capital structure is a function of the different treatment of federal income tax rebates in Alberta. In response to a question by Fording Coal, Kanelk noted that the percentage of preferred shares in TransAlta's capital structure is expected to be reduced in future as a result of changes in income tax treatment. (T. 398)

The Commission believes that, if a capital structure is to be deemed, as it must for this wholly-owned subsidiary, it should be more closely related to the capital structures approved for similar utilities in British Columbia. Accordingly, the Commission will deem a capital structure for the test years of 35% common equity and 65% debt.

6.2 Return on Capital

The Application uses an embedded cost rate for 1995-1997 of 9.461% for debt and 8.336% for preferred shares. TransAlta's current estimate of the 1995 embedded cost rates for debt is 9.61% and for preferred is 8.34%. Its current forecast for the year 1996 for debt is 9.67% and for preferred 8.27%. (T. 338)

The requested 12.5% return on common equity is the return used by Alberta utilities in the Alberta Electric Energy Marketing Act ("EEMA") Adjustment filings and TransAlta's cost of capital as forecast through 1995-1997. (Exhibit 10, T. 230) Kanelk believes this is generous to B.C. Hydro because, on a standalone basis, Kanelk could not raise capital at the same low rates as TransAlta. (Exhibit 10) The Kanelk witnesses were not appearing as rate of return experts and recognized that the cost of calling an expert witness was not warranted. (T. 150, 234)

B.C. Hydro agreed that an expert witness was not required, but argued that, rather than using a TransAlta rate, the Commission should apply the results of its examination of appropriate rates of return for utilities in British Columbia that it has established as a benchmark in the Joint Return on Equity Decision issued June 10, 1994. (T. 531)

B.C. Hydro entered Exhibit 29 which, using the same factors that the Commission does in its automatic adjustment mechanism, taken as at July 1995, calculated the rate of return to be 11.5%. The rationale for the later date was that Kanelk was not regulated by the Commission prior to that point. (T. 535) Mr. Wallace, on behalf of Kanelk, maintained the position put forth in the Application, but suggested that, if the Commission did adopt B.C. Hydro's approach, it should use the projections for 1995, where, according to Exhibit 28 (Commission Letter No. L-39-94), the 1995 returns were in line with that requested by Kanelk. (T. 572)

The Commission believes that, in future, the Kanelk rate of return on common equity should be that established by the Joint Return on Equity Decision and the automatic adjustment mechanism, as applied prior to the start of the utility's fiscal period. The Commission accepts the 9.461% return on debt and the 12.5% return on common equity in the Application as being reasonable and comparable to those awarded to similar utilities under its jurisdiction.

7.0 INCOME TAXES

In Kanelk's Application, the forecast of federal and provincial income tax has been calculated on the flow-through tax method where all tax deductions, including capital cost allowances, are maximized. (Exhibit 15) However, as depreciation for income tax purposes (capital cost allowance) is now less than depreciation taken for book purposes, this results in higher income tax expenses.

Prior to changing to the flow-through method in the 1970s, TransAlta (and therefore Kanelk) used to collect deferred income taxes and, accordingly, a reserve was built up. Exhibit 25 allocates a portion of what is left of the deferred tax balance on TransAlta's books to Kanelk based on gross property and amortizes this over two years. (T. 455)

As the Commission is only accepting the capital expenditures made since 1989 as approved rate base, the allocation of prior year deferred income tax benefits to Kanelk would not be appropriate. The Commission will continue to calculate income taxes using the flow-through method, as requested by Kanelk.

8.0 OPERATING EXPENSES

The operating expenses forecast in Schedule B of the Application included an allocation of certain head office costs. While the accounting expenses were based on actual time spent (T. 363), TransAlta's General and Administrative Expenses were allocated based on a ratio of Kanelk/TransAlta gross property. B.C. Hydro suggested that, taken together with the Network Services Charge, there may be an element of double-counting. (T. 218) Kanelk, however, noted that the amount allocated ($21,700) would not even cover the salary of one person, let alone the necessary office space. (T. 364)

Except for the Network Services Charge, as discussed in Chapter 4, the Commission accepts the Operating Expenses, as amended by Exhibit 25, including the correction for the treatment of salvage expense.

9.0 OTHER MATTERS

At the request of Commission counsel, Kanelk reviewed the utility's CPCN, as amended, and determined that it fully describes the existing services provided by Kanelk and that further modifications were not needed at this time. (T. 299) Fording Coal requested that the CPCN dated October 18th, 1967 be varied to remove the requirement for the consent of East Kootenay and B.C. Hydro, or either of them, to wheel power over the Kanelk system, thereby allowing this jurisdiction to revert to the Commission. (T. 544) B.C. Hydro argued that this is, in fact, a radical step towards retail wheeling and suggested that the Commission's recent report, "The Electricity Market Structure Review," recommended that the government reject retail wheeling at this time. (T. 537)

Fording Coal responded that the request was actually focused on the potential to give Fording Coal the ability to view TransAlta as a supplier. (T. 548)

The Commission agrees that there is merit to Fording Coal's request to modify the CPCN, but it may be premature until government policy with respect to competitive service in British Columbia is determined. If there is a change to transmission access in the rest of the B.C. Hydro service area, the Commission will review the appropriateness of the Kanelk CPCN at that time and will ensure that Fording Coal is not discriminated against.

Commission counsel covered several matters of regulation under the Utilities Commission Act, including the requirements to follow the Commission's Uniform System of Accounts, maintain an office in British Columbia, file System Plans, Annual Reports, etc. Although Kanelk's records do not follow the Commission's Uniform System of Accounts, the financial statements were prepared in accordance with Generally Accepted Accounting Principles and Kanelk determined that its system is aligned with the National Association of Regulatory Utility Commissioners Code of Accounts. (T. 299)

The Commission has been quite flexible with regard to the recording and filing of information by utilities under its jurisdiction and urges Kanelk to discuss the future requirements with Commission staff.

10.0 DECISION

In accordance with the determinations made in Chapters 4 through 8 of this Decision, the rate base and revenue requirements for the test years ending December 31, 1995, December 31, 1996 and December 31, 1997 have been determined as set out in the attached Schedules.

The annual charge to B.C. Hydro to recover the costs for services and facilities directly related to Kanelk is set at a total of $366,294 for 1995, $602,159 for 1996 and $735,550 for 1997. Based on the loads served, and the reported annual energy moved by B.C. Hydro, these rates equate to a wheeling charge of approximately 2.2 mills per kW.h for the seven-month period of 1995 and for 1996, increasing to 2.7 mills per kW.h in 1997.

The Commission has considered separately the matter of charges for Network Services supplied from TransAlta to Kanelk. In Chapter 4 of this Decision the Commission has set out its reasons for concluding that TransAlta's Rate 820 was inappropriate for a pass-through charge by Kanelk to B.C. Hydro. The matter of charges for support services remains in contention between the parties and will remain unresolved pending clarification of the arrangement under terms of the ICA, and the approach to be taken by the Alberta Transmission Administrator in 1996 for inter-utility Network Services charges. **The Commission has determined that no system support service charges will be levied for 1995. The Commission will address the situation for 1996 and 1997 when more information becomes available.**

Dated at the City of Vancouver, in the Province of British Columbia this 17th day of October, 1995.

Original signed by: ___________________________
Mr. K.L. Hall
Chairperson

Original signed by: ___________________________
Mr. F.C. Leighton
Commissioner

APPEARANCES

M. MOSELEY	Commission Counsel
R.B. WALLACE	Kanelk Transmission Company Limited
C.W. SANDERSON	British Columbia Hydro and Power Authority
J.D.V. NEWLANDS	Fording Coal Limited

W.J. GRANT B. MCKINLAY R.W. RERIE F.S. JAMES	Commission Staff
ALLWEST COURT REPORTERS LTD.	Court Reporters & Hearing Officer

LIST OF EXHIBITS

	Exhibit No.
Letter Dated April 27, 1995 and Application dated April 28, 1995	1
Letter Dated April 25, 1995 from TransAlta Utilities to Kanelk Transmission Company	2
Letter Dated April 26, 1995 from Kanelk to Mr. Threlkeld at B.C. Hydro and Power Authority	3
Letter Dated May 25 from Kanelk Transmission Company to Mr. Threlkeld at B.C. Hydro and Power Authority	4
Letter Dated May 31, 1995 from B.C. Hydro and Power Authority to M.A. Nelson Kanelk Transmission Company Limited	5
Letter Dated June 13, 1995 Responses from Kanelk Transmission Company to the B.C. Utilities Commission Information Request	6
Historic Correspondence Filed in Response to Question Number 3	6A
Letter From Kanelk Transmission Company to TransAlta Utilities dated June 20, 1995	7
Letter From B.C. Hydro and Power Authority, Mr. Harrison, dated June 23, 1995 to the B.C. Utilities Commission	8
Letter Dated July 18, 1995 from B.C. Hydro and Power Authority to TransAlta Utilities	9
Letter Dated July 18 from Kanelk Transmission Company to B.C. Hydro and Power Authority in Response to B.C. Hydro and Power Authority Information Request Number 1	10
Letter From Kanelk Transmission Company to the B.C. Utilities Commission in Response to Fording Coal Information Request Number 1	11
Letter From Kanelk Transmission Company to the B.C. Utilities Commission dated July 31, 1995 in Response to Fording Information Request Number 2	12
Letter From Pacific Western Energy Products to TransAlta Utilities Corporation dated July 31, 1995	13
Letter Dated August 4, 1995 from B.C. Hydro and Power Authority to the B.C. Utilities Commission in Response to Additional Information Request by the B.C. Utilities Commission Staff	14
Letter From Kanelk Transmission Company to B.C. Hydro and Power Authority dated August 14, 1995 in Response to B.C. Hydro and Power Authority	

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	Exhibit No.
Information Request Number 1	15
Fax to B.C. Hydro and Power Authority from TransAlta Utilities dated August 25, 1995	16
Letter Dated September 1, 1995 from Kanelk Transmission Company to the B.C. Utilities Commission, Balance of Requests from the July 26 and August 23 Kanelk Workshops	17
Letter From Kanelk Transmission Company Limited to the B.C. Utilities Commission	18
Revised Schedule B dated September 15, 1995	19
Revised Schedule B on the Basis of 100% Basis dated September 15, 1995	20
B.C. Hydro and Power Authority Schematic Diagrams of Transmission Facilities	21
Letter Dated August 23 from Mr. Sanderson to Mr. Wallace	22A
Letter Dated September 14 from Mr. Sanderson to Mr. Wallace	22B
B.C. Utilities Commission Letter L-36-94 dated December 15, 1994	23
Invoice from TransAlta Utilities to Kanelk Transmission Company dated September 6, 1995	24
Restated Schedule B Statement of Earnings (100% Pocaterra to Natal + 50% of Natal to Coleman)	25
Document Showing Amount of AFUDC With Respect to Various Sections of the Line	26
Document Entitled Comparison of Depreciation Rates and Method for Selected Utilities	27
B.C. Utilities Commission Letter L-39-94 dated December 2, 1994	28
Table Entitled Calculation of Rate of Return on Common Equity as of July 1995 Using Adjustment Mechanism from BCUC Decision June 10, 1994	29
Document Entitled Selected Canadian Regulated Utility Capital Structures, ROE'S and Bond Ratings	30
B.C. Hydro and Power Authority Inter-Office Memo Regarding the Rates of the East Kootenay Power Company Assets	31

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