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

and

IN THE MATTER OF
an Application by
Northland Utilities (B.C.) Limited,
Tumbler Ridge Division

DECISION

August 31, 1988

Before:

N. Martin, Commissioner and
Chairman of the Division
A.C. Michelson, Commissioner
H.J. Page, Commissioner

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A P P E A R A N C E S

C. SHEARD	for the Applicant Northland Utilities (B.C.) Limited
W. MOORE	for Quintette Coal Limited
G. DAVIES	for District of Tumbler Ridge
G. FULTON	Commission Counsel

W.J. GRANT J.A. GREINER	Commission staff
W.G. BEMISTER	Hearing Officer Allwest Reporting Ltd.
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LIST OF EXHIBITS

1.0 INTRODUCTION

Interest in providing natural gas service in the vicinity of the northeast coal properties existed for several years, and after firm commitments to the mining of the northeast coal properties came about in 1981, serious plans for natural gas service to the region were advanced. Inland Natural Gas Co. Ltd., ICG Utilities (British Columbia) Ltd. and Northland Utilities (B.C.) Limited made applications to provide service. Following completion of a public hearing at Dawson Creek, B.C. in 1982, Northland Utilities (B.C.) Limited ("Northland") was granted the right to provide natural gas service to Tumbler Ridge pursuant to Commission Order No. C-2-82.

The utility serves close to 1300 customers and is forecasting annual sales of 302 terajoules ("TJ"). Of this volume, the Quintette coal mine has a take-or-pay contract for 141 TJ. To date, Quintette has always taken substantially less than its full contract amount.

In the Decision accompanying Order No. C-2-82, the Commission stated that:

> "The Commission recognizes that Northland are prepared to offer a tariff for Tumbler Ridge which allows for recovery of costs plus rate of return over ten years. The effect of the rate structure is to reduce utility return in the early years with catch-up in the later years. The Commission believes that such an averaging of the rate is in the public interest for a new project like Tumbler Ridge." (p. 48)

The utility obtained grants, refundable at the end of ten years, totalling $1.2 million from Quintette Coal and the District of Tumbler Ridge. Despite this, the natural gas rates in Tumbler Ridge remained the highest in the province, for two reasons. Firstly, the gas sales originally anticipated by the utility did not materialize. Secondly, the gas processing plant which has a current depreciated value of $1.8 million was not rolled into the Westcoast toll but charged in its entirety to the Tumbler Ridge customers.

Northland began accumulating losses which it appeared would not be recovered by 1991 without significant rate increases. However, any rate increase, given the already high tariffs and the particular economic conditions in Tumbler Ridge would further erode sales and revenues.

On March 7, 1986, Northland applied for a rate increase of $0.899/GJ which would have resulted in a total energy charge of $6.823/GJ. The Application was put on hold when Northland entered into negotiations with government officials to determine whether there was an alternative available which would provide lower rates. These negotiations resulted in a proposal whereby Westcoast Energy Inc.* ("Westcoast") would purchase Northland's gas processing plant and transmission line. Northland would then be charged a system average cost for gathering, processing and transmission.

This proposal was endorsed by the Provincial Government and as a result Westcoast sought National Energy Board ("NEB") approval to include these assets in its rate base. In October 1987, the NEB issued a Decision which denied Westcoast the right to include those assets in rate base. As a result, Westcoast declined to purchase the processing plant and transmission line.

On February 18, 1988, Northland filed an Application to increase its rates to $6.309/GJ. This rate was based on extending the recovery period for accumulated losses to 1997.

Shortly after filing this Application, Northland was contacted by representatives of the Commission and the Ministry of Energy, Mines and Petroleum Resources to discuss a possible solution to the high cost of providing natural gas service to Tumbler Ridge. On May 4, 1988, representatives of the District of Tumbler Ridge, Quintette Coal, Northland, the Ministry and the Commission met to discuss the proposed solution. At that meeting agreement was reached whereby:

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* Formerly Westcoast Transmission Company Limited

1. Quintette and the District would relieve Northland of its obligation to refund their $1.2 million loan;

2. Northland would forego recovery of the accumulated shortfall of approximately $1.7 million; and

3. The provincial government would provide a contribution equal to the net book value of the processing plant at June 1, 1988 approximately equal to $1.8 million.

Northland subsequently submitted a rate Application based on the agreement which reduced the Tumbler Ridge tariff from $5.924/GJ to $4.526/GJ (a decrease of $1.398/GJ). The Commission, by Order No. G-56-88 dated May 26, 1988, accepted the filed tariff on an interim basis effective June 1, 1988 and set down the Application for hearing on July 12, 1988.

Order No. G-59-88 dated June 7, 1988 changed the hearing date to commence on July 26, 1988.

2.0 LOAD PROFILE

The Applicant provided a forecast of gas consumption and number of customers as Schedule 10 of its Application. It is forecast that sales in both 1988 and 1989 will be 302 TJ, including 141 TJ sales to Quintette. This volume is equivalent to the take-or-pay quantities included in the contract between Northland and Quintette. In the past Quintette's volume has fallen well short of its take-or-pay level. Actual consumption by Quintette in 1986 and 1987 was 87 TJ and 73 TJ, respectively. It is therefore most likely that the 141 TJ (take-or-pay volume) will be the correct level to utilize in determining rates. The remainder of the sales are made to residential, apartments and commercial customers. The forecast residential sales of 108 TJ are approximately equivalent to the normalized sales over the recent period. The sales to apartments and commercial enterprises of 53 TJ are also equivalent to the normalized recent sales.

Northland acknowledged that the reduced natural gas rates at Tumbler Ridge would afford the utility an opportunity to increase sales. Mr. Ellard stated in response to a question from the panel Chairman that:

> "Certainly with a lower rate the potential should be greater to entice conversions from alternate sources, provided the facilities can be built to get the gas there, and the economics justifies it. But certainly with a lower rate the potential should be greater."

Mr. Ellard later stated that he believed that customers would have to experience the lower gas bills for a period of time before they would increase their consumption of natural gas. This is particularly so with the amount of wood burning in the community. Although wood burning has created pollution problems during the winter time under periods of atmospheric inversions, Mr. Ellard believed that customers will have to experience the new lower rates for natural gas usage for a period of time before they lose the incentive to go out and chop wood.

The Commission panel accepts the sales forecast provided by Northland. However, the Commission believes that the reduction in natural gas rates provides Northland with an opportunity to more effectively market natural gas in the community. Northland may also find that the municipal government may assist the utility in its efforts to dissuade residents from increased usage of wood, particularly during periods of air inversions. Northland should also reassess the potential for the use of Natural Gas for Vehicles ("NGV") by Quintette.

The Commission is also aware that the forecast sales and number of customers assumes a static situation at Tumbler Ridge. Given the coal sales projections and risks facing the coal companies supporting this single industry town, the Commission believes this forecast is appropriate at this time but looks for an increased marketing effort on the part of Northland to develop additional consumption and hopefully thereby further decrease rates.

3.0 NATURAL GAS SUPPLY

Recent amendments to the Utilities Commission Act provide opportunities for utilities and natural gas producers to enter into direct sales arrangements. At the present time, Northland purchases its natural gas through Westcoast with gas supply coming from the British Columbia Petroleum Corporation ("BCPC"). In future, Northland will be free to negotiate with various producers for its gas requirements.

The new competitive options afforded by the provincial government legislation provide an opportunity for Northland to better control its natural gas supply costs. Northland provided evidence that the natural gas processing plant is designed with a capacity considerably in excess of current needs. This design provides flexibility for Northland in its gas purchasing practices and will accommodate future growth at Tumbler Ridge. However, the processing plant has limitations on the amount of natural gas it is able to process at varying levels of acidity. The Commission encourages Northland to evaluate its options for a long-term supply of natural gas for the utility.

4.0 OPERATING EXPENSES

The Commission finds the Applicant's forecast of operating costs to be reasonable. It does, however, note two areas where adjustments appear warranted.

Northland estimated rate hearing costs of $46,000 allocated over two years. Actual costs are now available and they are less than the estimate. The Applicant incurred rate hearing expenses of approximately $5,000. The Commission's direct hearing costs are in the order of $9,000. The current annual BCUC cost allocation to Tumbler Ridge is approximately $3,000.

When the rate hearing costs are allocated over two years, the annual recoverable expense becomes:

Applicant's Rate Hearing Cost: $5,000 x .5	$2,500
Commission Direct Cost: $9,000 x .5	$4,500
BCUC Annual Cost Allocation	$3,000
	$10,000

This amount of $10,000 will replace the $23,000 rate case expense shown in Northland's Application.

Northland also sought to increase the contribution of the Tumbler Ridge Division towards the Reserve for Injuries and Damages by $25,000 for each of the next two years. The reserve now stands at $58,000; $54,000 from Dawson Creek and $4,000 from Tumbler Ridge. The evidence at the hearing indicated that over the last few years, draws on this reserve have been very small, in the order of a few thousand dollars per year. The Commission is not persuaded on the strength of the evidence presented that it is necessary to double this reserve at this time. However, it does recognize that the Tumbler Ridge division should contribute more to the reserve than it has to date. Consequently, the Commission will allow an additional $10,000 in each of the two test years to be charged for an increase to the Reserve for Injuries and Damages. At the end of the two year period, Northland should reassess the Reserve requirement at that time and advise thereon in its Annual Report to the Commission.

5.0 RATE BASE

The Applicant's gross plant has been stable at approximately $6.4 million. Minor capital additions of $15,000 are anticipated in 1989.

Customer contributions over the life of the utility have been $262,000. Quintette coal and the District of Tumbler Ridge have together contributed $1.2 million.

The Provincial Government has also contributed the sum of $1,842,000, which is the net book value of the processing plant at June 1, 1988.

Customer Contributions	$ 262,000
Quintette and the District	$1,200,000
Provincial Government	$1,842,000
Total Contributions	$3,304,000

The contributions have an immediate effect of reducing rate base. The Company has chosen to amortize the contributions at the same rate as the depreciation on the assets which the contributions finance. Since the amortization will exactly offset depreciation expense, the subsequent net effect on rate base will remain neutral.

Northland's calculations of accumulated depreciation and working capital are in order.

The financial plan agreed to by Northland, Quintette, the District and the Provincial Government will result in a marked reduction in rate base. The Applicant's actual mid-year rate base was $5,640,000 in 1987 and is forecast to drop to $3,960,000 in 1988 and $2,355,000 in 1989. This reduction of rate base supports the reduced rates applied for by Northland.

6.0 CAPITAL STRUCTURE

The Applicant has been experiencing a divergence between its rate base and its capital structure, largely due to depreciation exceeding its asset growth. To redress this problem, its parent, Northwestern Utilities Ltd., will redeem $520,000 of its 13.10 percent debentures and Northland will reduce its equity through dividend distributions.

In order to take account of the approximately $3 million reduction in rate base resulting from the adoption of the financial agreement described previously, the Applicant will:

1. redeem $1,080,000 of 13.10 percent debentures;
2. redeem common equity by $720,000; and
3. remove $1,200,000 from long-term debt.

The end result of these transactions will produce, in 1989, a capital structure (excluding no cost capital) comprised of 60 percent debt and 40 percent equity. The Commission believes this to be an appropriate target for Northland.

Northland also proposes that:

> "... the capital structure used to determine the return on rate base for the Tumbler Ridge Division be determined by reference to the total capital structure for the consolidated entity. Northland submits that it is no longer appropriate to attempt to allocate specific debentures to specific divisions within the utility. With a declining rate base in Tumbler Ridge and a stable rate base in Dawson Creek, it is unreasonable to earmark specific issues to each division. Overall financing of capital is based upon the needs of the entity itself and not directly from divisional requirements. The debt rate used for each division should be based on the average rate for all debt issued by Northland. Therefore, debenture financing has been allocated between divisions in proportion to rate base requirements and the resulting cost of debenture financing for each division is the weighted average embedded cost rate for all debentures held by Northland." *

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* Page 11 - Exhibit 2

The Commission accepts the Applicant's methodology for calculating capital structure and finds it an appropriate position for the utility to adopt.

7.0 RETURN ON EQUITY

Northland relied on evidence provided by Dr. Sherwin for its requested return on equity for the 1988/89 test year. The Company, in an effort to reduce its costs for this Application, did not present Dr. Sherwin at the hearing as an expert witness. Instead, Mr. Tony Walker, Treasurer of Canadian Utilities Ltd., adopted Dr. Sherwin's testimony and answered questions on rate of return.

The Commission is pleased with the approach taken by the Applicant. The cost of an outside expert witness for rate of return was not justified in a utility the size of Northland. Mr. Walker's evidence was both helpful and adequate. The Commission is of the opinion that sufficient evidence was provided on this subject on which to base a reasoned decision.

The Applicant sought a return on equity in the 14.875 to 15.125 percent range, or a mid-point of 15 percent. Its assumptions leading to this recommendation were:

1. interest on long-Canada bonds of 9.5 percent;
2. a typical low risk utility earning 14.375 percent on common book equity; and
3. the addition of 0.50 to 0.75 percent to recognize the greater business risk inherent in the operations at Tumbler Ridge.

In considering this recommendation, the Commission believes, as at the writing of this Decision, the long-Canada bond rate is approximately 10.5 percent.

The Commission considers the implied risk premium of 4.875 percent for a low risk utility (including flotation costs) to be excessive but that the addition of 0.50 to .075 percent to recognize Tumbler Ridge Division's greater business risk is not unreasonable.

In the light of the past record of developments in the history of Tumbler Ridge, the corporate performance of Northland and the uncertain future of the whole area, the Commission accepts that a range of 14.75 to 15.25 percent rate of return on common book equity is appropriate. Hence, the Commission concurs with the Applicant's request for a 15 percent rate of return.

8.0 COMMISSION FINDINGS

The Commission accepts the Applicant's rate application with a few minor adjustments to the financial schedules. The 1988 Cost of Service is reduced from $23,000 to $10,000 for rate hearing costs and a change in the addition to Reserve for Injuries and Damages from $25,000 to $10,000. The requested rate of return on equity of 15 percent is accepted. All of these adjustments are reflected in the appended schedules and the new firm rates.

The effective general service rate at Tumbler Ridge will therefore be approximately $4.43/GJ effective September 1, 1988. Subject to timely presentation, the Commission will accept for filing the appropriate tariff amendments based on final computations made by Northland. The Commission accepts the interim rate of $4.526/GJ for the period June 1, 1988 to August 31, 1988 as firm.

DATED at the City of Vancouver, in the Province of British Columbia, this 31st day of August, 1988.

N. MARTIN, Division Chairman

A.C. MICHELSON, Commissioner

H.J. PAGE, Commissioner

BRITISH COLUMBIA UTILITIES COMMISSION

ORDER NUMBER G-81-88

PROVINCE OF BRITISH COLUMBIA

BRITISH COLUMBIA UTILITIES COMMISSION

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

and

IN THE MATTER OF an Application by Northland Utilities (B.C.) Limited

BEFORE:	N. Martin, Commissioner and Chairman of the Division; A.C. Michelson, Commissioner; and H.J. Page, Commissioner	August 31, 1988

O R D E R

WHEREAS Northland Utilities (B.C.) Limited ("Northland") applied May 24, 1988 ("the Application") to amend its filed Gas Tariff Rate Schedules for its Tumbler Ridge Division to incorporate an interim decrease in rates to all customers effective June 1, 1988; and

WHEREAS the Application was heard at a public hearing on July 26, 1988 in Tumbler Ridge, B.C. pursuant to Commission Order No. G-59-88; and

WHEREAS the Commission has considered the Application by Northland and the evidence adduced thereon during the public hearing of the Application all as set forth in the Decision ("the Decision") issued concurrently with this Order.

NOW THEREFORE the Commission orders as follows:

1. The interim rate decrease of $1.398/GJ for natural gas service in Tumbler Ridge, approved by Commission Order No. G-56-88 effective June 1, 1988 is confirmed through August 31, 1988.

.../2

BRITISH COLUMBIA
UTILITIES COMMISSION

ORDER
NUMBER G-81-88

2. The General Service Rate charged for natural gas service at Tumbler Ridge will be approximately $4.43/GJ, effective September 1, 1988, subject to timely filing by Northland.

DATED at the City of Vancouver, in the Province of British Columbia, this 31 day of August, 1988.

BY ORDER

Norris Martin
Commissioner and
Chairman of the Division

311/26/ac

SCHEDULE I

NORTHLAND UTILITIES (B.C.) LIMITED

TUMBLER RIDGE DIVISION

CALCULATION OF RATE BASE

($000's)

	Forecast	
	1988	1989
Property, Plant and Equipment	6,528	6,543
Less: Accumulated Depreciation	1,012	1,231
Net Plant in Service (Year End)	5,516	5,312
Less: Contributions	3,304	3,304
Plus: Amortization of Contributions	104	252
Net Plant in Service (Year End)	2,316	2,260
Mid Year Plant in Service	3,895	2,288
Working Capital	65	67
Mid Year Depreciated Rate Base	3,960	2,355

NORTHLAND UTILITIES (B.C.) LIMITED

TUMBLER RIDGE DIVISION

MID YEAR CAPITAL STRUCTURE AND RETURN ON EQUITY

Year	Mid-Year Capitalization ($000's)	Structure Percent	Cost Percent	Return Component Percent	Excluding No Cost Capital Percent
1988					
Long Term Debt	2,155	56.02	9.629	5.40	67.45
No Cost Capital	652	16.95	0	--	
Common Equity	1,040	27.03	15.0	4.05	32.55
	3,847	100.00		9.45	100.00
1989					
Long Term Debt	1,005	44.67	13.313	5.95	59.65
No Cost Capital	565	25.11	0	--	
Common Equity	680	30.22	15.0	4.53	40.35
	2,250	100.00		10.48	100.00

SCHEDULE 3

NORTHLAND UTILITIES (B.C.) LIMITED

TUMBLER RIDGE DIVISION

UTILITY REVENUE REQUIREMENTS

($000's)

	Forecast	
	1988	1989
Rate Base	3,960	2,355
Return on Rate Base	9.45	10.48
Utility Income	374	247
Gas Supply Expense	556	556
Operating & Maintenance	453	471
Taxes - Other	63	63
Depreciation	130	71
Sub Total	1,576	1,408
Utility Income Tax	147	87
Total Utility Revenue Requirements	1,723	1,495