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

and

IN THE MATTER OF
an Application by
Columbia Natural Gas Limited

DECISION

January 21, 1987

Before:

J.D.V. Newlands, Deputy Chairman
N. Martin, Commissioner

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COMMISSION ORDER NO. G-5-87

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ALLWEST REPORTING LTD.	Court Reporters

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1.0 INTRODUCTION

Columbia Natural Gas Limited ("Columbia", "the Applicant") pursuant to Sections 67(2) and 106 of the Utilities Commission Act ("the Act"), applied on May 30, 1986 for interim and permanent rate relief to be effective July 1, 1986. The requested increase of 2.4% or $660,000 over existing rates, contemplates a 13.15% return on rate base and a 15% return on common equity based on fiscal 1987 forecast. The last Commission Decision, dated March 1986, for Columbia approved a rate of return on common equity of 14.75%.

The Applicant stated that the rates presently in effect would only yield a return on equity of 9.89%. The reason for the rate increase was to avoid erosion of Columbia's earnings in its fiscal year ending June 30, 1987. The reduced earnings were attributed to a significant reduction in sales to industrial customers, and the full year inclusion of the capital costs of the Cranbrook Lateral in the rate base.

By Order No. G-39-86 dated July 4, 1986, the Commission approved the requested interim increase. By Order No. G-48-86, the Commission set the Application for hearing commencing October 14, 1986 at Cranbrook, B.C. Order No. G-59-86 rescheduled the date of hearing to October 15, 1986. The hearing proceedings required six days commencing in Cranbrook, British Columbia on October 15, 1986. The hearing continued in Cranbrook for five days and concluded in Vancouver on October 31, 1986.

Dr. R.E. Evans was retained as Columbia's expert witness to address the appropriate rate of return on common equity. Columbia entrusted to file an update of its rate design application on or before June 30, 1986 and proposed that the rate design matters be heard following the completion of the revenue requirement hearing of Columbia.

In addition to issues concerning the Applicant's cost of service, questions were also raised with regard to outstanding issues addressed in the fiscal 1986 Decision dated March 18, 1986. Other issues examined included the appropriate capital structure of Columbia as a result of its parent, Inland Natural Gas Co. Ltd.'s ("Inland") consolidated position; gas supply issues with respect to deregulation; and, disposition of a deferred account adopted by Columbia to accumulate the savings due to lower cost of gas to Schedules I through IV customers between June and October 1986.

Evidence for the Applicant was presented by Mr. C.I. Kleven, Vice-President, Finance and Administration; Mr. R.T. O'Callaghan, Vice-President, Gas Supply and Engineering; Mr. G.M.O. Solly, Vice-President, Operations; Mr. J.L. Randall, Vice-President, Marketing and Utility Planning; Mr. W.F.G. Arthur, Manager, Marketing; Mr. B.F. Vernon, Product Manager, Transportation Fuel; Mr. J.O. Wessler, Manager, Regulatory Affairs; and, Mr. R.G. Bowman, General Manager of Columbia.

The Commission expresses concern that Company policy was not confirmed by one appropriate witness, but rather that several Vice-Presidents appeared to be dealing with policy matters. Future proceedings could be improved if a single policy witness were to appear for Columbia.

Intervenors represented included Crestbrook Forest Industries Ltd. ("Crestbrook"), Crows Nest Resources Ltd. ("Crows Nest"), Westar Mining Ltd. ("Westar") and Fording Coal Ltd. ("Fording"). In addition, evidence was given by Mr. J.P. Gormley and Mr. G.R.G. Kennard on economic issues concerning their employer, Crestbrook. Dr. W.R. Waters appeared as expert witness on behalf of Crestbrook and Crows Nest with regard to the appropriate capital structure and rate of return of Columbia.

The Commission appreciates the assistance provided by Dr. Waters and the witnesses from Crestbrook. The Crestbrook witnesses provided information with respect to market conditions in the forest industry and the local economy, and the impact of those difficult conditions on Crestbrook's natural gas consumption. They also described the results of their efforts in budgetary restraint including the mill optimization program. The Commission was pleased that the relationship between Crestbrook and Columbia had improved since the last hearing.

The following quote from Mr. Gromley's testimony aptly stated the objectives that Columbia should strive towards in this era of declining natural gas consumption:

> "...I would like to ask that Columbia do more for us in regards to addressing costs and doing everything they can so that rather than ask for rate increases of services that they find ways, revolutionary ways, if they may be, to reduce or hold costs.
>
> I would ask that they do what they can to have objectives of instead of merely controlling costs to try and reduce them, as all of us have to do. Certainly if the Commission's role is in part to stimulate competition in this area of a natural monopoly that it should be and could be a very harsh and demanding master. Certainly the marketplace is." (Transcript p. 395).

Mr. Gormley indeed set out a theme for this hearing.

2.0 UTILITY CHARACTERISTICS

Columbia was incorporated on November 6, 1961 under the British Columbia Companies Act. It became a public company in 1962 and reverted to a private company in 1973. During the intervening period Columbia was acquired by Norcen Pipelines Ltd. On July 9, 1979 Columbia became a wholly-owned subsidiary of Inland Natural Gas Co. Ltd.

In 1962 Columbia was granted a Certificate of Public Convenience and Necessity by the Public Utilities Commission of British Columbia and commenced distribution of natural gas within the communities of Cranbrook, Kimberley, Creston and Fernie. Service has since been extended to the communities of Elkford, Sparwood and Yahk. In 1982 Columbia commenced gas service to the communities of Jaffray and Galloway, as a result of the federal funding from the Distribution System Expansion Program ("DSEP"). Columbia serves approximately 14,270 customers. In addition, Columbia currently serves five large industrial customers located within its general service area.

The Head Office of Columbia is located in Vancouver. The operations of Columbia are managed from its Regional Office located in Cranbrook and from District Offices in Kimberley, Creston, Fernie and Sparwood. Columbia's direct payroll includes 33 permanent employees providing operational, maintenance and clerical services. Support services in the areas of customer billing, accounting, finance, marketing, legal, employee relations, gas supply, gas measurement and corporate matters, are provided by employees and officers of Inland.

Natural gas supplies are obtained from seven taps located on the transmission pipeline of Alberta Natural Gas Company Limited ("ANG"). These taps are located at Sparwood, Fernie, Elko, Jaffray, Cranbrook, Yahk and Creston. Gas supply is contracted from the Alberta and Southern Gas Co. Ltd. ("A & S") and

Westcoast Transmission Company Limited ("Westcoast") on a "cost-of-gas" plus "cost-of-service" basis, at the taps or delivery points on the ANG pipeline. In 1976, natural gas became available from Inland on an exchange basis with A & S. This gas is provided through the East Kootenay Link on an "as available" interruptible contract basis.

3.0 THE APPLICATION

The following are major features of the Columbia Application of May 30, 1986 on which the interim increase of 2.4% was provided:

- Columbia forecast plant additions of $1.6 million in fiscal 1987 as compared to $2.9 million in the 1986 Rate Application; the latter included $1.5 million for the construction of the Cranbrook Lateral. Mains and services additions are significantly lower than in 1986. Natural Gas for Vehicle stations ("NGV") estimated to cost $924,000 exclusive of overhead are major additions to plant.

- Forecast sales are expected to be 15% lower than those in the 1986 Decision due to reduced forecast sales to industrial customers, particularly Fording Coal and Westar-Sparwood.

- Cost of gas was forecast to be uncertain due to deregulation of field prices and a potential mix of purchases from A & S, the Deep Basin area of British Columbia, and Inland. An example is that on Exhibit #4, Tab 9, Columbia indicated the effects of deregulation would reduce its forecast cost of gas from $22 million in the Application to $14.8 million. The difference would form part of a pass-through application to reduce all customer rates.

- Operation and Maintenance ("O and M") costs were forecast to increase 8.57% over 1986 projection, which in turn was 4.2% over the 1985 normalized costs. The bulk of the 8.57% increase was due to costs related to Byron Creek and new NGV operations.

- The income tax rate was forecast at 52.947%, a reduction from the 1986 rate of 53.8%.

- Columbia requested a rate of return on common equity of 15%. The current approved rate is 14.75%. The impact of the 0.25% increase would be approximately $30,000 in additional revenue requirement.

- Columbia stated that it would expect to issue $3-4 million of additional long-term debt in fiscal 1987.

- Columbia would file a report on management fees charged by Inland, as directed in the 1986 Decision.

- The Company would also submit a response on alternate insurance.

As a result of various issues raised during the hearing, the Applicant filed revised Exhibit #24 dated November 14, 1986 which significantly revised the initial Application. The submission was very helpful to the Commission in its consideration and analysis of the Application.

The revised Application restated the Applicant's revenue deficiency to $812,000 or 3% of existing rates. The additional increase is mainly due to the inclusion of only one NGV station in the Application as compared to three stations originally forecast to be in place in fiscal 1987. The lack of capital cost allowance write-off for the exclusion of the two NGV stations has caused an increase in revenue deficiency of approximately $150,000. The Commission directs the Applicant that should either of the remaining two NGV stations come on stream in fiscal 1987, capital cost allowance should not be deducted until the next fiscal year to ensure equity between the rate payers and shareholders.

In this Decision the Commission does not need to account for the impact on rates of significant gas price reductions effective November 1, 1986 resulting from natural gas price deregulation. The reductions have been dealt with by the Commission in its Order No. G-74-86 pursuant to Section 67(4) of the Act in response to the Applicant's cost of gas pass-through reduction application dated November 10, 1986. The overall rate reductions that occurred ranged from $0.86/GJ for Rate I customers to $1.58/GJ for large industrial customers. Average savings of approximately $10 million are expected from Columbia's forecast gas cost of $22 million.

4.0 ISSUES

The environment facing Columbia in fiscal 1986/1987 is one of reduced and less volatile interest rates, reduced capital expenditure by the utility and declining industrial sales. At the same time natural gas commodity prices have declined dramatically as a result of provincial and federal initiatives to provide a competitive market for natural gas sales.

The Commission has considered the revised Application and will accept the forecast plant and rate base additions as requested. Total plant and rate base additions of $860,000 represent modest mains and service additions, plus the addition of one NGV station addition. Industrial sales were verified by the various industrial intervenors (Transcript pp. 277, 625) and are accordingly accepted by the Commission.

The following are major issues raised during the hearing which require the Commission's comment.

4.1 Gas Supply

The Commission's last rate Decision for Columbia in March of 1986 addressed the matter of future gas supply for Columbia in the environment of gas price decontrol. Initiatives by the Government of British Columbia and Canada removed many constraints on the purchase of natural gas by utilities and by industrial customers. Columbia moved quickly to take advantage of the new conditions facing utility gas purchases. At the same time producers were adjusting to the new environment and began negotiating sales agreements under what was termed "Competitive Market Pricing".

Columbia has become the first utility in British Columbia to obtain significantly reduced gas prices for all of its customers. The Commission commends Columbia on its initiatives which have greatly assisted its customers. In June of 1986 Columbia arranged gas supply from the Deep Basin region in British Columbia to be processed and delivered through the Alberta pipeline network to the utility. Those arrangements remained in place until November 1, 1986 when further discounts were obtained.

Since the Columbia hearing the Commission has become aware that Crestbrook Forest Industries has arranged a direct purchase of natural gas. This direct purchase is being assisted by Columbia and is in the best interest of the industrial customer. The Commission is also aware that at least one other industrial customer on the Columbia system is considering a direct purchase supply of natural gas. The Commission is encouraged that arrangements are being put in place to allow industrial customers to obtain gas supplies that are most suitable for their needs.

The Commission's consideration of the purchase pattern of natural gas by each utility in British Columbia is that secure supplies be obtained with sufficient capability to meet peak requirements, while at the same time negotiating prices with producers or others which are most advantageous to <u>all</u> segments of the utility's market. The Commission is concerned that, with the exception of Columbia, the bulk of the benefits of reduced gas prices have flowed to industrial customers. The Commission recognizes the producer interest in maximizing sales under market sensitive pricing and further recognizes that the higher load factor and volumes sold to industrial customers should command preferred prices. However, the discounts to industrial customers have been very sizeable while the residential customers may not have shared commensurately in the new era of gas price decontrol. Columbia is an exception to the general pattern by achieving significantly reduced residential rates, and the Commission will give consideration to methods to encourage the utility further. Such considerations will include a flowing through to shareholders of a portion of the savings achieved for the "core market". The Commission directs the Applicant to submit its suggestions, if any, by March 31, 1987 for consideration by the Commission.

The Commission is also concerned that gas supplies be available on a long term basis for the utility core customers. At the present time there is substantial availability of natural gas; however, at some point in the future, gas supply may tighten up and prices would rise. The Commission expects Columbia to anticipate market conditions and to ensure the long term availability of natural gas for its core customers at the best prices which can be negotiated.

In determining gas purchases for 1987 the Commission is aware that the Westcoast peaking contract will be renegotiated. To the extent that circumstances may have changed with respect to deliverability through the A & S system the Commission anticipates that the Westcoast contract will only be extended if it is price competitive.

4.2 Cost of Service Issues

4.2.1 Working Capital

Inventories

Columbia's forecast inventory level of $208,000 is 8% lower than in 1986. However, the Company's construction activities have been reduced significantly in forecast 1987. Regular plant additions in the 1986 forecast included $285,000 in mains and services, but the 1987 forecast has only $95,000 for mains and services. DSEP additions in 1986 were $480,000, compared with none in 1987. In addition, there was the addition of the Cranbrook Lateral and the Byron Creek extension in 1986.* Therefore, the 1986 inventory level would be expected to be higher than 1987 (Exhibit #24).

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* The Byron Creek costs are offset by individual charges to Esso Resources.

In 1987 Columbia planned three NGV station openings but only one station will be completed. That station should not affect inventory levels dramatically since it will be a contract installation. Therefore, the inventory provision by the Applicant appears high. The Applicant responded that the trend of inventory levels was down (Transcript pp. 758, 811), but Columbia had to carry certain basic levels in particular parts for emergency purposes. In some categories parts were being phased out over time. The Commission accepts the Applicant's explanation and expects that inventory levels will go down further in future. The Commission directs the Applicant to ensure that any obsolete parts are removed from inventory and the matter of potentially obsolete parts, if any, will be reviewed by the Commission during the course of the 1987 Annual Review.

Prepaid Expenses

Columbia's prepaid expenses have increased from $22,000 in fiscal 1986 to $111,000 in forecast 1987 due to increased insurance premiums. The Applicant agreed (Transcript p. 812) that $81,000 should be removed due to double counting, and left a balance of $30,000 for items such as odorant, stationery and postage. The Commission notes that the Applicant's 1986 test year provision of $22,000 was described as "primarily made up of prepaid insurance". The Commission will not make an adjustment at this time but expects the Applicant to review the Prepaid Expenses content for better representation.

4.2.2 Plant Utilization

Planned construction and other capital budget activity by Columbia in fiscal 1986/87 was modest. Apart from normal work the utility extended service to the mine services complex of Crows Nest Resources and planned NGV installations at industrial sites. These installations are discussed later in this section.

Extension to Crows Nest Resources

Columbia obtained Commission approval to extend natural gas service to the mine services complex at Crows Nest. At the time of approval the estimated construction cost of the pipeline was $500,000. The mains extension test of Columbia provided a utility contribution of $215,000 based on the expected heating loads. Crows Nest committed to a contribution of $285,000. Construction advanced quickly within the environmental time constraint for crossing Line Creek. Final costs are estimated to be slightly less than forecast and, hence, Crows Nest will receive a refund of a small portion of its contribution. The Commission expects to be kept informed of developments in this matter and Columbia shall file a final report.

Natural Gas for Vehicle ("NGV") Services

Columbia had budgeted to extend NGV service to three outlets in the Columbia service area. As a result of the extension of natural gas service to the mine services complex at Crows Nest, the utility was able to enter into an agreement with Crows Nest to convert approximately 50 vehicles to natural gas service and install an NGV compressor and dispensing facility at the site. The approximate capital cost of the compressor and dispensing facility is approximately $166,000.

The NGV facility at the mine services complex should not be confused with another demonstration project at Crows Nest to convert large haul vehicles to liquified natural gas ("LNG") use. The latter project is being tested with financial support from the federal government.

Columbia was also hopeful of reaching agreement to provide NGV services to either Fording or Westar. That conversion would be for a significantly larger group of vehicles. However, through examination at the hearing it was found unlikely that NGV services at either of these sights would come to fruition during the forecast fiscal year. The projected costs and revenues for this potential facility were removed by Columbia from the Application.

Columbia also hoped to reach agreement to put in place a public NGV fuelling station in Cranbrook. That station may yet proceed in this fiscal year since Columbia is hopeful of taking advantage of the current federal grant program for stations. That federal grant would provide up to $50,000 in support of the compressor and dispenser. The grant program is scheduled to terminate in March, 1987. However, due to the improbable likelihood of extending service to a public NGV fuelling station in this fiscal year the projected costs and revenues for the public station were also removed by Columbia from the Application.

Cranbrook Lateral

Crestbrook Forest Industries Ltd. questioned the prudency of the construction of the Cranbrook Lateral, which was completed in 1985. Evidence showed that during the winter of 1985/86, Columbia would have been able to meet the needs of customers on the Lateral without the Cranbrook Loop as the pressures from the ANG transmission line were considerably in excess of minimum contract pressures. However, at contract pressures the "Loop" is required.

The Commission notes that Crestbrook has not reduced its peak hour requirement below the 350 Cfh which existed at the time of issuance of Certificate of Public Convenience and Necessity No. C-6-85. Therefore, circumstances have not significantly changed from those on which the Cranbrook Lateral was justified. The Loop is in operation and provides service to the customers on the Cranbrook Lateral. The Loop is required should pressure from ANG fall towards the contract minimums and the Loop provides additional security for the Lateral in the event of a line break. The Commission therefore concludes that the load characteristics on the pipeline and the supply from the transmission line have not substantially differed from that forecast in 1985.

Used and Useful Plant

The issue of "used and useful" was raised during in the last rate hearing. The Commission directed the Applicant "to explain, at the next hearing, precisely how the growth in the number of customers and demand has changed Columbia's required investment in rate base". Exhibit #14 was filed in this hearing, and the Applicant further explained (Transcript pp. 56, 212, 237) that by removing the impact of transmission growth such as the Cranbrook Lateral and Byron Creek, the rate base cost per customer over four years was approximately the same as Inland, and therefore concluded that rate base additions were reasonable in comparison to total number of customers. The Applicant concluded that percentage fluctuations between the two variables should not be a great concern because plant additions in any year would bring in customers in later years. However, the Commission cautions that the Applicant must ensure its rate base is utilized, and only economic plant is added. The onus remains on the utility to ensure that the public interest is met.

4.2.3 Residential Use Per Customer

Columbia forecasts residential use per customer to be 117 GJ in fiscal 1987. Normalized consumption the previous year was 119 GJ. The Commission anticipates normalized consumption in 1987 to likely be 118 GJ per customer and the adjustment is reflected in Schedule I.

4.2.4 Strike Adjustments

Columbia utilizes a strike adjustment clause to recover lost revenues resulting from strikes at industrial customer sites which cause gas sales to be reduced. The existing clause allows Columbia to recover sales lost due to strikes over a period of 10 years.

It was suggested during the hearing (Transcript p. 748) that the Applicant could have applied the percentage loss of previous experience to the current forecast volume in order to reflect the declining sales volume of the Applicant. The Applicant initially accepted this suggestion as a reasonable alternative (Transcript p. 753) but later maintained (Transcript p. 814) that the current method would result in fair recovery of strike loss.

The Commission will not require the Applicant to change its method of strike adjustment allowance at this time. However, the purpose of the strike adjustment allowance is not to guarantee the Applicant recovery of all previous losses due to strike but is a vehicle to avoid requiring the Applicant to make forecasts for a test year. The Commission will continue to consider other methods which could yield more equitable results to both the Applicant and its customers.

4.2.5 Deferred Credit Account

In June, 1986 Columbia established a deferred credit account to accumulate savings in gas purchase costs negotiated with gas suppliers which would otherwise have been credited to the consumption of Schedule I to IV customers.

Columbia's rate application was based on gas purchases from traditional pipeline suppliers as at May 30, 1986. Since June 1986 Columbia was able to purchase gas from the Deep Basin area of British Columbia for discounts of 60-70 cents per GJ until the end of October. Savings were passed on to the industrial customers by virtue of the cost of gas plus cost of service contracts.

Columbia, however, withheld the gas cost savings from Schedules I to IV customers. Columbia proposed that "the disposition of this deferred credit account is to be determined by the Commission coincidental with or following Columbia's hearing on rate design matters".

A rate design hearing was not scheduled at the time of this hearing for Columbia, and the size of the potential refund had become substantial for the current Schedules I to IV customers. A delay of the refund would also cause an intergeneration equity problem. After examination by the Commission during the hearing, the Applicant proposed that a refund would be made to the Rates I to IV customers in the December 1986 billing. The refund, including interest, amounted to approximately $600,000, or in excess of $30 per Rate I customer.

4.2.6 Operation and Maintenance ("O and M")

The O and M statistics shown in Exhibit #1, p. 1-09-02.1 indicate significant increases in 1987. The main reasons were additional costs due to NGV operations, Byron Creek costs (offset by additional revenue), and increased insurance. After removing the impacts on Byron Creek and NGV, the net increase was 1.97%. The Applicant also filed Exhibits #12 and #13 in order to demonstrate the merit of the O and M expense increase. The Applicant, in response to questions about the phenomenon of sharply increased O and M cost per GJ sold in recent years, explained that most costs are not volume related (Transcript pp. 190, 264), particularly in view of its declining industrial volumes. Further, the Applicant suggested that O and M cost per customer (in real terms, after inflation) is a more meaningful measure of performance (Transcript p. 227).

The Commission believes that any one method of performance measurement is unlikely to accurately report real performance. Results of different methods must be evaluated together to provide an early alarm system should certain decisions and results stray from Company objectives. The Commission appreciates the Applicant's mandate of "obligation to serve" but has to reiterate its concern that all costs be controlled, especially during the current period of economic hardship in the local economy.

Although the Applicant has demonstrated that its O and M increases have been lower than inflation during the last two years, it did not show that this was the best effort of the Applicant. The Applicant filed Exhibit #19, an inter-office memorandum from its President, Mr. R.E. Kadlec. The memorandum stated that its fiscal 1987 financial forecast had indicated that the companies, Inland and Columbia, would not earn their allowed returns in 1987, and that the options were to increase sales, lower O and M expenses and as a last resort apply for a rate increase. It appears to the Commission that there is room for improvement in O and M expenses.

The Applicant also filed Exhibit #20, letters from its Budget Department to Mr. Bowman, the General Manager, with respect to payroll and operating budgets for fiscal 1987. The letters were referred to as "specific budgeting guidelines" by Mr. Kadlec in Exhibit #19, however, they appear to emphasize efficiency and proper distribution of costs rather than setting budget limits and constraints. From Mr. Bowman's evidence (Transcript pp. 120-123), it appears that the budgetary approval process from the branch level is based on a few qualitative instructions and then the final approval is more or less a negotiation process with senior management. The introduction of stronger guidelines by the senior management should produce actual reductions in costs as opposed to forecast budget saving.

The Applicant did not put forth any structured program or detailed policy to exercise restraint, such as a listing of expense priorities so that certain low priority expenses could be further evaluated or phased-out over time. The Commission encourages the company to follow a systematic approach to justify each expense item and to develop approval and monitoring procedures to provide maximum fiscal efficiency without loss of operating effectiveness.

After consideration of the evidence in this proceeding the Commission believes that the Applicant should have at least held the expense level constant as directed by Mr. Kadlec in Exhibit #19 of the hearing: "Thus our effort must focus foremost on increasing revenues and holding constant or reducing our operating and capital expenditures, until such increased revenues are realized". Therefore, the requested net increase of 1.97% or $43,000 is disallowed as reflected in the Decision schedules.

4.2.7 Inter-Company Charges

The Commission in its last decision directed "Columbia to review with Inland the inter-corporate charges and present a detailed report on that review at the next Columbia rate hearing". The Applicant provided an analysis in Exhibit #4A, Item 1 indicating that comparable services on a stand-alone basis could cost Columbia between $488,000 to $588,000 annually. Total charges by Inland for fiscal 1986 and forecast 1987 are $241,000 and $264,000 respectively.

The same issue was raised in the Inland hearing. The Applicant stated that its parent company, Inland, has been following a consistent methodology since 1969 to allocate corporate overhead to subsidiaries. The Touche Ross management audit as contained in Exhibit #4A agreed that Inland had allocated inter-company charges on the basis of sound accounting principles. Although the Commission accepts that the existing method of allocation may be reasonable, it should be reviewed periodically to account for changes in operation and circumstances. For example, the Commission has been informed in past hearings of changes in coding of expenses resulting in confusion in current and prior period comparisons. In this hearing, as in previous hearings, misunderstandings have occurred between the Applicant and other participants. Greater efforts should be made to eliminate these misunderstandings in order to reduce hearings costs for all parties.

The recent expansion of Inland into non-utility operations has caused additional concern in inter-company charges inasmuch as utility operations might subsidize non-utility operations (Transcript p. 787-790). The Commission is understandably concerned that utility operations, such as Inland and Columbia, could be allocated a disproportionate share of joint costs to allow non-regulated affiliates to record lower costs and attain a competitive edge in the market. Although no specific evidence was given, the Commission is taking some comfort from the Applicant's assurance that it will not over-allocate costs to the utility segment, but will continue to monitor and ensure inter-corporate charges are fair and reasonable to the utility customers.

4.2.8 Short-Term Debt

Columbia forecast its mid-year short-term debt balance with the average of the beginning and ending balances. However, the monthly short-term debt balances during the year are significantly higher than the mid-year balance (Exhibit #1, page 1-14-03.1). Since short-term debt is less expensive than the other components of the capital structure, a smaller balance would increase the average cost of capital. The Applicant was asked why the average 13-month balance method was used by Inland but was not applied to Columbia. Columbia responded that the timing of disbursements in Columbia is different than in Inland, particularly in gas purchases (Transcript p. 795). However, the Applicant conceded that it would not be uncomfortable if an unfunded debt balance were used to balance the rate base with the capital structure.

4.2.9 Other Issues

Questions were raised as to why Columbia ceased providing service calls without a tariff change (Transcript pp. 103-106). The Applicant's tariff provides a desirable rate to customers requiring service calls (Transcript p. 200). The Applicant acknowledged that it would make the information on Columbia rates for service calls available to the customers (Transcript pp. 200, 240-241, 630-633).

The Applicant explained its effort to obtain cost effective insurance coverage (Exhibit #29). The Commission accepts the Company's forecast as reasonable in the circumstances.

The Applicant was able to reduce its property tax by convincing the assessment authority to recognize a utilization factor on transmission plant two years ago, but the Company was recently informed that the factor would no longer apply. While there is the possibility of appeal, the action to date will cause an increase of $14,000 in property tax for fiscal 1987 (Transcript p. 649). The Commission accepts the Applicant's forecast.

The Applicant entered into a contract with Esso Resources providing transportation services to Byron Creek (Exhibit #4, Tab 11, Sheet 5-21, paragraph C.5). The Applicant made provision that the weighted average cost of capital of Inland would be used should Columbia amalgamate with Inland. In view of the current average cost of capital of Inland being lower than Columbia, amalgamation would lower the rates chargeable to Byron Creek (Transcript p. 766). It was decided that the issue should be put to the full Commission or the original Panel for a decision (Transcript p. 775).

Fording Coal addressed the Panel with respect to its complaint that the rate charged Fording compared to that of Greenhill was excessive. It has been the Commission's intention that the complaint would be dealt with as part of a rate design hearing for Columbia. Presently the rate design hearing is deferred and the Panel now determines that unless the rate design hearing can commence in 1987, separate action should take place on the complaint. Columbia is instructed to advise the Commission of the expected time when Columbia's rate design evidence will be complete and filed with the Commission. Also, in light of Columbia's desire to combine Columbia with Inland by June 30, 1987, this matter should be finalized before that action and this may require a separate hearing prior to June 30, 1987.

Other issues such as the Greenhill rate, separate transportation tariffs and the Applicant's request to redesign block rates (Transcript pp. 836-837) will be dealt with in a rate design hearing to be scheduled at a future date.

4.2.10 Hearing Costs

The Applicant submitted hearing costs totalling $78,000 of which $19,000 represented outside assistance for rate of return evidence. The Commission believes that appropriate revenue requirements are beneficial to the customers and the shareholders. However, an inequity may exist to the extent that the Applicant can be allowed the full recovery of its costs while other participants must bear their entire costs regardless of the contribution made to the proceeding. One method to overcome this potential inequity would be to permit the Applicant to recover, through its rates, only the percentage of its costs upon which it has been successful. In other words, if the Applicant were granted the full revenue requirement sought, then the full amount expended would be recovered. Similarly, if it received less than that applied for, a lesser portion would be recovered through the rates, with the balance absorbed by the shareholders. This will be given further consideration in the next proceeding.

Total hearing costs including those of the Applicant, Commission and Court Reporters are to be recovered over two years commencing fiscal 1987. These costs total approximately $128,000.

4.3 Return on Equity

The Applicant submitted a final capital structure comprised of:

Long-term debt	37.24%
Unfunded debt	21.27
Common equity	41.49
	100.00%

This was derived from Columbia's forecast mid-year balance sheet for the test year.

The witness for the intervenors concluded that Columbia's rate of return should be established on the basis of a 20% common equity ratio. Because Columbia is a wholly-owned subsidiary of Inland, he viewed Columbia as part of the economic entity which is Inland, the consolidated company. Since both companies are in the same business and regulated by the same Commission, he assumed that they should have similar capitalization supporting the rate base. His calculations indicate that the utility operations of Inland consolidated are supported by a common equity component of approximately 20%.

This Commission does not generally look at how the common equity of a utility is financed. Indeed it would not be surprising to find that utility equity is financed with a blend of debt and equity (double leverage). However, the debt in such instances is the responsibility of the equity owner, not the utility. Hence, it can reasonably be considered equity.

The witness for the intervenors has not suggested that the Commission consider the double leverage aspect of Columbia's equity. Rather, he proposes that the Company be viewed as part of the Inland consolidated economic entity. This perspective has merit.

From a strictly accounting perspective, it can also be argued that the equity recorded on the books of Columbia has been retained in Columbia. Only by paying additional dividends to the parent can Columbia's absolute equity be reduced. It should, however, be noted that payment of dividends from subsidiary to parent is eliminated in the preparation of consolidated financial statements of Inland.

The Commission has decided to accept the Applicant's capital structure for this Decision. The issue of capital structure of the parent will be addressed in detail in the Commission's Decision concerning Inland's May 30, 1987 Application for rate relief. In accepting the proposed capital structure the Commission is aware that Columbia may seek approval to amalgamate with Inland in 1987.

Columbia's financial risk has not changed since the last Decision. At that time, the Company had a common equity component of 39.24% supporting rate base. The current application shows a common equity component of 41.49%. The Applicant submitted that there has been a decline in the overall business risk experienced by Columbia; and Columbia's investment (total) risks are not significantly different from those of Inland. The Commission concurs with this assessment.

The Commission believes that the corporate ownership of Columbia by Inland results in benefits to both companies such as:

- broader customer base;
- geographic diversification;
- economies of scale;
- sharing of expertise; and
- access to more and better sources of supply.

The North American economy and capital markets have experienced bouyant growth over the last few years. Corporate profits and earnings growth have been favourable.

The fear of rekindled inflation has subsided and the long-term government of Canada bond yield is currently just over 9%. Considering that the real rate of interest is still at an historical high and Canadian rates are well above those in the United States, any significant and prolonged increase in the test year interest rates would appear to be unlikely. If this does occur, the Applicant can seek an adjustment to ensure the return to the investors remains reasonable. The Applicant used 9.5% as the yield for 1987 whereas the intervenors suggested 9%. The Commission will accept that the range of 9% to 9.5% is a reasonable concensus forecast at this time for long-term Government of Canada bond yield.

Dr. Evans, rate of return witness for the Applicant, used three tests in arriving at his recommendation:

1. comparable earnings;
2. discounted cash flow ("DCF"); and
3. equity risk premium.

He gave primary weight to the results obtained from the comparable earnings test and expressed reservations about the use of the DCF method because of the difficulty in inferring investor growth expectations.

To permit Columbia the opportunity to undertake new common equity financing without dilution of nominal book value, Dr. Evans assumed a 110% to 120% market-to-book ratio and a 60% payout ratio. He derived the following returns:

1.	comparable earnings	14.75% - 15.50%
2.	DCF	14.00% - 14.70%
3.	equity risk premium	14.30% - 15.30%

Evaluating the results of his studies and applying his professional judgement to his findings, Dr. Evans recommended a 15% rate of return on book common equity which falls within the range of 14.25 to 15.25% established by the Commission in the March 1986 Decision.

Dr. Waters, financial witness for the industrial intervenors, relied extensively on the evidence he presented in Exhibit #47 in the Inland proceedings. He used the DCF and equity risk premium tests. As well, he used the "beta" values for a sample of utilities.

Dr. Waters recommended a rate of return on book common equity in the range of 12-7/8% to 13-1/8% based on a common equity ratio of 35% to 35.7% which generally would fall within the range established by the Commission in the previous Decision if an adjustment was made to reflect the decline in long-term Canada bond yield albeit the parameters of the range have been significantly narrowed by Dr. Waters.

The Commission in determining the appropriate range of rates of return and the specific return on equity to be used to determine the revenue requirements has reviewed various methods of estimating appropriate returns but is cognizant that when interest rates were rising rapidly a narrowing of the spread between long-term Canada bond yield and return on equity occurred. Similarly, if equity to the investor over the long-term is to prevail, a temporary widening of the spread, when long-term interest rates are falling, is reasonable.

In the circumstances of the Applicant the Commission believes that a return on equity of 14%, within a range of 13.50% to 14.25%, is just and reasonable and this results in an increase in the implied spread between the return on equity and long-term Government of Canada bonds from the last Decision to this Decision.

5.0 DECISION

The Commission confirms as permanent the interim refundable rates applicable to Schedules I through IV which became effective at the commencement of the Applicant's fiscal year. The refund required shall be applicable to Special Contract customers.

The approved rates will provide the Applicant the opportunity to earn 14.0% return on equity, within the range of 13.50% to 14.25%, found to be reasonable by the Commission.

DATED at the City of Vancouver, in the Province of British Columbia, this 21st day of January, 1987.

J.D.V. Newlands, Deputy Chairman

N. Martin, Commissioner

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 for Rate Relief by Columbia Natural Gas Limited

BEFORE:	J.D.V. Newlands, Deputy Chairman; and N. Martin, Commissioner	January 21, 1987

O R D E R

WHEREAS a 6-day public hearing pertaining to Columbia Natural Gas Limited ("Columbia") commenced before this Commission at Cranbrook, B.C. on Wednesday, October 15, 1986 and concluded in Vancouver, B.C. on Friday, October 31, 1986 reviewed, inter-alia an Application dated May 30, 1986 for a 2.40% interim rate increase to its filed Tariff Rate Schedules effective July 1, 1986, as amended during the hearing to a requested increase of 3.00%; and

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

NOW THEREFORE the Commission hereby orders Columbia Natural Gas Limited as follows:

1. The mid-year Rate Base for the Test Year ending June 30, 1987 shall be approximately $14,100,000.

2. The Revenue Requirements for the Test Year ending June 30, 1987 are approximately $28,000,000 which will provide the Applicant the opportunity to earn a return on common equity of approximately 14.0% within the range of 13.50% to 14.25%.

.../2

3. The interim rates approved July 1, 1986 for Schedules I, II, III and IV are determined to be just and reasonable and confirmed.

4. The interim rates applicable to the Special Contract customers shall be reduced as set forth in the Schedules attached to the Decision and the appropriate refund shall be made inclusive of interest. The refund on an annual basis is approximately $40,000.

5. Columbia will comply with the directions incorporated in the Commission's Decision.

DATED at the City of Vancouver, in the Province of British Columbia, this 21st day of January, 1987.

BY ORDER

Deputy Chairman

COLUMBIA NATURAL GAS LIMITED

Schedule 1

UTILITY INCOME AND EARNED RETURN
for the year ending June 30, 1987

($000)	Fiscal 1986 Decision (March 18/86)	1987 Rate Application (May 30/86)	1987 Amended Application	Adjustments	Adjusted Balances
SALES VOLUME (TJ)	9,010	7,703	7,640	13 [1]	7,653
UTILITY REVENUE					
Gas sales -present rates	$30,705	$27,498	$27,095	$53 [1]	$27,148
Gas sales -interim rates	764	660	660	1 [2]	661
Revenue from Byron Creek	160	233	237		237
Additional deficiency	(172)		152	(193)	(41)
Total	31,457	28,391	28,144		28,005
Cost of Gas	25,752	22,100	21,917	36 [1]	21,953
Gross Margin	5,705	6,291	6,227		6,052
OPERATING EXPENSES					
Operating and maintenance	2,183	2,370	2,317	(43)[3]	2,274
Property, francise taxes	915	989	1,004	(2)[4]	1,002
Depreciation & amortization	525	527	505	64 [5]	569
Other operating revenue	(113)	(100)	(100)		(100)
	3,510	3,786	3,726		3,745
Utility Income before Taxes	2,195	2,505	2,501		2,307
Income Tax - current	380	587	647		506
- deferred	0	0	0		0
EARNED RETURN	$1,815	$1,918	$1,854		$1,801
UTILITY RATE BASE	$13,125	$14,583	$14,035		$14,067
RETURN ON RATE BASE %	13.83	13.15	13.21		12.80

[1] Increase residential sale from 117 GJ to 118 GJ per customer.
[2] Additional interim revenue as result of [1].
[3] Disallowed O and M expenses.
[4] Change in franchise fee.
[5] Amortization of hearing costs.

Schedule II

COLUMBIA NATURAL GAS LIMITED
Utility Rate Base for the Year Ending June 30, 1987

($000)	Decision for Fiscal 1986 (March 18/86)	Fiscal 1987 Application (May 30/86)	1987 Amended Application (Ex. 24 rev.)	Adjustments	Adjusted Balances
Gross plant in service Beginning of Year	$17,582	$20,001	$20,001		$20,001
Additions to gas plant Mid-year	1,429	815	431		431
Less- customer advances on construction	(99)	(92)	(92)		(92)
Gross Plant	18,912	20,724	20,340		20,340
Less - CIAC	(842)	(914)	(914)		(914)
	18,070	19,810	19,426		19,426
Accumulated depreciation	(3,706)	(4,095)	(4,095)		(4,095)
Adj. to accu. depreciation	(202)	(233)	(233)		(233)
Net Plant	14,162	15,482	15,098		15,098
Deferred income tax	(1,559)	(1,559)	(1,559)		(1,559)
Deferred charges	88	173	96	32 [1]	128
Working capital allowance	434	487	400		400
Utility Rate Base	$13,125	$14,583	$14,035	$32	$14,067

[1] Hearing cost: amortized in 1987.

Beginning	$ -
Addition	128
Amortization	64
Ending	64
Mid-year	32

COLUMBIA NATURAL GAS LIMITED

Schedule III

CALCULATION OF INCOME TAXES ON UTILITY INCOME
FOR THE YEAR ENDING JUNE 30, 1987

($000)	DECISION (Mar. 18/86)	1987 Rate Application	1987 Amended Application	Adjustments	Adjusted Balances
Earned return	$1,730	$1,918	$1,854		$1,801
Deduct: interest on debt	(970)	(1,043)	(981)	(8)[1]	(989)
Add:non-tax deductible exp.	15	26	4		4
Accounting income aft. tax	702	901	877		816
Deduct: timing differences	(333)	(379)	(302)		(302)
adj. hearing costs	(43)			(64)[2]	(64)
Taxable income after tax	$326	$522	$575		$450
Income tax rate %(current)	53.800	52.947	52.947		52.947
1-current income tax rate	46.200	47.053	47.053		47.053
Deferred income tax rate	0.000	0.000	0.000		0.000
Taxable income before income tax	706	1,109	1,222		956
Add: amount required to provide for deferred tax	0	0	0		0
TAXABLE INCOME	$706	$1,109	$1,222		$956
Income tax - current	$380	$587	$647		$506
- deferred	0	0	0		0
TOTAL INCOME TAX	$380	$587	$647		$506

[1] Utility debt interest = rate base * cost component % of debt.
[2] Timing difference adjustment:

Hearing cost expensed for tax purpose	$128,000
Amortization per Sch. II	64,000
Balance	$64,000

Schedule IV

COLUMBIA NATURAL GAS LIMITED

COMMON EQUITY AS AT JUNE 30, 1987

	1986 DECISION	1987 Application	1987 Amended Application	Adjustments		Adjusted Balances
Common share capital Beginning of Year	$1,045	$1,045	$1,045			$1,045
Retained Earnings						
Balance- beginning of year	3,815	4,443	4,443			4,443
Forcast net income for the year	762	861	869		[1]	811
DEDUCT: Dividends	155	200	200			200
TOTAL - End of Year	$5,467	$6,149	$6,157			$6,099
Common equity as at Beginning of Year	$4,860	$5,488	$5,488			$5,488
MID-YEAR COMMON EQUITY	$5,164	$5,819	$5,823			$5,794

[1] Mid-year Common Equity multiplied by % return on common equity.

Schedule V

COLUMBIA NATURAL GAS LIMITED

RETURN ON CAPITAL FOR THE YEAR ENDING JUNE 30, 1987

($000)

1986 DECISION	Capitalization Per Decision (March 18/86)	Adjustments	Capitalization Amount	Percentage %	% Average Embedded Cost	Cost Component %
Long Term debt	$5,360		$5,360	40.74	13.100	5.34
Unfunded Short-term Debt	2,634		2,634	20.02	10.250	2.05
Preference Shares	0		0	0.00	0.000	0.00
Common Equity	5,163		5,163	39.24	14.750	5.79
	$13,157		$13,157	100.00		13.18

1987 RATE APPLICATION	Capitalization (Ex.1,p1-02-05)	Adjustments	Capitalization Amount	Percentage %	% Average Embedded Cost	Cost Component %
Long Term Debt	$5,226		$5,226	35.95	13.200	4.75
Unfunded Short-term Debt	3,491	(0)	3,491	24.02	10.000	2.40
Preference Shares	0		0	0.00	0.000	0.00
Common Equity	5,819	0	5,819	40.03	14.988	6.00
	$14,536		$14,536	100.00		13.15

1987 AMENDED APPLICATION	Capitalization	Adjustments	Capitalization Amount	Percentage %	% Average Embedded Cost	Cost Component %
Long Term Debt	$5,226		$5,226	37.24	13.200	4.92
Unfunded Short-term Debt	2,986	1	2,987	21.28	9.750	2.07
Preference Shares	0		0	0.00	0.000	0.00
Common Equity	5,823	(1)	5,823	41.49	14.992	6.22
	$14,035		$14,035	100.01		13.21

1987 ADJUSTED BALANCES	Capitalization	Adjustments	Capitalization Amount	Percentage %	% Average Embedded Cost	Cost Component %
Long Term Debt	$5,226		$5,226	37.15	13.200	4.90
Unfunded Short-term Debt	2,986	[1] 62	3,048	21.66	[3] 9.840	2.13
Preference Shares	0		0	0.00	0.000	0.00
Common Equity	5,823	(30)	5,794	41.19	[2] 14.000	5.77
	$14,035		$14,067	100.00		12.80

[1] Automatic change in equity and rate base cash requirement.
[2] Approved rate of return on common equity.
[3] Weighted average cost of forecasted short term and long term rates.