Columbia Natural Gas Limited Rates March 18, 1986
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I INTRODUCTION

Columbia Natural Gas Limited ("Columbia", "the Applicant") applied on May 31, 1985, pursuant to Section 67 (2) of the Utilities Commission Act, to amend its schedule of rates filed with the Commission. On the basis of a fiscal 1986 test year the Applicant sought an increase in rates on both an interim and permanent basis of 2.49% (approximately $772,000) effective July 1, 1985. The Applicant testified that continuation of the existing rates would yield a return on common equity of 8.80%, or substantially less than the allowed return of 15.50% determined in the 1984 Decision.

As a result of a number of quantifiable changes to the Application identified during the proceedings, the Commission requested an update of the projected revenue requirement from the Applicant (Transcript pages 693-694). The requested update was designated Exhibit 38 and filed after conclusion of the hearing. This raised the final revenue requirement to $777,000 requiring a rate increase of 2.53%.

The Applicant indicated that the major reasons for the forecast revenue deficiency in fiscal 1986 were:

(i) significant reductions in sales to Fording Coal Limited ("Fording Coal") and Crestbrook Forest Industries Ltd. ("Crestbrook"); and

(ii) increases in plant and rate base principally due to the Cranbrook Lateral at $1.7 million approved by Commission Order No. C-6-85.

The Applicant also sought Commission approval for the write-off of the balance in the Deferred Rate Case Account which had been created as a result of the last Commission Decision on Columbia. It was proposed that this revenue be recovered from all customers other than Cominco Ltd. ("Cominco") and Crestbrook. Columbia also requested elimination of the Interest Deferral Account, on the grounds that short-term interest rates had stabilized in recent months.

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By Order No. G-52-85 dated June 10, 1985 the Commission approved the interim rate increase as requested and set down a public hearing for September 23, 1985 in Cranbrook. In the period prior to commencement of the hearing, the Commission issued a number of Orders affecting the Applicant, including cost of gas pass-throughs and revisions to terms and conditions of its tariff, and issued a Certificate of Public Convenience and Necessity approving construction of the Cranbrook Lateral (Order No. C-6-85 dated June 27, 1985).

During the summer, Columbia was affected by labour disruption and a formal strike by employee members of Office and Technical Employees Union, Local 378. During the strike period, some intervenors requested that Columbia's previously filed and deferred rate design application be heard in conjunction with the rate application. Because of the complexities of both, on September 6, 1985, the Commission rescheduled the revenue requirement hearing to commence October l, 1985 in Cranbrook, B.C. and deferred hearing the rate design application at that time.

The proceedings required four hearing days, commencing in Cranbrook, British Columbia on October 1, l985 and concluding on October 4, l985. The evidence and argument presented during the hearing mainly concerned the Applicant's l986 revenue requirement. Broader issues were also raised, however, including the impact of and requirements for the Cranbrook Lateral, the Byron Creek extension and potential for direct and discount gas purchases.

Evidence for the Applicant was presented by Mr. R.E. Kadlec, President and Chief Executive Officer; Mr. C.I. Kleven, Vice President, Finance and Administration; Mr. R.T. O'Callaghan, Vice President, Engineering; Mr. J.L. Randall, Vice President, Marketing and Utility Planning; Mr. J.D.A. Ferguson, Manager of Gas Supply; Mr. J.O. Wessler, Manager, Regulatory Affairs and Mr. R.G. Bowman, General Manager.

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Evidence was also given by the following witnesses for industrial intervenors: Cominco by Mr. D.J. DeBiasio; Crestbrook by Mr. J.P. Gormley and Mr. G.R.G. Kennard; and Fording Coal by Mr. C.A. Bleaney and Mr. D. Gaspe. Mrs. K. Kennelly, a residential customer, was also present and cross-examined the witnesses.

II BACKGROUND

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. ("Inland").

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 present communities of Cranbrook, Kimberley, Creston and Fernie. Service has since been extended to the communities of Elkford, Sparwood and Yahk. In 1982 Columbia commenced service to the communities of Jaffray and Galloway, made possible by the Government of Canada Distribution System Expansion Program (DSEP). At March 31, 1985 Columbia served approximately 13,600 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 main 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, financial, marketing, legal, employee relations, gas supply, gas measurement and corporate matters, are provided by employees and officers of Inland.

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Natural gas supplies are obtained from seven taps located on the export transmission pipeline of Alberta Natural Gas Company Limited ("A.N.G."). 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 A.N.G. pipeline. In l976, 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.

III GAS SUPPLY

Witnesses for the Applicant spoke to the rapidly changing environment of gas supply to Columbia and its industrial customers. Bill 52, the Natural Gas Price Act, has created opportunities to reduce the cost of gas for direct sales by producers to qualifying consumers. Subsequent to the Columbia hearing, the Federal, British Columbia, Alberta and Saskatchewan governments reached agreement on natural gas marketing which will further reduce government involvement in natural gas pricing and is expected to lead to competitive buying and selling of natural gas. Of particular significance, the Alberta Border Price is to be eliminated November 1, l986.

Columbia testified that the utility has been active in three potential sources of gas supply: the Deep Basin field; direct sale arrangements; and development of an industrial discount gas pool.

The Deep Basin

The Deep Basin is a gas supply area located on the northern Alberta/British Columbia border. The B.C. gas can be moved to Columbia markets through Alberta. Columbia has signed a letter of intent to move this B.C. gas to market by March l, l986 at a price approximately 40¢/GJ below existing

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prices. Subsequent to the hearing, the Commission learned that the Applicant's parent company, Inland, has invested in a joint drilling program with Esso Resources Canada Ltd. ("Esso Resources"). The Commission commends Columbia for seeking lower-priced gas sources for the utility, and expects that the Applicant will not tie itself or its customers to any gas supply source until it has negotiated the best combination of price and security of supply.

Direct Sales

With respect to direct gas sales, Columbia testified that its policy is to accept the principle of direct sales between producers and industrial customers as long as such sales do not adversely affect the rest of Columbia's customers. The Applicant's witnesses stated they were "facilitating" a direct sale between Fording Coal and Czar Resources Ltd.

The Commission notes that opportunities for direct sales have been created by government policy and legislation. The benefits of such sales may well prove to be substantial to the producers, industrial customers, and to other customers of the utility, to the extent that more gas is moved through the utility's delivery system than otherwise would be the case. The Commission notes, however, that at the time of the hearing no direct sales had actually been achieved because of difficulty in arranging acceptable transportation conditions. Much of the delay appeared to be attributable to the tariff structure on the Westcoast system during 1985. The Commission intends that the objectives of direct sales policies will be met and that eligible industrial customers will be afforded direct access to producers without facing impossible terms or conditions in the transportation of the gas. Transportation terms and conditions and the question of appropriate tariffs may therefore require further action by the Commission in l986.

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Industrial Discount Gas Pools

The Applicant testified that to improve the prospects for increasing direct sales, and to protect the competitive position of the utilities and their customers, Inland, Columbia, B.C. Hydro and Pacific Northern Gas Ltd. have made a combined approach to all producers under contract with British Columbia Petroleum Corporation for tenders of natural gas at low prices. The Applicant testified that this gas will be pooled and used to serve the small industrials of the four utilities and that a total market of 20 Bcf per year had been identified and approximately 7 Bcf per year of gas has been tendered. Subsequent to the hearing, the Commission was advised that the four utilities have created a non-utility brokerage company to facilitate such sales. The Commission was further advised that eligible industrial customers will contract for gas from the brokerage company.

It is government policy to encourage competitive sales of natural gas through increased price competition. The introduction of industrial gas pooling by the Applicant is designed to protect the utilities from potential loss of load and revenue through direct sales by producers to industrial accounts. The witness for the Applicant assured the Commission that the operation of the gas pool would not adversely affect the utility's customers not served by the pooled gas.

While the Commission will expect the Applicant to make every effort to seek and obtain reliable gas supplies at the lowest possible cost to its customers, the Commission will also expect to continue to be kept adequately informed on progress in those efforts.

IV COST OF SERVICE (Excluding Return)

Operating and Maintenance Expenses

The Applicant has forecast an increase of l.7% or $35,000 in net O & M expenses. Although testifying that it continues to examine costs to improve

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efficiency, the Applicant found it difficult to quantify or summarize those existing programs or costs that may have been reduced or eliminated. The industrial customers, on the other hand, indicated that they have not only exercised restraint on new expenditures but have also cut back on existing programs, wages and benefits.
At the request of the Commission, the Applicant filed additional information dated October 28, l985 titled "Cost Control and Restraint". The Commission recognizes that the Applicant's management practices in cost control and efficiency described in that response are prudent and normal business management practices every well-managed company should possess even in normal economic times. The Applicant failed, however, to provide sufficient specific quantified evidence to demonstrate cost restraint and increased efficiency, in what have clearly been difficult recessionary times.

The Commission notes that in the interest of restraint the Applicant decided to postpone construction of a new office building in Cranbrook. The Applicant's filed material indicated that since l98l the overall number of employees had increased by only two from 3l to 33. In the Commission's view this did not in itself support the need for new space. The decision to defer this project has not produced a saving, nor does it necessarily demonstrate restraint.

The Applicant argued that increased efficiency was demonstrated by the small increase in the number of employees and the evidence that total salaries and wages have increased 3.2% over the amount allowed in the l984 Decision (Exhibit 1, page 1-09-01), and that O & M cost per customer is forecast to decrease from $l53.05 in l985 to $l5l.33 in forecast l986 (Exhibit 1, page 1-09-04). The Commission is encouraged by these indications, but concludes that the total increase in salaries and wages should more correctly be interpreted in light of the increase, from 1984 levels, of 66% in the intercompany charges by Inland for management services, and the recent contracting-out of meter reading to outside labour.

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In its consideration of the Applicant's overall revenue requirement, the Commission is concerned by the increase in capital additions and expenses in the face of declining sales. Comparison of the l986 test year with the previous year indicates a l2% decrease in sales volume and revenue (mainly attributable to Fording Coal and Crestbrook) as opposed to a 7.8% increase in operating expenses and a l4% increase in rate base. A longer trend reveals that while l986 sales volume will have decreased 7% below that of l982, operating expenses and rate base will have increased by 29% and 48% respectively in the same period (Exhibit 3, Item 3, page 2). The unavoidable result is that existing customers will have to bear the increasing costs.

The evidence also indicated that the management and employees of Columbia collectively have not suffered any loss in terms of real income over the last few years, and that the shareholders' real return over the last few years has been increasingly better than in prior years (Exhibit 32). The Applicant's customers on the other hand, have been suffering throughout the recession*. Supporting evidence of this is the increase in uncollectible accounts and the incidence of business failures in the utility's service area.

As a matter of principle the Commission concludes that the Company has a responsibility to minimize the impact of increasing costs on customers, and that the shareholders should expect to share the burden of increasing costs in order that management keep the aforementioned adverse trends in check. Accordingly, the Commission has reflected this principle in what it deems to be the reasonable allowed rate of return for the Applicant in the circumstances.

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* Transcript, Volume 2, pages 225-229 and page 250 (Fording Coal witness); page 254 (Westar); page 270 and pages 283-284 (Cominco witness); pages 296-299 and pages 344-345 (Crestbrook witness).

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Billing System and Data Processing

Columbia is in the process of modifying its billing system. The old system is being re-built to the Inland standard, at a total estimated cost of $66,000. The original justification for the expenditure was primarily to shorten the number of days in the cash cycle. Additional justification, including micro-encoding and mechanical bank processing, lower cost of bill preparation and increased message space, was also cited by the Applicant as improvements now being realized. The new system has not, however, reduced the cycle days as significantly as originally hoped and is still a long way from the Inland cycle-time. While the Commission accepts as reasonable the other items of justification, it is concerned that the originally-planned principal benefit of the new billing system has fallen short. The Commission therefore directs the utility to increase its efforts to achieve a reduced turnaround time for Columbia's bills and to do so without any additional major expense.

Strike Adjustment

The Applicant's current practice is to forecast the test year as strike-free and to provide an allowance for any actual loss of sales due to strikes, based on a moving average of actual strike losses incurred in previous years. Counsel for the principal industrial intervenors (Crestbrook, Cominco, Crows Nest and Fording Coal) all expressed concerns with respect to the impact on the allowance for strike loss, of the Applicant's actual strike-free record in fiscal 1985 and prospects for the same in 1986. Their concerns focussed on the fact that the Applicant exceeded its allowed rate of return in 1985, while at the same time adding an allowance to the strike adjustment account in forecast 1986.

Calculation of the strike adjustment is contained in Exhibit 1, page 1-06-21. The Commission recognizes that any forecast of reduced consumption reflecting expectation of possible labour disputes is likely to be unreliable, whether made by the industrial customers or by the Applicant. The history of

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this account has indicated that there were substantial losses of sales due to strikes in the years l98l, l982 and l984 totalling 826 TJ. The strike adjustment was introduced in 1983. In fiscal 1983 and 1984 provision for strikes in the
two-year period proved to be lower than actual experience. Had the Company accurately forecast those strike losses, higher revenue requirements would have been necessary in the appropriate test years.

The Commission concludes that the absence of strikes in l985 and in the forecast test year will allow the Applicant to recover at least part of the losses incurred in the previous strike years. The Commission believes this is fair and reasonable to both the customers and the shareholders. Accordingly the Commission directs that the strike adjustment should continue to be made, using a moving average of the available actual annual strike loss data to a maximum of 10 years when accumulated.

Property Tax Adjustment

The actual property tax for the second half of fiscal l985 was $37,500 lower than forecast in the l985 test year. The Applicant attributes this to its success in obtaining "throughput factors" for the tax assessment of transportation pipelines and, therefore, passes the savings entirely to the shareholders. The Commission does not accept the view that such savings can be fairly categorized as a normal forecast variance (Transcript page 571) and concludes that they are more appropriately considered to constitute an unforeseen corporate gain. The Commission further concludes that this corporate gain, while in part resulting from effective negotiation by management, should be shared equally by the Applicant's customers and shareholders and that the customers' share should be included in revenue for fiscal 1986.

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Intercompany Charges

Columbia proposes no increase in management fees payable to Inland. The charges for services provided by Inland are paid for on an actual time basis for the Inland personnel utilized. The rate for each individual's time is reviewed and set every three years, with the current agreement being in its second year of the three-year term. The Commission accepts this arrangement as reasonable, to the extent that the parent thereby avoids the necessity for maintaining duplicate overhead functions in all areas of the subsidiary. This is especially beneficial in seasonally or infrequently utilized functions. It also, however, creates the opportunity for excessive charges against the subsidiary to the benefit of the parent. The Commission wishes to ensure that intercorporate charges remain reasonable and justifiable and, accordingly, directs Columbia to review with Inland the intercorporate charges and present a detailed report on that review at the next Columbia rate hearing.

Insurance

The Commission recognizes that very substantial increases in premiums, particularly for liability insurance, have occurred industry-wide. Throughout this hearing Columbia witnesses testified as to the difficulty the company was encountering in renewing required insurance coverages at prior rates. In the Commission's view, recent conditions in the insurance field are unlikely to be relieved in the immediate future. Accordingly, the Commission directs the Applicant to review and report on its insurance coverage, including provisions for deductibles and self-insurance, to maintain essential coverage at reasonable cost. In the interim, and in the event that the Applicant undertakes some degree of self-insurance, the Commission will accept the establishment of an insurance reserve commencing in fiscal year 1987, sufficient to provide for uneven and unpredictable incidence of deductible claims.

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Deferred Rate Case Account

As a result of additional peak load from its residential customers and the forecast lower delivery pressure from the A & S transmission lines, in the 1984 Rate Application the Applicant requested the Commission to approve construction of a $1.7 million Cranbrook Lateral. The uncertainty about the need and feasibility caused the Commission to postpone issuing a Certificate of Public Convenience and Necessity to the Applicant. In order to ensure gas supply to meet peak demand to all customers, and after Cominco and Crestbrook had volunteered to accept curtailment for firm gas in exchange for compensation for standby fuel usage, the Commission approved, by Order G-12-85 dated February 20, 1985, the establishment of a Deferred Rate Case Account. This account was to record the payment by Columbia to Cominco and Crestbrook, in the event that the Applicant might not be able to deliver firm gas to Cominco and Crestbrook during the winter of 1984/85. The Applicant subsequently recorded a balance of $46,400 in the Deferred Rate Case Account and requested Commission approval for recovery in 1986.

The Commission ruled in Order G-12-85 that the Deferred Rate Case Account should be recovered as soon as practicable from all of Columbia's customers except Crestbrook and Cominco. In cross-examination, Counsel for Fording Coal questioned the proposed recovery of the balance in the deferred account in 1986, since the Applicant had over-earned in fiscal 1985 (Transcript page 510). The Commission considers that the purpose of the account was to preserve Columbia's sales position while the Commission, in the public interest, reviewed the proposed construction of the Cranbrook Lateral. Moreover, the delay of the project for one year saved the customers approximately $150,000 in return on rate base which would otherwise have been included in fiscal 1984 revenue requirement. As provided for in Order G-12-85, the Commission accordingly now approves recovery by the Applicant in the amount of $46,400.

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Discontinuance in 1986 of the Interest Deferral Account

The Applicant requested that ". . . the Commission consider and give approval to the cessation of the Interest Deferral Account in the l986 test year" (Exhibit 1, page 1-01-04). This request is supported by the Applicant's evidence in Exhibit 2, Tab 2, page 7 and Transcript pages 656 to 658. The Commission accepts the Applicant's proposal to discontinue use of the Interest Deferral Account in the 1986 test year, and accepts as reasonable the proposed revised short-term interest rate of 10.25%, reflecting the forecast average prime rate.

Sales Forecasts

Accurate sales volume forecasts are of critical importance to the accuracy of revenue requirement forecasts when the Application is based on a forecast test year. The Applicant incorporated the sales update of its industrial customers in its final position (Exhibit 38) with the exception of Crows Nest's forecast filed in Exhibit 25.

The Applicant stated that it was more comfortable with Crows Nest's original forecast of l58 TJ. It appears that the Applicant may be prepared to accept updated forecasts reflecting sales reductions but is skeptical of those showing sales increases (Transcript page 608). The Commission notes that (Exhibit 1, page 1-06-16) Crows Nest's forecasts for l984 and l985 were l3l TJ and l70 TJ respectively, while projected actual sales were l75 TJ and 204 TJ respectively. The Commission notes that forecast sales to Crows Nest have been under-estimated in the past two years, and therefore accepts the l92 TJ updated 1985 forecast by Crows Nest filed in Exhibit 25, as the appropriate forecast for fiscal 1986.

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Deductions for Income Tax Purposes

Subsequent to the Commission Decision dated December 20, 1983 returning the Applicant to the flow-through basis for income tax purposes, Columbia has been required to follow the tax payable method of calculation for regulatory accounting. Using that method in the determination of utility revenue requirements and rates, it is important to match tax deductions with the appropriate capitalized expenses. Recognizing this, the Applicant appropriately amended its proposed tax treatment by carrying the capitalized expenses relating to its cost of service study and its customer information system in rate base, on an after-tax basis.

Capitalized Overhead - 1985

Compared to its forecast for the fiscal 1985 test year, the Applicant capitalized $40,000 more overhead than forecast, thereby increasing the 1986 opening plant balance by that same amount. The extra overhead was thereby out of proportion to the related capital expenditures.

The Commission concludes that this amount should have been more properly expensed in 1985, and has therefore removed $40,000 from the 1986 opening plant balance in the rate base calculation.

Hearing Costs

The Applicant submitted an estimate of hearing costs totalling $54,500 for recovery in the revenue requirement. The Commission notes that these costs include salary and wage costs amounting to $3l,000 for the four-day hearing. The charges for those particular costs following the previous hearing of seven days amounted to $28,000. Moreover, the latter amount included charges for time spent on lead/lag studies, Court of Appeal, Fording Coal complaint and Rate 5 Tariff Schedules. The Commission therefore considers the Applicant's

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charges to be excessive and has accordingly reduced the amount allowed for recovery to $16,000, thereby reducing the total for recovery to $39,500.

Total hearing costs including those of the Applicant, Commission and Court Reporters are to be recovered over two years commencing fiscal 1986.

V PLANT UTILIZATION

Under cross-examination of the Applicant, an issue arose as to the degree of utilization of the utility's physical assets or plant and its relationship to the rate base claimed by the utility. Evidence was presented indicating that in the 1986 forecast year, sales volumes will be lower than in 1982, while over the period 1982 to 1986 inclusive the rate base will have increased by approximately 48%. The Applicant testified that while individual customer consumption had decreased, the number of customers had increased causing an increase in peak demand. The Applicant further testified that it was this need for peaking capacity that determined the need for its plant additions. The witness for the Applicant was adamant in his position that when plant has been approved for utility use, it should continue to be categorized as "used and useful" without regard to the actual level of utilization.

The Commission expects all utilities and their customers to work together to ensure that peak demands do not result in excessive additions to capacity requirements and ultimately in transportation rates. The need to balance firm and interruptible requirements has been recently highlighted by federal regulatory changes which have increased the emphasis on full demand/commodity pricing.

The Commission concludes that the whole issue of "used and useful" is of such major importance, that it requires much more extensive and detailed consideration than it was given at this hearing. At this time the Commission takes no position with respect to removal from rate base of any assets that are

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deemed to be potentially useful but currently under-utilized. The Commission wishes to ensure, however, that there is no misunderstanding as to the Commission's continuing adherence to the widely accepted principle of "used and useful" in the regulation of utilities.

The Commission is concerned by the apparent relationship between the increased number of customers and Columbia's increasing rate base. From 1982 to 1986 the number of customers has increased by 20.8% while the total rate base has increased by 48%. While percentages do not tell the complete story, the trend is indicative and the Commission is sufficiently concerned to direct 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. This direction should not be interpreted as authorizing costly studies.

Major Extensions

In June 1985, Certificate No. C-6-85 was issued by the B.C. Utilities Commission approving the construction of the Cranbrook Lateral and in October of the same year Columbia received approval for the Byron Creek extension, subject to review of the contract by the Commission. Both projects were reviewed and decisions rendered prior to the writing of this Decision. No further comment is required here on these matters, except as noted below with respect to Byron Creek.

Byron Creek

Columbia submitted material dated September 24, 1985 with regard to the construction of the Byron Creek extension. The Applicant assumed construction under Section 51(2) of the Act and that a Certificate of Public Convenience and Necessity was not required. The Applicant testified that Esso Resources would pay the full cost of the line plus related operating expenses over the life of the project and that there would be no impact on the

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existing customers. The Applicant also assumed that the project would be financed on the basis of a 60/40 debt/equity ratio in the capital structure and included an equity issue of $325,000 in its final submission (Exhibit 38).

At the time of the hearing, there was no firm agreement between the Applicant and Esso Resources. All parties concerned agreed that this matter could be dealt with outside of this Decision.

On October 16, 1985, the Company applied for a Certificate of Public Convenience and Necessity and filed with the Commission a revised letter of understanding with Esso Resources, in which a major change was inserted deeming the basis of certain charges on ". . . the equity component shall be reflective of the then current equity component as permitted by the Utilities Commission" rather than a fixed 40% equity component.

The Commission approved the project on October 31, 1985, by Order No. G-86-85, subject to receipt of an executed contract between Columbia and Esso Resources, acceptable to the Commission. With respect to financing of the project, the Commission has considered the changes in the charges incorporated in the letters of agreement and the equity ratios resulting from alternative financing, and concludes that there is no need to issue additional equity at this time.

VI RETURN ON EQUITY

In its Decision of November 1984, using fiscal 1985 as a test year, the Commission concluded that the opportunity to earn a return of 15.50% on equity was fair and reasonable in the circumstances. It concluded that ". . . even on a "stand-alone" basis, Columbia's capital market standing is largely determined by its association with Inland and that, accordingly, a higher rate of return for that purpose cannot be justified" (Decision, page 15).

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In 1985, Columbia achieved a return on common equity of 17.67% (Exhibit 3, Item 1, Schedule V) with a normalized result of l6.40%. This compares to the l5.50% return approved in the last Decision. The Commission concludes that the principal reasons for the disparity were unforeseen sales to Westar-Greenhills combined with income tax savings achieved through greater tax-deductible expenses than anticipated and allowed in the Decision.

For its 1986 test year, the subject matter of this Decision, the Applicant seeks the opportunity to earn the same return of l5.50% on equity as allowed in the 1984 Decision.

The Applicant relied largely on the relationship between yields on long-term Government of Canada bonds and appropriate rate of return on equity. Columbia testified that as investors' risk preference and Columbia's risk profile had not changed materially since the last Decision, the Government of Canada bond rate could be appropriately used as a guide to the current required equity return. The Applicant's position was that the Commission selected, in its last Decision, a range of 11.00% to 11.50% as the appropriate prospective yield on long-term Government of Canada bonds. It was therefore argued that as the yields at the time of the Application were still within the 11.00% to 11.50% range, returns on common equity in the range of 15.50% to 16.00% remained appropriate for purposes of this Decision.

In the opinion of the Commission, over a period of months preceding the hearing the Canadian financial markets and the economic climate had been relatively stable. There was, however, some softening in the rates of return achieved by the long-term bonds. At the time of the hearing, 1986 long-term Canadian bonds were forecast* to yield between 10.5% and 11.5% or 0.5% less than those recognized as relevant by the Commission in the last Decision.

* MacLeod Young Weir

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In these proceedings, employment of the Applicant's chief financial officer as the expert witness, coupled with a minimum of filed rate of return evidence, reduced the hearing costs significantly. Moreover, because of the intimate corporate knowledge and experience of this witness, it reinforced the Commission's view that the use of either outside or inside

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expert witnesses should not be exclusive but selective, with the choice in each case determined by the complexity of the matters to be considered and any requirement for specialized technical knowledge and expertise.

Mr. Gustafson, counsel for Crestbrook, Crows Nest and Cominco argued

> ". . . I suggest that there has been a tendency in Canada . . . to worry too much about the question of maintaining what is so often fondly referred to as the utility's financial integrity." (Transcript page 774)

and

> "Columbia should be made to share the burden of the economic hardship, and accept a lower return than would otherwise be warranted." (Transcript page 778)

Other intervenors supported this position and argued that shareholders should expect a lower return as customers are switching to alternative fuels due to the high cost of natural gas.

While the Commission is sympathetic to these arguments it must also consider and give weight to the long-term financial needs of the utility as the provider of an essential service. In the Commission's view, equity returns in conjunction with other considerations, should be awarded in the context of the long-term business outlook, and adjustments to equity return reflecting volatility in the movements of short-term rates are not appropriate.

The Commission has carefully considered the foregoing arguments and concerns, in light of relevant long-term economic indicators. In the absence of specific evidence demonstrating the Applicant's accomplishments in cost

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control and restraint (Ref. Section IV, Cost of Service), and the Commission's aforementioned conclusions with respect thereto, the Commission concludes that the opportunity to earn a return on common equity within the range of 14.25% to 15.25% is just and reasonable at this time. Accordingly, the rate of return to be included in revenue requirement is l4.75%

Adoption by this Commission of the forecast test year as the basis for rate regulation for all utilities in its jurisdiction, rather than the historic test year utilized in the past, was primarily undertaken to eliminate or reduce regulatory lag, in the interest of the utilities. For the most part, this change has proven to be in the public interest. It does, however, put the onus on the utilities to produce forecasts which prove to be reasonably accurate. Where the record of actual versus forecast performance indicates a tendency to underestimate revenues and overestimate expenses, leading inevitably to excessive rates of return, in the absence of extenuating circumstances the Commission will act to ensure just and reasonable rates, as required by the Utilities Commission Act.

It continues to be a concern of the Commission that, for whatever reasons, the Applicant has exceeded its normalized allowed rate of return for the past two years. Moreover, in 1985 Columbia substantially exceeded the upper limit of the allowed range in the rate of return. While in this Decision the Commission will not require a retroactive adjustment to correct the past over-earning by the Applicant, the Commission expects Columbia to take appropriate measures to ensure that the range of return determined as appropriate by this Decision will not be exceeded. In the event that it is exceeded in the forecast 1986 test year, in fairness to the Applicant's customers the Commission will consider a possible refund of all or part of any excess earnings.

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VII DECISION

In light of the foregoing, the Commission directs that the Rate Base is $13,125,000 (Schedule II) and the Revenue Requirement is $31,457,000 (Schedule I), with the result that the interim rates in place since July 1, 1985 have produced revenue in excess of requirements. In the circumstances the Commission concludes that an average rate increase of 1.93% is fair and reasonable, as compared to the requested increase of 2.53%. Accordingly, the Commission directs the Applicant to proceed with appropriate refunds including interest, as specified in Order No. G-52-85, to all customers of record in the period July 1, 1985 through March 31, 1986. Such refunds will apply to actual consumption for the period ending March 31, 1986 or such earlier date as may be appropriate, resulting from the timely filing of amended Tariff Rate Schedules together with a reconciliation thereof. The refunds may be implemented as a credit on customer billings.

DATED at the City of Vancouver, in the Province of British Columbia, this day of March, 1986.

M. TAYLOR, Chairman

D.B. KILPATRICK, Commissioner

N. MARTIN, Commissioner

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

March 18, 1986

Before:

M. Taylor, Chairman
D.B. Kilpatrick, Commissioner
N. Martin, Commissioner

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D. LEACH	Hearing Officer
ALLWEST REPORTING LTD.	Court Reporters

LIST OF EXHIBITS

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