

SIXTH FLOOR, 900 HOWE STREET, BOX 250
VANCOUVER, B.C. V6Z 2N3
CANADA



BRITISH COLUMBIA
UTILITIES COMMISSION

ORDER
NUMBER G-73-96

TELEPHONE: (604) 660-4700
BC TOLL FREE: 1-800-663-1385
FACSIMILE: (604) 660-1102

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

and

Application by West Kootenay Power Ltd.
for Approval of its Revenue Requirements

BEFORE: L.R. Barr, Deputy Chairperson; and)
K.L. Hall, Commissioner) July 4, 1996

O R D E R

WHEREAS:

- A. On November 29, 1995 West Kootenay Power Ltd. ("WKP") filed with the Commission, pursuant to Sections 64 and 67 of the Utilities Commission Act ("the Act"), a draft Revenue Requirements Application (the "Application") for approval of rates effective January 1, 1996; and
- B. WKP also requested the implementation of a negotiated settlement process ("NSP"); and
- C. The Commission issued Order No. G-111-95 approving an average interim increase in rates of 3.85 percent effective January 1, 1996; and
- D. The Commission issued Order No. G-119-95 setting down a pre-hearing conference on January 19, 1996 at which a consensus was reached to proceed with the negotiation settlement process; and
- E. The Final Application, filed on February 27, 1996, included a request for Orders concerning automatic adjustment mechanisms to replace cost of service regulation with incentive regulation; and
- F. The Commission issued Orders No. G-10-96 and G-27-96 setting down a regulatory timetable, including a series of Workshops, Information Requests and Negotiated Settlement dates; and
- G. On May 24, 1996 a proposed negotiated settlement was reached among certain of the participants and circulated to all Registered Intervenors, Interested Parties and the Commission; and
- H. Letters of concern or objection to the proposed settlement were received from some participants; and
- I. At the public hearing held on June 27, 1996 in Trail, B.C., the Commission reviewed the impacts of, and objections to, the proposed settlement; and
- J. The Commission has considered the Application and is satisfied that the negotiated settlement, attached as Appendix A hereto, is necessary and in the public interest.

BRITISH COLUMBIA
UTILITIES COMMISSION

ORDER
NUMBER **G-73-96**

2

NOW THEREFORE the Commission orders as follows:

1. The Commission approves the settlement, attached as Appendix A, in its entirety.
2. Reasons for Decision will follow this Order at a later date.
3. WKP is ordered to file Electric Tariff Rate Schedules which confirm the existing interim rates as firm effective January 1, 1996.

DATED at the City of Vancouver, in the Province of British Columbia, this 4th day of July, 1996.

BY ORDER

Original signed by:

Lorna R. Barr
Deputy Chairperson

WILLIAM J. GRANT
EXECUTIVE DIRECTOR,
REGULATORY AFFAIRS & PLANNING



SIXTH FLOOR, 900 HOWE STREET, BOX 250
VANCOUVER, B.C. CANADA V6Z 2N3
TELEPHONE: (604) 660-4700
BC TOLL FREE: 1-800-663-1385
FACSIMILE: (604) 660-1102

~~CONFIDENTIAL~~

VIA FACSIMILE

May 3, 1996

Dear :

Re: Proposed Settlement of Issues
Concerning the February 26, 1996 Revenue Requirement
Application of West Kootenay Power Ltd.

The purpose of this letter is to record the proposed settlements achieved with respect to the West Kootenay Power Ltd. ("WKP") February 26, 1996 Revenue Requirements Application. This letter remains confidential until it is submitted to the B.C. Utilities Commission for consideration. I, therefore, ask that you provide to me a communication of endorsement for the proposal by Friday, May 10, 1996. At that time, the Settlement Agreement will be made public and provided to the Commission and all interested parties.

I have attached the negotiation worksheets utilized at the sessions, noting both the Application and the final positions reached, as well as the schedules required to finalize the revenue requirement for 1996. I have also added commentary to explain the proposed settlement to those parties who were not present at the negotiations.

It is recognized by all the parties that the agreement represents a package proposal within which there has been give and take by all parties. No issue is to be severed from the proposed settlement without allowing signatories the opportunity to address other related issues in the package.

In accordance with the NSP Guidelines, the right of parties to dissent from a proposed agreement is explicitly recognized by the Commission. If a party dissents, it can submit a written argument to the Commission panel. If the Commission panel is of the view that the dissent is reasonable and material, it may request written rebuttal argument or, where the settlement review process is to occur at an oral hearing, request argument at the oral hearing. If the dissent is determined to be reasonable and material, the dissenting party retains the right to present evidence and to cross-examine, or to rebut the evidence of others if there is a written hearing.

The terms of the settlement are as follows:

1. Rate Adjustment Mechanism

It is agreed that the rate adjustment mechanism will be put in place for a three year test period. In order to accomplish this, the parties agree to West Kootenay Power Ltd. applying for Orders approving the following deferral accounts:

- a. Deferral of differences between target costs and actual costs as determined in accordance with the specific items in the negotiation worksheet and application of those differences to rates in subsequent years.
- b. Deferral of the tax impact of changes in the effective income tax rate arising from a change in policy by Revenue Canada with respect to the tax deduction for overheads capitalized.
- c. Deferral of uncontrollable costs arising from legislative changes, changes in generally accepted accounting principles, catastrophic events or other costs imposed on WKP until such time as these costs can be incorporated into rates.
- d. Change of the amortization period for the outstanding balance of deferred demand side management costs from 20 years to 8 years.
- e. Deferral of incremental costs relating to regulatory and related activities as they arise until such time as these costs can be incorporated into rates.
- f. Disposition of the following:
 - i) Amortization of deferred B.C. Hydro power purchase costs over five years beginning in 1996;
 - ii) Amortization of deferred least cost integrated resource plan costs over five years beginning in 1996;
 - iii) Amortization of a federal sales tax refund over two years beginning in 1996;
 - iv) Amortization of deferred property tax refunds over two years beginning in 1996;
 - v) Amortization of deferred electricity market review costs over three years beginning in 1996;
 - vi) Amortization of actual 1996 rate application costs over three years beginning in 1996;
 - vii) Amortization of deferred EMF research costs, if and when adequate justification is available; and
 - vii) Amortization of additional deferred debt issue costs over twenty years beginning in 1996.

2. Three Year Review

In the fall of 1998, West Kootenay Power Ltd. will provide an application for rates in 1999 and beyond. The application will detail all cost components and may propose a continuation of existing ratemaking methods. The application will detail the performance of each of the existing target costs by category along with actual costs. The components of the target cost will be reviewed, including base cost, cost driver, base cost escalator and productivity improvement factor to determine their appropriateness for ongoing rate regulation. New categories of target costs and new cost components may be proposed to make target costs more effective. All parties reserve their rights to argue in favour of proposed targets, performance based regulation methods or traditional rate regulation.

3. Annual Review

Under the rate adjustment mechanism in the Application, West Kootenay Power Ltd. proposes to file with the Commission a Statement of Adjustments for a rate increase effective January 1 of the next year. An annual review process will be instituted in accordance with the attached outline, whereby the public will be invited to examine the material, submit other issues for determination by the Commission, and meet to review all issues prior to this application being made. This review will be required in order to set the Load Forecast and Power Purchases forecast for the ensuing year and to set the Distribution Extension Capital Expenditures for 1997 only. It is proposed that this review be similar to a negotiation settlement process and that parties may institute a complaint procedure before the Commission if not satisfied. In addition, a "Town Hall" type meeting will be held in the evening for those parties not wanting to participate in the Annual Review.

4. Participant Funding

It is agreed that, in order to have effective public participation, the Annual Review, 3 Year Review, or related activities should be deemed "proceedings" by the B.C. Utilities Commission for the purpose of participant funding. WKP agrees to pay participant funding for advisory committees related to this application.

In closing, I wish to commend the efforts of West Kootenay Power Ltd. and all intervenors at the workshops and settlement discussions. The extensive efforts made by all parties to understand each issue along with the concerns and interests of other parties has allowed this settlement to come to fruition.

Yours truly,

W.J. Grant

/bmck

Annual Review

Process

- Notice of Annual Review and Material filed by the Company by November 1.
- Customers to file "Operational Issues" list for consideration by the Commission at the Annual Review by 2nd week in November.
- Annual Review to take place last week of November.

Agenda

Approval Required

- Load Forecast
- Power Purchases
- Distribution Plant - Extensions (1997/98)*

Informational Only

- Capital Budgets Review
- By Capital Cost Account
- Generation
- Transmission
- Distribution
- General
- Extraordinary
- Last Year
- Next Year
- 1997 Only
- Distribution extensions
- Other operational issues

Other

- Information Report in 1997 on 1996 performance
- Ability to complain directly to Commission

- * West Kootenay Power Ltd. is expected to file a new electricity extension test this year which will move towards direct cost recovery from new customers. This major change in this account requires a resetting of base costs and incentives for the 1997 and 1998 fiscal years.

**West Kootenay Power
Revenue Requirements Application
Negotiation Worksheet**

Description	Application	Settlement	Notes
COST ACCOUNTS			
POWER PURCHASES	Not included in Incentive Plan	\$35 million in 1996 with no sharing	
OPERATING EXPENSES			
Labour			
Cost Driver	Average Number of Direct Customers	Average Number of Direct Customers	
Base Cost	\$241 per Customer	\$234 per Customer	
Base Cost Escalator	CPI - Canada	CPI - B.C.	
PIF	1%	4%,4%,3%	
Sharing of Variances from Target	Equally with Customer	Equally with Customer	
Materials, Vehicles, Contracts			
Cost Driver	Average Number of Direct Customers	Average Number of Direct Customers	
Base Cost	\$97 per Customer	\$101 per Customer	
Base Cost Escalator	CPI - Canada	CPI - B.C.	
PIF	1%	4%,4%,3%	
Sharing of Variances from Target	Equally with Customer	Equally with Customer	
Capitalized Overhead			
Cost Driver	Capital Expenditures	Capital Expenditures	
Base Cost	7%	7%	
Base Cost Escalator	Not Applicable	Not Applicable	
PIF	Not Applicable	Not Applicable	
Sharing of Variances from Target	Equally with Customer	Equally with Customer	
Wheeling			
Cost Driver	BC Hydro Nomination	BC Hydro Nomination	
Base Cost	1995 BCH Rate	1995 BCH Rate	
Base Cost Escalator	BCH Escalation	BCH Escalation	
PIF	Not Applicable	Not Applicable	
Sharing of Variances from Target	Not Applicable	Target to become Actual	
Water Fees			
Cost Driver	Generation	Generation	
Base Cost	Provincial Rates	Provincial Rates	
Base Cost Escalator	BCH Escalation	BCH Escalation	
PIF	Not Applicable	Not Applicable	
Sharing of Variances from Target	Not Applicable	Target to become Actual	
Other Income			
Cost Driver	Average Number of Direct Customers	Average Number of Direct Customers	
Base Cost	\$34 per Customer	\$34 per Customer	Changes to BCUC Tariffs to be put in the Base
Base Cost Escalator	CPI - Canada	CPI - Canada	
PIF	Not Applicable	Not Applicable	

**West Kootenay Power
Revenue Requirements Application
Negotiation Worksheet**

Description	Application	Settlement	Notes
FINANCING COSTS			
Interest Expense			
Cost Driver	Capital Expenditures	Capital Expenditures	
Base Cost	1995 Weighted Average Cost of Debt Outstanding	1995 Weighted Average Cost of Debt Outstanding	
Base Cost Escalator	Canada 10 Year Bonds + 125 bp	Canada 10 Year Bonds + 125 bp	
PIF	Not Applicable	Not Applicable	
Sharing of Variances from Target	Equally with Customer	Volume variances shared equally with Customer	
Preferred Shares			Wind out ASAP
Cost Driver	Capital Expenditures	Capital Expenditures	
Base Cost	Current Dividend Yield	Current Dividend Yield	
Base Cost Escalator	Not Applicable	Not Applicable	
PIF	Not Applicable	Not Applicable	
Sharing of Variances from Target	Equally with Customer	Volume variances shared equally with Customer	
Cost of Equity			
Cost Driver	Capital Expenditures	Capital Expenditures	
Base Cost	BCUC ROE Adjustment Mechanism	BCUC ROE Adjustment Mechanism	
Base Cost Escalator	Not Applicable	Not Applicable	
PIF	Not Applicable	Not Applicable	
Sharing of Variances from Target	Equally with Customer	Volume variances shared equally with Customer	
Amortization Expense			
Cost Driver	Capital Expenditures	Capital Expenditures	
Base Cost	Current blended Amortization Rate	Current blended Amortization Rate	
Base Cost Escalator	Not Applicable	Not Applicable	
PIF	Not Applicable	Not Applicable	
Sharing of Variances from Target	Not Applicable	Target to become Actual	
Amortization of Deferred Charges			
DSM	Over 8 years	Over 8 years	
BC Hydro Costs	Recover over 5 years	Recover over 5 years	
IRP	Recover over 5 years	Recover over 5 years	
FST	Recover over 2 years	Recover over 2 years	
Property Tax	Recover over 2 years	Recover over 2 years	
EMR	Recover over 2 years	Recover over 3 years	
Rate Application	Recover over 2 years	Recover over 3 years	
EMF	Recover over 3 years	Defer	Application when justified

**West Kootenay Power
Revenue Requirements Application
Negotiation Worksheet**

Description	Application	Settlement	Notes
AFUDC			
Cost Driver	Capital Expenditures	Capital Expenditures	
Base Cost	8%	8%	
Base Cost Escalator	Not Applicable	Not Applicable	
PIF	Not Applicable	Not Applicable	
Sharing of Variances from Target	Taken into rates in the next year	Taken into rates in the next year	

TAXES

Income Tax			
Sharing of Variances from Target	Effective Tax Variances to be Shared Equally with Customer	Effective Tax Variances to be Shared Equally with Customer	Changes to Statutory Tax rate to be borne by Customer
Property Tax			
Sharing of Variances from Target	Taken into rates in the next year	Taken into rates in the next year	
BC Capital Tax			
Sharing of Variances from Target	Taken into rates in the next year	Taken into rates in the next year	

CAPITAL EXPENDITURES

BASE CAPITAL EXPENDITURES

Generation Plant			
Cost Driver	Number of Generation Plant Units	Number of Generation Plant Units	
Base Cost	\$1,400,000 in Total	\$1,300,000 in Total	
Base Cost Escalator	CPI - Canada	CPI - Canada	
PIF	1%	2%	
Sharing of Variances from Target	Equally with Customer	Equally with Customer	
Transmission Plant		Remove 44L and 49L	
Cost Driver	Normalized Peak Load	Normalized Peak Load	
Base Cost	\$9,600 per MW	\$8,000 per MW	
Base Cost Escalator	CPI - Canada	CPI - Canada	
PIF	1%	2%	
Sharing of Variances from Target	Equally with Customer	Equally with Customer	
Distribution Plant- Upgrades			
Cost Driver	Normalized Peak Load	Normalized Peak Load	
Base Cost	\$7,040 per MW	\$6,500 per MW	
Base Cost Escalator	CPI - Canada	CPI - Canada	
PIF	1%	2%	
Sharing of Variances from Target	Equally with Customer	Equally with Customer	

**West Kootenay Power
Revenue Requirements Application
Negotiation Worksheet**

Description	Application	Settlement	Notes
Distribution Plant-Extensions			
Cost Driver	Number of New Customers	Number of New Customers	
Base Cost	\$1,766 per New Customer	\$1,600 per New Customer	For 1996 only. 1997 and 1998 will reflect new extension tests.
Base Cost Escalator	CPI - Canada	CPI - Canada	
PIF	1%	2%	
Sharing of Variances from Target	Equally with Customer	Equally with Customer	
General Plant			
Cost Driver	Average Number of Direct Customers	Average Number of Direct Customers	
Base Cost	\$46 per Customer	\$46 per Customer	
Base Cost Escalator	CPI - Canada	CPI - BC	
PIF	1%	2%	
Sharing of Variances from Target	Equally with Customer	Equally with Customer	
DSM			
Cost Driver		kW.h savings	
Base Cost		Variable costs only	
Base Cost Escalator		CPI - Canada	
PIF		Incentive to take effect only if 90% of Target met	
Sharing of Variances from Target		50/50 equally with Customer	
EXTRAORDINARY CAPITAL EXPENDITURES			
Turbine Upgrade		To be approved by project	
Dam Rehabilitation		To be approved by project	
43 Line Upgrade		To be approved by project	
46 Line Upgrade		To be approved by project	
44 Line Upgrade		To be approved by project	
49 Line Upgrade		To be approved by project	
OTHER ITEMS			
Review Period		Review before 4th year	
Performance Standards		Compare to WKP Trend as guideline	
Customer Satisfaction			
System Reliability			
Safety			
Losses		Include as PS measure	
Capital Structure	Equity level of 40%	Equity level of 40%	
Load Forecast		Accept 1996 forecast. 1997 to include regression studies. Annual Review	Form Working Committee

WEST KOOTENAY POWER LTD.

Rate Application Overview
(thousands)

SUMMARY	Actual <u>1994</u>	Actual <u>1995</u>	Forecast <u>1996</u>
Sales Volume (GW.h)	2,525	2,572	2,566
Rate Base	\$191,725	\$212,423	\$239,397
Return on Rate Base	9.7%	10.2%	9.6%
REVENUE DEFICIENCY			
RATE BASE			
Earned Return	\$18,614	\$21,562	\$22,914
Income & Capital Taxes	3,442	7,459	9,314
Property and BC Capital Tax	9,417	10,190	9,643
Depreciation	8,410	9,418	10,397
	<u>39,883</u>	<u>48,629</u>	<u>52,268</u>
POWER PURCHASES	33,999	33,766	35,000
WHEELING	3,228	3,336	3,383
	<u>37,227</u>	<u>37,102</u>	<u>38,383</u>
OPERATION AND MAINTENANCE			
Labour	18,290	18,680	18,815
Materials, Vehicles, Contracts	10,100	8,560	8,121
Capitalized Overhead	(2,525)	(2,198)	(2,450)
Other Income	(2,664)	(2,743)	(2,848)
AFUDC	(445)	(150)	(266)
Water Fees	7,431	7,389	7,260
	<u>30,187</u>	<u>29,538</u>	<u>28,631</u>
TOTAL REVENUE REQUIREMENT	107,297	115,269	119,282
REVENUE AT EXISTING RATES	<u>107,297</u>	<u>115,269</u>	<u>114,786</u>
ANNUAL REVENUE DEFICIENCY			<u>4,496</u>
RATE INCREASE REQUIRED in 1996			<u>3.9%</u>

WEST KOOTENAY POWER LTD

ACTUAL AND FORECAST UTILITY RATE BASE
AS AT DECEMBER 31

SCHEDULE I

(thousands)			
	Actual 1994	Actual 1995	Forecast 1996
PLANT IN SERVICE - Beginning of Year	\$264,073	\$293,700	\$317,956
Additions to Plant in Service	29,627	24,256	33,250
PLANT IN SERVICE - Year End	293,700	317,956	351,208
ADD - Work in Progress	3,111	6,331	3,880
- Plant held for future use	741	741	741
- Deferred Charges	9,022	11,262	13,552
- Plant Aquisition Adjustment	11,912	11,912	11,912
	24,786	30,246	30,085
LESS - Accumulated Depreciation and Amortization	92,035	100,570	109,571
- Contributions in Aid of Construction	30,504	33,131	34,595
	122,539	133,701	144,166
DEPRECIATED RATE BASE	195,947	214,501	237,124
DEPRECIATED RATE BASE - Prior Year	175,806	195,947	214,501
MEAN DEPRECIATED RATE BASE	185,877	205,224	225,813
Allowance for Working Capital	6,956	9,037	13,161
Adjustment for Capital Expenditures	(1,108)	(1,838)	423
DEPRECIATED RATE BASE FOR REGULATORY PURPOSES	\$191,725	\$212,423	\$239,397

WEST KOOTENAY POWER LTD.

ACTUAL AND FORECAST EARNED RETURN
FOR THE YEARS ENDING DECEMBER 31

SCHEDULE II

(thousands)

	<u>Actual 1994</u>	<u>Actual 1995</u>	<u>Forecast 1996</u>
SALES VOLUME (GW.h)	2,525	2,572	2,566
ELECTRICITY SALES REVENUE			
Existing Rates	\$107,297	\$115,269	\$114,786
Rate Increase January 1			4,500
	<u>107,297</u>	<u>115,269</u>	<u>119,286</u>
EXPENSES			
Power Purchases	33,999	33,766	35,000
Wheeling	3,228	3,336	3,383
	<u>37,227</u>	<u>37,102</u>	<u>38,383</u>
Operating and Maintenance			
Labour	18,290	18,680	18,815
Materials, Vehicles, Contracts	10,100	8,560	8,121
Capitalized Overhead	(2,525)	(2,198)	(2,450)
	<u>25,865</u>	<u>25,042</u>	<u>24,485</u>
Property and BC Capital Tax	9,417	10,190	9,643
Water Fees	7,431	7,389	7,260
	<u>16,848</u>	<u>17,579</u>	<u>16,903</u>
Depreciation	8,410	9,418	10,397
Other Income	(2,664)	(2,743)	(2,848)
AFUDC	(445)	(150)	(266)
	<u>(3,109)</u>	<u>(2,893)</u>	<u>(3,114)</u>
UTILITY INCOME BEFORE TAX	22,056	29,021	32,232
INCOME AND CAPITAL TAXES	3,442	7,459	9,314
	<u>3,442</u>	<u>7,459</u>	<u>9,314</u>
EARNED RETURN	<u>\$18,614</u>	<u>\$21,562</u>	<u>\$22,918</u>
RETURN ON RATE BASE			
Utility Rate Base	\$191,725	\$212,423	\$239,397
	<u>\$191,725</u>	<u>\$212,423</u>	<u>\$239,397</u>
Return on Rate Base	9.709%	10.151%	9.573%
	<u>9.709%</u>	<u>10.151%</u>	<u>9.573%</u>

WEST KOOTENAY POWER LTD.

ACTUAL AND FORECAST COMMON SHARE EQUITY
FOR THE YEARS ENDING DECEMBER 31

SCHEDULE IV

(thousands)			
	Actual 1994	Actual 1995	Forecast 1996
COMMON EQUITY			
Opening Balance			
Share Capital	\$31,500	\$31,500	\$31,500
Contributed Surplus			
Retained Earnings	55,176	58,870	63,884
	<u>86,676</u>	<u>90,370</u>	<u>95,384</u>
Less: Common Dividends	(5,544)	(6,489)	(6,497)
Preferred Dividends	(35)	(35)	(35)
	<u>(5,579)</u>	<u>(6,524)</u>	<u>(6,532)</u>
Add: Net Income	9,273	11,538	10,771
Shares Issued (Withdrawn)			
	<u>9,273</u>	<u>11,538</u>	<u>10,771</u>
Deemed Equity Adjustment			(3,530)
Closing Balance	<u>90,370</u>	<u>95,384</u>	<u>96,092</u>
AVERAGE COMMON SHARE EQUITY	88,523	92,877	95,738
	<u>\$88,523</u>	<u>\$92,877</u>	<u>\$95,738</u>

WEST KOOTENAY POWER LTD.

ACTUAL AND FORECAST RETURN ON CAPITAL
FOR THE YEARS ENDING DECEMBER 31

(thousands)

	Actual 1994	Actual 1995	Forecast 1996
LONG TERM DEBT	\$88,847	\$75,271	\$113,854
Proportion	44.14%	35.27%	47.56%
Embedded Cost	11.04%	11.49%	9.46%
Cost Component	4.87%	4.05%	4.50%
\$ Return	\$ 9,809	\$ 8,649	\$ 10,776
BANK LOANS	\$12,840	\$34,158	\$17,625
Proportion	6.38%	16.01%	7.36%
Embedded Cost	7.00%	7.00%	7.00%
Cost Component	0.45%	1.12%	0.52%
\$ Return	\$ 899	\$ 2,391	\$ 1,234
DEEMED DEBT	\$0	\$0	\$1,102
Proportion	0.00%	0.00%	0.46%
Embedded Cost	0.00%	0.00%	8.95%
Cost Component	0.00%	0.00%	0.04%
\$ Return	\$ -	\$ -	\$ 99
DEFERRED INCOME TAXES	\$10,578	\$10,578	\$10,578
Proportion	5.26%	4.96%	4.42%
Embedded Cost	0.00%	0.00%	0.00%
Cost Component	0.00%	0.00%	0.00%
\$ Return	\$ -	\$ -	\$ -
PREFERRED SHARES	\$500	\$500	\$500
Proportion	0.25%	0.23%	0.21%
Embedded Cost	7.00%	7.00%	7.00%
Cost Component	0.02%	0.02%	0.01%
\$ Return	\$ 35	\$ 35	\$ 35
COMMON EQUITY	\$88,523	\$92,877	\$95,738
Proportion	43.98%	43.53%	39.99%
Embedded Cost	10.44%	12.35%	11.25%
Cost Component	4.59%	5.37%	4.50%
\$ Return	\$ 9,238	\$ 11,467	\$ 10,771
TOTAL CAPITALIZATION	\$201,288	\$213,384	\$239,397



IN THE MATTER OF

WEST KOOTENAY POWER LTD.

February 26, 1996
Revenue Requirements Application

and

COMMISSION ORDER NO. G-73-96

REASONS FOR DECISION

July 19, 1996

Before:

**Lorna R. Barr, Chair of the Division
Kenneth L. Hall, P.Eng., Commissioner**

1. INTRODUCTION

West Kootenay Power Limited ("WKP", "the Utility", "the Company") is a regulated utility under the provisions of the Utilities Commission Act ("the Act"). On November 28, 1995, WKP filed a draft revenue requirement application requesting an interim increase in rates of 4.9 percent effective January 1, 1996. The application also applied for the implementation of incentive rate adjustment mechanisms and the use of a negotiated settlement process for approval of the application. On December 15, 1995, the Commission approved an average interim rate increase of 3.85 percent (Order No. G-111-95). On December 22, 1995 the Commission established a date for a pre-hearing conference to discuss, among other matters, the review process for the application (Order No. G-119-95).

Subsequent to the January 19, 1996 pre-hearing conference and based on public input at the conference, the Commission established a timetable and process for dealing with the WKP application (Order No. G-10-96). The process ordered by the Commission involved a series of workshops to be followed by negotiated settlement discussions. Following the workshops, WKP filed a final application on February 26, 1996 (Ex. 1). The negotiated settlement discussions took place in Trail on April 23, 24 and 25, 1996 and a proposed settlement package was circulated to the Commission and the public on May 24, 1996.

At the oral hearing on June 27, 1996, dissenting parties were given the opportunity to present evidence, cross-examine witnesses and submit oral argument.

The Commission issued Order No. G-73-96 approving the settlement in its entirety, with Reasons to follow. This document constitutes those Reasons. Issues raised at the hearing focused on the incentive mechanism, the annual review, the contracting practices of WKP, especially with respect to line work, and the negotiated settlement process, itself.

2. NEGOTIATED SETTLEMENT AGREEMENT

Over the past few years the Commission has, on a number of occasions, used a negotiated settlement process as an alternative to the major portion of a public hearing for revenue requirement applications. All settlements between utilities and intervenors require final approval of the Commission following an opportunity for public review. The Commission has published "Guidelines" for negotiated settlement processes which establish the format for negotiations and the rights of all intervenors. In this case, the negotiated settlement was supported by most of the participants (Ex. 5). The settlement agreement was circulated to all registered intervenors, interested parties and the Commission panel. Further comments on the settlement proposal were received from intervenors.

The settlement agreement is for a three year period effective January 1, 1996. It confirms the interim rate increase and incorporates a cost indexed incentive-based formula. The formula consists of cost drivers, base cost, base cost escalators and productivity improvement factors. The formula is applied to selected cost accounts. The difference between target costs and actual costs is the incentive portion which, in certain cost categories, is to be shared equally between customers and the Company. The settlement provides for an equity component of 40 percent and determination of the return on equity by the Commission approved Return on Equity ("ROE") mechanism. The Company's performance under the incentive mechanism is subject to an annual review with involvement of the public in that process. In each of the last two years of the test period the Commission will be required to approve power purchase costs and sales levels along with ROE and some flow-through costs. The base costs and methodology are to be reviewed at the end of the three year period when, under the settlement agreement, WKP is required to submit a revenue requirements application for 1999 and beyond.

3. THE INCENTIVE MECHANISM

Mr. Scarlett, on behalf of the Kootenay-Okanagan Electrical Consumers Association ("ECA"), raised concerns about the implementation of the incentive-based mechanism proposed by WKP. In particular, the ECA is concerned about the experimental nature of the model compared with the traditional approach and the lack of opportunity to examine other incentive-based models. The latter concern was also noted by Ms. Plummer, appearing on her own behalf (Ex. 9). The ECA claimed that the incentive mechanism addresses only costs and that service levels generally, and in small communities, are ignored by this approach.

The ECA maintained that the three year period of the settlement was not consistent with the traditional hearing schedule for revenue requirement applications which usually occurred every two years. The ECA urged the Commission to implement a two year time frame for the agreement.

At an early stage in the process the Commission indicated that a price cap incentive mechanism would not be acceptable (Ex. 7C, Appendix A). As a result, the range of options for designing a cost-based incentive mechanism are limited. WKP recognized that its proposal is an innovative, incentive-based approach to regulation (T. 8) and is new in the electricity sector in Canada (T. 3). At the same time, it is consistent with trends in both the natural gas and electricity utility industry. WKP also pointed out that this cost-based approach is not dramatically different from traditional regulation (T. 43). Establishing a base cost, an annual adjustment and an adjustment for productivity improvements are common to both (T. 44). WKP noted that its proposal is consistent with the formula applied by BC Gas for O&M costs

and accepted by the Commission as part of the negotiated settlement of that utility's revenue requirement application in 1995 (Order No. G-99-95).

In conjunction with the incentive mechanism, WKP has established performance standards for customer services, system reliability, safety and line losses. To measure customer services, WKP will continue to conduct its annual survey to provide a customer satisfaction index. WKP's customer advisory panels, the annual review and town hall type meeting provide other avenues for monitoring the performance of the Utility. At each annual review the performance standards will be compared to historic performance and if the performance is inadequate the Utility will not receive the incentive (T. 57).

The Commission recognizes incentive-based regulation is not new. Different incentive mechanisms have been debated in the literature for some time now and incentive-based models have been adopted in other jurisdictions especially in the gas industry. With the emergence of competition in the electric industry, the trend is to move to incentive-based regulation. The WKP model may be a leader in the electric industry in Canada, however, that in and of itself, is not a sufficient reason to reject the proposal. The Commission notes that the proposal incorporates performance standards for customer satisfaction, safety and reliability and that the Utility's performance will be addressed in a public forum on an annual basis. The Commission is satisfied that the WKP proposal is based on sound regulatory principles and that implementation of the proposal is in the public interest.

While the revenue requirement test period in the settlement is slightly longer than the typical test period in the past, the Commission notes that the settlement agreement contains provisions for a much greater degree of public involvement in the intervening period than in the past. Certain major costs like power purchase expense will be set annually. Moreover, one of the purposes of implementing incentive mechanisms is to decrease the frequency of regulatory proceedings. At the same time, the Commission does have authority under the Act to initiate an earlier proceeding, if warranted (Section 114).

The Commission has concluded that the WKP incentive methodology offers sufficient merit to put in place for this three-year period. The Commission recognizes the similarities in cost setting between the proposed settlement and traditional regulation along with likely benefits of aligning shareholder incentives with customer needs.

4. THE ANNUAL REVIEW

The format for the annual review proposed in the settlement agreement also received attention from the ECA. The ECA wanted to know what formalities would be in place, such as rules of evidence and

recording of proceedings, and whether there would be an opportunity to raise other issues of public concern. The Electrical Contractors Association of British Columbia ("Electrical Contractors") were concerned about the separation of issues listed under the proposed annual review and the traditional hearing process.

The evidence shows that the agenda for the annual review was established as part of the settlement agreement but the format for the review has yet to be finalized. WKP indicated that the format would be established in consultation with stakeholders. The outline for the annual review provides for customers to file an "Operational Issues" list for consideration by the Commission prior to the annual review. In addition, as part of the settlement agreement, a town hall type meeting will be held in the evening for parties not wishing to participate in the annual review.

This process is acceptable to the Commission and Commission staff will work with WKP and other stakeholders to ensure a productive format is established.

5. CONTRACTING PRACTICES

The Electrical Contractors opposed granting a rate increase to WKP since it was argued that the Utility appeared to ignore implementing certain cost-saving measures the Electrical Contractors held to be attainable.

The Electrical Contractors is a province-wide association of some 200 electrical contractors, suppliers and distributors. Approximately 55 of the contractors are engaged in power line contracting work with at least three of these resident in the WKP service area. 'Line Work' is described as pole or tower line construction and maintenance (Ex. 16, answer 10).

The Electrical Contractors opposed the base rates and productivity improvement factors agreed to in the negotiated settlement for Labour, Transmission Plant, Distribution Plant Upgrades and Distribution Plant Extensions cost accounts. The basis for this opposition was that WKP, for the past 15 years, had not tendered any line work for competitive bidding, thereby ignoring potential savings held to be attainable by the Electrical Contractors through contracting out at least a portion of this line work. Specifically, the Electrical Contractors asked the Commission to examine in a public hearing one key question, namely "If WKP had an open and competitive tendering process for line work, could costs be reduced?".

Evidence of Mr. Mike Scheer, filed on behalf of the Electrical Contractors, emphasized the importance of the issue of putting line work up for tender for three reasons:

- "1) Opening the work for tendering would at the very least ensure that West Kootenay Power was using the most cost-effective means at its disposal for providing electrical energy. This would translate into lower costs for the consumer.
- 2) The second very important reason to sustain a viable, reliable and capable group of line contractors within the operations area of WKP, is the reserve backup concept. It is comforting for the Utility to realize there are available crews and equipment in the event of catastrophic storm damage; or to handle a short term work load requirement without the additional capital cost to the WKP customer.... most line contractors have approximately \$500,000 worth of mobile equipment available at any given time.
- 3) The existence of a tendering process for WKP's line work protects the survival of a competitive line work industry in the region. Without competition, there is no incentive or pressure to improve the efficiency of line work and reduce costs". (Ex. 16, p. 2).

In cross-examination Mr. Scheer agreed that a prudently-operated utility needs to maintain a key work force of trades personnel and the associated equipment to carry out both regular maintenance and emergency work (T. 145). He also agreed that the Utility needs to balance the use of that key work force with the cost savings potential of contracting out.

Mr. Scheer expressed his pleasure on hearing WKP's evidence that they were considering meeting with contractors to work something out on line work. He felt that the Utility could improve its performance by ensuring that alternative work forces and equipment would be available (T. 146). He was in favour of the presence of an economic incentive involving customer and company sharing in any savings brought about by productivity improvement (T. 147).

In final argument, Mr. Waldman, counsel for the Electrical Contractors, requested that the Commission approve the Negotiated Settlement Agreement only if an Order is made that WKP bring forward a policy which would allocate an amount of work that is to be set aside for independent contractors, similar to an Order made earlier for B.C. Hydro. He modified this request by stating that, in a spirit of negotiated settlement, perhaps WKP and the Electrical Contractors could be given a period of time to try to work out a policy and bring it forward to the Commission (T. 176).

WKP acknowledged that they did not have a formal policy for tendering transmission and distribution work in general. They did have written instructions for use by personnel when evaluating a project and deciding whether or not to tender a job (T. 76). A witness for WKP testified that they were creating a set of guidelines to provide a more uniform way of dealing with tendering decisions throughout the Company in all areas (T. 77).

In response to an Information Request from the Electrical Contractors, WKP described the decision-making process used to determine whether or not a line-work project is put out for tender:

"Tendering consideration for a project will occur when a project cannot be handled by the existing work force unless temporary employees are added. Incremental costs of adding the temporaries are estimated and compared to what a contractor's bid would have to be in order to be more cost-effective than the in-house option. Based on this information, the decision to contract in or out would be made". (Ex. 4, IR #2, q. 1a).

The total expenditures for line work amounted to \$32 million in 1994 and \$34 million in 1995. This includes all pole and tower line work and that associated with substations and terminal stations (T. 84). The dollar value includes all costs for labour, materials, vehicles and other equipment. Of the line work done by WKP employees, 17 percent is charged to operations and maintenance and 83 percent to capital projects (Ex. 2, Electrical Contractors IR #1, q. 6). In response to an earlier question from Mr. Byrnell, representing International Brotherhood of Electrical Workers, Local 258 ("IBEW"), WKP stated that their total labour costs were in the order of \$20 million, approximately equal to 17 percent of total revenues (T. 24).

In response to a suggestion by counsel for the Electrical Contractors that the amount of contracting out was minimal, WKP replied that in 1995 the Utility entered into contracts valued at over \$7.3 million which represented 13.6 percent of the total Operation and Capital budget expenditures (Ex. 2, Tab 3, Electrical Contractors IR #1, q. 4). They suggested that this amount may have been optimal, not minimal.

Witnesses for WKP testified that their ability to contract out line trades work is somewhat limited by restrictions in their Collective Agreement with the IBEW. Article 20 deals with work done by contractors. In recent bargaining this article was changed substantially. The previous language required that WKP pay contractors on the basis of the same wages and working conditions as exist in the WKP Collective Agreement. This made a tendering process impractical in that WKP did not have the ability to take advantage of any competition in rates between bidders. That clause has now been removed from the agreement so that WKP can invite bids from contractors and award contracts based on the cost of the work independent of the wages paid and the working conditions (T. 94). However, a long-standing Article 20.03 remains unchanged. Article 20.03 reads:

"The company agrees that it will not contract out any work at any of its operations if, as a direct result, an employee will be demoted or laid off." (T. 93).

The witness for WKP testified that with the recent changes there is now no restriction on what work can or cannot be contracted out (T. 92). In answer to an information request WKP replied that activities such as

transmission line design, pole supply, civil and backhoe work, surveying, brushing, pole stabbing, flagging and crane work have been contracted out. The line trades work has typically been done in-house and has not been put out for tender in the past (Ex. 2, Tab 3, Electrical Contractors IR #1, q. 2). With the changes in the Collective Agreement noted, WKP now have greater flexibility in tendering decisions. Mr. Debiene, testifying for WKP, stated that:

"We're more than open to considering utilizing contractors, partnerships, strategic partnerships, suppliers and contractors, and just about any other means that we can bring to bear to meet the cost savings targets and maintain our performance and reliability." (T. 89).

WKP witnesses cautioned that some distribution work comes in small packages and requires great flexibility in scheduling. Also there are administrative costs to contracting out involving tender preparation, review of bids and supervision of the work. It is not always practical nor cost-effective to competitively tender all work. Counsel for WKP, in final argument, further confirmed the intent of the Utility to pursue contracting out opportunities where there are efficiencies to be gained (T. 178).

On the basis of the evidence presented, the Commission is of the view that, in general, WKP has conducted its operations, maintenance and capital works in a cost-effective manner commensurate with its responsibilities as a public utility. The one possible exception is the total avoidance of contracting out line work. During the hearing, WKP testified that they now have more flexibility in this area and stated their intention to work with local line contractors to explore the potential savings and other advantages available through this alternative. The Commission encourages WKP to pursue this activity and directs that, at the time of each annual review, WKP is to present a progress report on negotiations and the details of any line work projects successfully tendered.

6. NSP ISSUES

The ECA brought forward a number of issues with respect to the Commission's negotiated settlement process (the "NSP") and the difference between that process and a traditional hearing. In particular, the ECA was unclear about the role of the Commission in the NSP (T. 136), the stages of the process, what would happen if a party was not happy with the negotiated settlement, what opportunities there were for raising issues not directly addressed in the application and whether there would be a hearing on the settlement agreement. In the filed material, the Electrical Contractors expressed some similar concerns over the NSP process and the traditional hearing (Ex. 5). However, at the meeting, Mr. Scheer testified that he did not personally object to the concept of negotiated settlements. The ECA also raised concerns about the notice period for this hearing, and limitations of the NSP for obtaining information under oath

and through cross-examination. The ECA suggested that it would have been helpful if a workshop on incentive-based mechanisms had been included as part of the NSP.

In January 1996, the Commission issued a document entitled "Negotiated Settlement Process: Policy, Procedures and Guidelines". The responsibilities of the Commission within the context of the NSP are clearly specified, "The Commission continues to administer its responsibilities under the Utilities Commission Act and cannot delegate decision making power to others; ... "The role of the Commission in initiating a negotiated settlement process, in identifying the specific steps in the process and in evaluating settlements are detailed in the document. The document discusses procedures for the NSP as well as the rights of parties that dissent from a proposed agreement.

Negotiations are conducted in confidence and participants are expected to act in good faith. This is to encourage open negotiations without the fear that bargaining positions may later be disclosed in a public hearing if negotiations failed to achieve a settlement. At an oral hearing, parties who dissent from a proposed agreement can present evidence and cross-examine witnesses. To date, the Commission has not evaluated a settlement agreement without either an oral or a written hearing, with the former being the most frequent process employed.

In the case of the WKP NSP, the Commission issued a series of Orders outlining the process with a timetable for the key activities. Mr. Scarlett received the Commission's NSP document and the Commission Orders for the review of the WKP application. Mr. Scarlett, on behalf of the ECA, attended the pre-hearing conference and the workshops. Mr. Marsh attended the negotiation days on behalf of the ECA.

At the inception of the public review of the WKP revenue requirements application, an Order was issued by the Commission and notice of the application was widely distributed and advertised in the WKP service area. Those who wished to participate in the review of the application were asked to register with the Commission at that time. Consequently, the hearing notice was circulated to registered intervenors and interested parties only. The notice period for the hearing was relatively short because much of the preliminary work for a public hearing, including the issuance and receipt of responses to information requests, had already been undertaken as part of the negotiated settlement process. No requests for an adjournment were received by the Commission.

The Commission recognizes that the ECA suggestion for a broad-based workshop on incentive-based mechanisms may have been a useful addition to the NSP to assist participants to review utility proposals for incentive mechanisms. The Commission will keep this suggestion in mind for future refinements to its processes. The Commission will also consider the other concerns of the ECA as it establishes future Negotiated Settlement Processes.

APPEARANCES

FRED WEISBERG	Commission Counsel
ROBERT HOBBS	West Kootenay Power
ROB BYRNELL	International Brotherhood of Electrical Workers, Local 258
DON SCARLETT	Kootenay-Okanagan Electrical Consumers Association
JOHN HALL	Princeton Light and Power Company, Limited and Interior Municipal Utilities
MS. K. PLUMMER	Herself
LORNE WALDMAN	Electrical Contractors Association of British Columbia
KEN OSTRAT	Interior Municipal Electrical Utilities

B. MCKINLAY
W.J. GRANT
F.S. JAMES
R.W. RERIE

Commission Staff

ALLWEST COURT REPORTERS LTD.

Court Reporters & Hearing Officer

LIST OF EXHIBITS

	<u>Exhibit No.</u>
Revenue Requirements Application Volume 1	1
Revenue Requirements Application Volume 2	2
Ten Year Transmission System Plan	3
Responses to Information Request No. 2 from the Electrical Contractors Association of B.C.	4
Settlement Agreement Under Cover of B.C. Utilities Commission letter dated May 24, 1996	5
Letter from Princeton Light and Power Company, Limited dated May 6, 1996	5A
Letter from West Kootenay Power Ltd. dated May 7, 1996	5B
Letter from Electrical Contractors Association of B.C. dated May 10, 1996	5C
Letter from City of Kelowna dated May 13, 1996	5D
Letter from the Corporation of the City of Grand Forks dated May 14, 1996	5E
Letter from the B.C. Public Interest Advocacy Centre dated May 7, 1996	5F
Letter from the B.C. Public Interest Advocacy Centre dated May 22, 1996	5G
Letter from the Corporation of the District of Summerland dated May 23, 1996	5H
Letter from the Corporation of the City of Penticton dated May 22, 1996	5I
Letter from the Kootenay Okanagan Electric Consumers Association dated May 23, 1996	5J
Letter from Mr. Grant, B.C. Utilities Commission, dated May 27, 1996, to Mr. Scarlett	6
Copies of Various B.C. Utilities Commission Orders	7
Commission Order No. G-111-95, Approval of Interim Rate Increase	7A
Commission Order No. G-119-95, Pre-Hearing Conference Document	7B
Commission Order No. G-10-96, Scheduling Workshops and Negotiated Settlement Days	7C
Commission Order No. G-64-96, Public Hearing to Review the Proposed Negotiated Settlement	7D
Affidavit of Publication	8
Letter from Ms. Kathy Plummer to B.C. Utilities Commission dated June 7, 1996	9

Letter from Natural Resource Industries signed by Mr. Richard Tarnoff to Mr. Grant at the B.C. Utilities Commission dated May 31, 1996	10
Letter from Mr. Don Scarlett on behalf of the Kootenay Okanagan Electric Consumers Association to the B.C. Utilities Commission dated June 7, 1996	11
Kootenay-Okanagan Electric Consumers Association Document dated June 26, 1996	12
Letter dated February 26, 1996 from Mr. Scarlett to the B.C. Utilities Commission	13
Letter from Mr. Hobbs to Workshop Participants dated February 21, 1996	14
Letter dated April 1, 1996 from the B.C. Utilities Commission to Workshop Participants	15
Written Statement of Mike Scheer	16