BRITISH COLUMBIA UTILITIES COMMISSION

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BRITISH COLUMBIA
UTILITIES COMMISSION

ORDER
NUMBER G-5-98

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IN THE MATTER OF
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473

and

An Application by West Kootenay Power Ltd.
for Approval of 1998 Rates

BEFORE: K.L. Hall, Commissioner) January 8, 1998
F.C. Leighton, Commissioner)

O R D E R

WHEREAS:

A. Commission Order No. G-73-96 approved the May 24, 1996 Settlement Agreement ("the Agreement") setting up a rate adjustment mechanism for a three-year period beginning January 1, 1996, whereby West Kootenay Power Ltd. ("WKP") is required to file with the Commission a Statement of Adjustments for a rate increase effective January 1 of the next year; and

B. The Agreement requires that an Annual Review process be instituted whereby the public would be invited to examine the material, submit other issues for determination by the Commission, and meet to review all issues prior to the rate application being made. The Annual Review is also required to review the Load Forecast, Power Purchases and Distribution Extension Capital Expenditures for 1998; and

C. The Commission, by Order No. G-108-97, set down the 1997 Annual Review of the 1998 Revenue Requirements for December 3, 1997 in Kelowna, B.C.; and

D. On November 7, 1997 WKP filed its Preliminary 1998 Revenue Requirements material for the Annual Review; and

E. On December 9, 1997, following the Annual Review of the 1998 Revenue Requirements, WKP filed its application for final rates which included a 1.2 percent rate increase for all customers; and

F. The Commission has reviewed the submissions made by WKP and participants to the Annual Review and has determined that a rate increase is required.

NOW THEREFORE the Commission orders as follows:

1. The Commission approves for WKP its 1998 Revenue Requirement as filed with adjustments to remove $100,000 from 1998 power purchase costs and to deny the $88,000 incentive sharing payment to the shareholders. The Commission's Reasons for Decision is attached as Appendix A to this Order.

2. WKP is to file with the Commission an amended Revenue Requirements Summary indicating the adjusted rate increase and Electric Tariff Rate Schedules that include the rate increase approved by this Order.

3. WKP is to inform all customers of the effect of the rate increase by way of a detailed customer notice.

DATED at the City of Vancouver, in the Province of British Columbia, this 14th day of January, 1998.

BY ORDER

Original Signed by:

Kenneth L. Hall
Commissioner

Attachment

REASONS FOR DECISION

1. INTRODUCTION

Commission Order No. G-73-96 approved the May 24, 1996 Settlement Agreement setting up a rate adjustment mechanism for a three-year test period beginning January 1, 1996, whereby West Kootenay Power Ltd. ("WKP") is required to file with the Commission a Statement of Adjustments for a rate increase effective January 1 of the next year.

The terms of the Settlement Agreement require that an Annual Review process be instituted, 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 the rate application being made. The Annual Review is also required in order to set the Load Forecast, Power Purchases and Distribution Extension Capital Expenditures for the following year and parties may institute a complaint procedure before the Commission if not satisfied.

On November 7, 1997 WKP filed with the Commission its Preliminary 1998 Revenue Requirements material for the Annual Review, which was held December 3, 1997 in Kelowna, pursuant to Commission Order No. G-108-97. The Annual Review was attended by representatives of the Electrical Consumers Association, the Interior Municipal Electrical Utilities, the Corporation of the District of Summerland, the Consumers Association of Canada (B.C.) ["CAC(B.C.) et al."], Princeton Light and Power Company, Limited ("PLP") and Natural Resource Industries among others.

On December 9, 1997 WKP filed its Application for final rates effective January 1, 1998 requesting a general rate increase of 1.2% for all customer classes. At the conclusion of the Annual Review participants were asked to make submissions to the Commission on a list of outstanding issues. WKP responded to these issues with comments attached to its 1998 Rate Application. Submissions on this Application were also received from the six registered participants noted above.

The Commission has the following comments to make regarding several issues raised at the Annual Review and in submissions from the participants.

2. POWER PURCHASES

As part of the three-year rate settlement for WKP, the Commission must establish the power purchases expense for each year. At the Annual Review in November, 1997 there was no agreement between the stakeholders and WKP on the appropriate power purchase expense.

The CAC(B.C.) et al. has provided a submission arguing that cost of power should be treated as a pass-through cost in a similar way to what occurs for the natural gas utilities. This submission may have considerable merit for the future as competition in the electricity industry evolves and the number, timing and cost of various power purchase contracts becomes increasingly difficult to forecast. However, for this final year of the rate settlement, the Commission believes WKP should continue the existing practice of forecasting an overall power purchase expense. The most appropriate way of dealing with power purchase expense in future years will likely be a significant issue in WKP's Rate Application for 1999 and beyond.

In reviewing the forecast and experience with respect to other energy market purchases the following results are noted. Last year WKP planned to purchase 300 gigawatt-hours from British Columbia Hydro and Power Authority ("B.C. Hydro") but due to market opportunities WKP was able to limit its actual purchases to 189 gigawatt-hours. Therefore, of the 175 gigawatt-hours purchased from the other energy market purchases, 111 gigawatt-hours can be attributed to displacement of planned B.C. Hydro purchases. The Commission has calculated that the average price for these energy purchases was approximately 18 mills. As a result, WKP was able to effect a saving of approximately $900,000 compared to the power purchase expense planned for and approved by the Commission for 1997.

In 1998 the Commission acknowledges the evidence provided by WKP that the circumstances which led to very low prices in the winter of 1996-97 are likely to become less advantageous during the 1998 year. However, the Commission expects that market opportunities for energy savings in the price range of 20-22 mills kWh are probable. There may also be modest additional capacity savings available from the market. The Commission, therefore, believes that the power purchase expense proposed by WKP should be reduced by the displacement of approximately 110 gigawatt hours of energy purchased from B.C. Hydro to an equivalent purchase from the energy market at an average price of approximately 21 mills. This leads to an expected saving of approximately $550,000.

The Commission also acknowledges that there is an "asymmetry" problem to be addressed resulting from the consequences to WKP of power purchases cost in warmer than average years compared with unusually cold years. The Commission recognized this problem in its rate setting for the 1997 fiscal year and directed WKP to provide further evidence with respect to the asymmetry problems prior to this year's rate setting.

WKP has provided a study (the asymmetry study) which was discussed at the Annual Review. The Commission understands that while the asymmetry problem is recognized by all parties, its valuation remains in dispute. The Commission had hoped that this issue could be resolved between the parties but recognizes it must now address the evaluation issue for this final year of the rate settlement.

The Commission has considered the four categories of asymmetry variation identified by WKP in its study. Based on the information provided, the Commission is of the view that the first issue, with respect to the cost of energy related to market capacity requirements, is generally dealt with by the power purchase forecasts and no additional asymmetry exists. The Commission accepts WKP's rationale with respect to the power purchase benefits resulting from surplus energy sales in declining load periods and the additional costs of B.C. Hydro energy during cold periods. These items offset each other for a net increase in expected risk of only $29,000.

The major issue in the asymmetry study comes from the impact of B.C. Hydro capacity charges in unusually cold periods. WKP has done considerable expected value analysis to estimate the cost for this risk factor at about $419,000. This expected value analysis is problematic due to the large number of assumptions to be made. However, the Commission is prepared to accept the inherent assumptions and the expected value calculation for this year only.

In summary, the Commission has identified some $550,000 of expected savings due to other market energy purchases, and also recognizes an expected value for the asymmetry surrounding WKP's power purchase cost in high load versus low load weather conditions to a cost of approximately $450,000. Therefore, the power purchase expense is to be reduced by a net value of $100,000.

3. CAPITALIZED OVERHEAD

At the Annual Review the issue of capitalized overheads was raised. The terms of the Settlement Agreement state that WKP will set the amount of capitalized overhead using a base cost of 7% and a cost driver being capital expenditures. Any variance from the target calculated using these parameters would be shared equally with the ratepayers.

The information filed by WKP indicates that the actual rate used in 1996 and 1997 was 8.8%, i.e., WKP did not meet its target of 7% of the capital expenditures and the result would be a sharing of the variance with the customer. CAC(B.C.) et al. objected to the 8.8% rate and stated that the result of using a higher overhead capitalization rate was to decrease the amount of operating expenses and, as a consequence, the payment the Utility would receive through the incentive sharing mechanism would increase.

The Commission has reviewed the settlement document and is of the view that the rate used by WKP is correct and that the incentive mechanism is operating as contemplated in the agreement. The issue of the impact of the capitalized overhead calculation on operating expenses and the incentive mechanism was reviewed and discussed during the settlement negotiations. The comments made by CAC(B.C.) et al. do have merit, but should be raised when WKP files for adjustments to its performance based rates ("PBR") in November, 1998.

The Commission concludes that no adjustment to the overheads capitalized amounts in the Application is required.

4. PERFORMANCE STANDARDS

One of the key features of WKP's PBRs is the incentive sharing mechanism that, simply put, allows for a 50:50 sharing between the Utility and ratepayers of the difference between the target costs set for the year for particular cost categories, and the actual costs achieved. If costs are lower than the target amounts customers and WKP share in the savings. If costs are higher than the target costs, the excess cost is shared 50:50. The effect of the variance is incorporated into rates for the next year.

One of the principles of incentive regulation sought by WKP, and agreed to in the Settlement Agreement, is that there should be no deterioration of service reliability and employee safety. This concept was agreed to during the Alternate Dispute Resolutions sessions. The Reasons for Decision accompanying Order No. G-73-96 approving the PBR plan stated "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." (Reasons, p. 3).

At the 1997 Annual Review it was apparent that WKP had not improved on its reliability performance. WKP itself states in the Application "The Company is far from satisfied with its reliability performance". Commission staff and participants in the review were of the opinion that the performance measures were sufficiently reduced as to deny WKP the incentive payment calculated as a result of O&M cost savings. There was much discussion at the review regarding this issue and participants and WKP were requested to make submissions to the Commission.

The measures that highlighted WKP's poor performance in 1997 relate to system reliability ("SAIDI and SAIFI") and customer service. The Utility's reliability performance is measured using a three-year average. The average in 1997 had deteriorated relative to the average measure in 1996.

SAIDI measures the amount of time the average customer's power is off in a year. The measure indicates increasing hours of interrupted time from 1995 through to 1997 (2.698 - 3.953 - 4.281 hours respectively). SAIFI measures the average number of interruptions per customer per year and the results for 1995-1997 show a similar trend (5.741 - 6.475 - 7.367 respectively).

WKP responds in its submission by citing the poor weather the Utility experienced in 1997, i.e., significant violent winter and summer storms within its service area, as the primary cause for the decline in reliability measurements. The Utility also states that the performance standards are designed to ensure that incentives are earned from productivity improvements and not by compromising performance. WKP also points out that at the 1996 review there was a decline in the Safety Performance Standards measure, yet the Commission still approved the incentive payment to the Company.

A further measure, the Customer Satisfaction Index ("CSI"), also declined in 1997 relative to 1996 (80.0% vs. 82.6% respectively). WKP maintains that it is more important to look at whether the CSI remains relatively constant over an extended period of time, not the year-to-year differences. The Utility maintains that the CSI has remained relatively constant over the past several years and that over the past three years the "Overall Customer Satisfaction" rating has improved.

Submissions on this issue were received from several participants. CAC(B.C.) et al., The Corporation of the District of Summerland, the Interior Municipal Electrical Utilities and Natural Resource Industries all supported the denial of the incentive payment.

As CAC(B.C.) et al. points out, WKP's own statements at the oral hearing into the Settlement Agreement conclude that if there is a dramatic change with respect to its performance over historical trends, then it would not expect to receive the incentive. The Utility also reiterates that it is necessary for it to exceed the historical threshold measurement in order to gain the incentive.

CAC(B.C.) et al. also raises the issue of the incentive payment earned last year, and the fact that the entire 1996 year results are now known and show that the 1996 performance was worse than indicated at the 1996 Review. Consequently, CAC(B.C.) et al. states that the 1996 incentive should be repaid by WKP.

In its December 9, 1997 filing, WKP requests an incentive adjustment for its 1998 rates in the amount of $88,000 relating to its 1997 performance and a final adjustment of $153,000 to the 1998 rates relating to the utilities performance in 1996.

The Commission does not believe that the fact the incentive was allowed last year, when the safety measure was declining, should be considered in the determination of this year's amount. In addition, the Commission does not conclude that the 1996 incentive should be repaid by WKP, as requested by CAC(B.C.) et al. However, the Commission supports the position taken by the participants to the Annual

Review and concludes that the incentive payment of $88,000 should not be received by WKP due to the poor performance on its reliability measures and customer satisfaction.

5. LOAD FORECAST

The terms of the Settlement Agreement require that the Commission approve for each year the Load Forecast presented at the Annual Review. A Load Forecast Committee was formed, including a Commission staff member, which reviewed the Load Forecast and reported to the Annual Review their acceptance or rejection.

The WKP 1998 Load Forecast included for the first time an adjustment to account for the weather phenomenon known as El Nino. WKP concluded that the El Nino effect on its service area was significant enough to warrant a change to the methodology of the forecast.

The Committee was unanimous in its opposition to the El Nino inclusion, citing both the fact that it was a change in methodology and the fact that the 20-year average used for the normalization in the forecast would already include the effect of previous El Ninos.

After much discussion WKP agreed to remove the El Nino effect from the Load Forecast and agreed with the recommendation put forth by the Committee at the Annual Review. However, in its submission of December 9, 1997, WKP has changed its opinion and states that the El Nino effect should be included and the change in methodology accepted, if a change in methodology related to the Power Purchases is approved by the Commission.

The Commission does not agree with WKP's submission. The Load Forecast methodology should not be linked with the Power Purchases change of methodology. The issue of the El Nino effects should properly be reviewed at the next Revenue Requirements proceeding.

The Commission therefore approves the Load Forecast presented at the Annual Review without the effect of El Nino.

6. EXTRAORDINARY CAPITAL EXPENDITURES

CAC(B.C.) et al. in its December 11, 1997 submission also raised the issue of the extraordinary capital expenditure as a result of the replacement by WKP of its Ohio Brass Insulators.

WKP had previously come before the Commission for approval of the insulator replacement on Line 72 as an extraordinary capital expenditure. The Commission reviewed the application and the need for the insulator replacement program and approved it at that time by Letter No. L-28-97. Future Ohio Brass insulator replacement programs are of the same nature as the previous program and therefore should be treated in the same manner, i.e., as an extraordinary capital expenditure which will require a Certificate of Public Convenience and Necessity ("CPCN") application and further review at that time.

In the view of the Commission the issue has been reviewed and dealt with properly, and there is no need for a further examination. Consequently, CAC(B.C.) et al.'s request that the insulator replacement program be treated as a normal transmission capital expenditure is denied.

7. ISSUES REQUIRING A HEARING

CAC(B.C.) et al. submitted in its December 11, 1997 letter that there are three issues of significant importance that require further proceedings before the Commission. The issues are: extraordinary capital expenditures, capitalized overheads and power purchase costs.

The extraordinary capital expenditure issue has been reviewed by the Commission through the previous application by WKP for the Ohio Brass Insulator replacement. Concerning capitalized overheads, the Commission is of the opinion that WKP has followed the Settlement Agreement and therefore there is no need for further action at this point. Finally, the power purchase issue does require debate, but the need for a separate hearing to deal with the issue would be excessive in terms of Commission time. The next revenue requirements proceeding, which will realistically be in the spring of 1999, is the proper forum in which to deal with CAC(B.C.) et al.'s concerns.

The Commission concludes that the request for a hearing should be denied.