



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

and

An Application by Eurocan Pulp and Paper Company
for Reconsideration of Order No. G-56-02

BEFORE: P. Ostergaard, Chair) October 29, 2002
N. Nicholls, Commissioner)

O R D E R

WHEREAS:

- A. On March 6, 2002, a public hearing commenced into the Pacific Northern Gas Ltd. ("PNG") November 30, 2001 application for approval of its 2002 revenue requirements pursuant to Sections 91 and 58 of the Utilities Commission Act (the "PNG Application" and the "Act"). The oral public hearing concluded on March 11, 2002, reconvened on May 27, 2002 to consider a Memorandum of Agreement ("MOA") entered into by PNG and Methanex Corporation ("Methanex") on March 20, 2002, and was followed by written argument; and
- B. By Order No. G-127-01 dated November 22, 2001, the Commission required that the application by Methanex for a load retention rate be reviewed coincident with PNG's 2002 revenue requirements application; and
- C. Commission Decision and Order No. G-56-02 accepted the MOA, and denied requests to reduce PNG's revenue requirements by an amount equivalent to the reduction in revenues from Methanex; and
- D. On August 30, 2002, Eurocan Pulp and Paper Company ("Eurocan") applied, pursuant to Section 99 of the Act, to have the Commission reconsider and vary that portion of the Decision that allocates solely to PNG customers other than Methanex, the entire amount of the revenue deficiency arising out of the MOA and from the closure of the Skeena Cellulose facilities (the "Reconsideration Application"); and
- E. The Commission has considered the Reconsideration Application all as set forth in the Reasons issued concurrently with this Order, and attached as Appendix A.

BRITISH COLUMBIA
UTILITIES COMMISSION

ORDER
NUMBER G-78-02

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NOW THEREFORE the Commission has determined that it will neither reconsider nor vary Order No. G-56-02 and the Decision that was issued concurrently with that Order. The Reconsideration Application is denied.

DATED at the City of Vancouver, in the Province of British Columbia, this 30th day of October 2002.

BY ORDER

Original signed by:

Peter Ostergaard
Chair

Attachment

**Eurocan Pulp and Paper Company
Reconsideration Application
Pacific Northern Gas Ltd. 2002 Revenue Requirements Application**

REASONS FOR DECISION

1.0 Background

Pacific Northern Gas Ltd. (“PNG”) delivers natural gas to about 24,000 customers in 12 communities and to a number of industrial facilities, in a region extending west of Prince George to tidewater at Kitimat and Prince Rupert.

One of PNG’s major industrial customers is Methanex Corporation (“Methanex”) whose methanol plant at Kitimat historically accounted for about two-thirds of the volume transported on the PNG system and 45 percent of PNG’s operating margin. On March 20, 2002, PNG and Methanex entered into a Memorandum of Agreement (“MOA”) to terminate their existing agreements for firm transportation and interruptible gas sales service and to replace those agreements with a new load retention rate agreement effective November 1, 2002.

On March 27, 2002, PNG submitted revisions to its application for 2002 Revenue Requirements to reflect the impact of the MOA. It also revised the allocation of the overall revenue deficiency among customer classes but recommended no further re-balancing until it can complete a Fully Allocated Cost of Service (“FACOS”) study.

On July 31, 2002, the Commission issued Decision and Order No. G-56-02 which establishes the 2002 revenue requirements for PNG (“the Decision”). Among other determinations, the Decision accepted the MOA, approved the cost allocation methodology as applied for by PNG, and directed PNG to include a FACOS study with its 2003 revenue requirements application.

On August 30, 2002, Eurocan Pulp and Paper Company (“Eurocan”), one of PNG’s large industrial customers, applied pursuant to Section 99 of the Utilities Commission Act (the “Act”), to the Commission to reconsider and vary that portion of the Decision that allocates solely to PNG customers other than Methanex the entire amount of revenue deficiency arising out of the MOA and from the closure of the Skeena Cellulose facilities (the “Reconsideration Application”).

Specifically, the Reconsideration Application takes issue with the section of the Decision (page 13) which states: “*The Forest Companies infer that the large overpayments in past years by Methanex benefited PNG shareholders when, in fact, they did not. Rates that generated revenue/cost ratios above 1.0 were applied to the overall revenue requirement and reduced the rates to other customers.*” Eurocan alleges that this aspect of the Decision was based on an error in fact and law because the Commission findings are either contrary to evidence or are without evidentiary basis.

The Reconsideration Application argues that the Decision was without foundation when it determined that the surplus revenues from Methanex and Skeena Cellulose did not benefit PNG shareholders. It further submits that the 1998 FACOS Study shows that on the basis of the revenue to cost ratio, the rates charged to Eurocan were not in fact reduced as a result of overpayments by Methanex or Skeena Cellulose. It argues that the Commission has failed to take into account the subsidy that Eurocan has provided to other customers and has not discussed whether, and to what extent, PNG should be allowed to recover from its customers the revenue shortfall associated with the closure of the Skeena Cellulose facilities. Eurocan asserts that the Commission has acted upon conjecture or supposition on the issue of the existence and magnitude of benefits to PNG shareholders and PNG’s customers including Eurocan.

The Commission issued Letter No. L-32-02 which established the reconsideration process, providing opportunities for PNG and intervenors to comment on the Reconsideration Application and for Eurocan to reply to those written submissions. The process was limited to the first phase of reconsideration to determine if there are sufficient grounds to grant reconsideration.

Submissions were received from PNG and three intervenors. One supported Eurocan, one took no position and two opposed the Reconsideration Application.

The Consumers Association of Canada (BC Branch) and others [CAC (BC) *et al.*] submission argues that Eurocan was incorrect to claim that the revenue to cost ratios from the FACOS Study indicate that the rates charged to Eurocan were not in fact reduced as a result of overpayments by Methanex or Skeena Cellulose. CAC (BC) *et al.* further submits that the fact that a customer has a ratio in excess of 1.0 does not mean it did not benefit from contributions from other customer classes.

Methanex does not take any position on the Reconsideration Application.

Alcan Primary Metal Group supports the principle that PNG shareholders should bear some or all of the financial consequences of the Methanex load retention rate.

The PNG submission asserts that PNG's rates were fixed each year in such a manner as to allow it to recover its approved revenue requirement. According to PNG, shareholders cannot be said to benefit from payment by Methanex when PNG's rates were just and reasonable. Therefore, PNG argues that the Commission's conclusion is so basic that it does not need to be supported by an evidentiary record. PNG argues that there is no regulatory principle or authority for Eurocan's proposition that some of PNG's 2002 revenue requirement should be imposed on PNG.

In its reply, Eurocan submits that the Commission had recognized that PNG shareholders must have benefited from large industrial customers in its Decision on PNG's 1992 revenue requirements. It quotes from that Decision: "*to the extent that the risk imposed by the highly concentrated industrial sales may be borne by the residential and commercial customers rather than the shareholders, this reduces the risk to PNG considerably.*" While Eurocan does not dispute PNG's statement that past rates for Methanex were fair, just and reasonable, it observes that the same should be said for Eurocan and hence the Commission ought not to distinguish between surplus revenue contribution by Methanex benefiting Eurocan and vice versa. Eurocan submits that the 2002 Decision contradicts the 1992 and 1998 Decisions by sheltering PNG shareholders from the entire burden of the revenue shortfall from Skeena Cellulose and Methanex. In response to the CAC (BC) *et al.* submission that a customer class with a revenue to cost ratio in excess of 1.0 does not mean that it did not benefit from the utility's receipt of "excess" revenues from other customer classes, Eurocan observes that there is no evidence to support a conclusion that every other class of customer must necessarily receive a benefit.

2.0 Decision

The Decision allows PNG to recover from customers other than Methanex the entire amount of revenue deficiency that was determined. There are two important contextual elements in the Decision: the approval of the MOA entered into by PNG and Methanex and the expected closure of Skeena Cellulose for the entire year 2002. These two elements have created a revenue deficiency much larger than it would have been otherwise.

Benefits, when broadly defined, refer to all revenues after the costs of the utility are paid. When narrowly defined as used in the context of benefits to the shareholders of PNG, whose return is regulated by an allowed return on equity ("ROE"), they mean excess enrichment through rates that are not fair or reasonable. When used in the context of benefits to PNG customers they refer to issues of revenue and cost allocation.

Eurocan correctly points out that in the 1992 Decision, the Commission identified a reduced risk to PNG as the risk imposed by the highly concentrated industrial sales may be borne by the core customers. It is also correct for Eurocan to observe that the Commission had concluded that PNG's risk was reduced by the

existence of residential and commercial customers. One of the tasks for the Commission is to ascertain the risk profile of the utility in order to determine the allowed equity return in the revenue requirements. It is however incorrect for Eurocan to imply that the reduced risk to PNG amounted to a benefit to PNG shareholders. PNG is a distinct and separate entity from the shareholders of PNG. Given an allowed rate of return based on the assessed risk profile of PNG, PNG shareholders cannot be said to have benefited from the reduced risk.

Eurocan submits that its revenue to cost ratio has been in excess of 1.0 and, therefore, not only did it not benefit from overpayment by Methanex, but the Commission failed to take account the subsidy that Eurocan has been providing to the other customers. The Commission is aware of Eurocan's revenue to cost ratio as indicated by the 1998 FACOS Study and is cognizant that ratios may change over time. Revenue to cost ratios are only one of many factors considered in a rate design process to establish fair, just and reasonable rates among classes of customers. The Decision stated that "other customers" benefited from payments by Methanex but the Commission did not make direct reference to benefits received by Eurocan or any other customer classes or in what proportion they benefited. The Commission's statement comes from the basic nature of establishing revenue requirements and customer rates which has occurred in all PNG reviews.

It is a fundamental proposition of forward year, rate base, rate of return regulation, that revenue requirements are set to recover the expected costs of the utility from prudent operations plus an opportunity to earn a fair return. This proposition applies whether a revenue deficiency is a result of the shortfall from Methanex or the lack of margin from Skeena Cellulose. The individual customer classes are allocated portions of the approved revenue requirements and rates are set to recover the revenue requirement among all the customers. Individual rates are established based on rate design principles, of which revenue to cost ratios are one of many inputs. If one customer contributes more revenue than its cost, then the remaining revenue requirement to be recovered from all other customers is reduced from what it would be if the revenue to cost ratio for that first customer was set at 1.0.

The allocation of the approved revenue requirement to customers is constrained in that the total of the allocation equals the revenue requirement. Therefore, the PNG shareholders do not receive any benefit - above the approved ROE and capital structure - from Methanex being allocated a revenue to cost ratio greater than one in its past rate settings. The additional revenue generation allocated to Methanex, above its allocated cost, resulted in lower rates to other customers (in aggregate) than would be the case if Methanex rates were set at a revenue to cost ratio of 1.0. The approved revenue requirement was unchanged and the approved ROE was unchanged.

The Commission has determined that it has committed no errors in fact or in law in the July 31, 2002 Decision and that the Eurocan Reconsideration Application does not meet the Commission's criteria for reconsideration. **The Reconsideration Application is therefore denied.**