



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

and

Applications by Pacific Northern Gas Ltd.
and
Pacific Northern Gas (N.E.) Ltd.
(Fort St. John/Dawson Creek and Tumbler Ridge Divisions)

for Approval of 2002 Rate Increases

BEFORE: P. Ostergaard, Chair)
N.F. Nicholls, Commissioner) April 23, 2002
P.G. Bradley, Commissioner)

O R D E R

WHEREAS:

- A. By Order No. G-127-01 dated November 22, 2001, the Commission directed that Methanex Corporation's ("Methanex") September 28, 2001 application for a load retention rate would be reviewed coincident with Pacific Northern Gas Ltd.'s ("PNG") 2002 Revenue Requirements Application. That Order made PNG's rates to Methanex interim effective October 1, 2001; and
- B. On November 30, 2001, PNG and Pacific Northern Gas (N.E.) Ltd. (Fort St. John/Dawson Creek and Tumbler Ridge Divisions) ["PNG (N.E.)"] filed for approval its 2002 Revenue Requirements Applications ("the Applications") to increase its rates on an interim and final basis, effective January 1, 2002, pursuant to Sections 91 and 58 of the Utilities Commission Act ("the Act"); and
- C. On December 13, 2001 the Commission, by Order No. G-132-01, established a Pre-hearing Conference on the Applications for January 8, 2002, and scheduled the commencement date for an oral public hearing into the PNG Application for March 6, 2002 in Terrace, B.C.; and
- D. The Pre-hearing Conference took place in Vancouver on January 8, 2002, and an oral public hearing on the PNG Application was held in Terrace, B.C. on March 6, 7, and 8, 2002, and completed in Vancouver on March 11, 2002; and
- E. At the conclusion of the oral public hearing, the Commission set a timetable for final argument commencing with the filing of final argument by PNG and Methanex on Thursday, March 28, 2002; and
- F. PNG and Methanex have entered into a Memorandum of Agreement made as of the 20th day of March, 2002, to terminate their existing agreements for firm transportation and interruptible gas sales service and to replace those agreements with a new agreement effective November 1, 2002. The new agreement, if approved, would result in the withdrawal of the Methanex load retention rate application; and

- G. Having regard to the impact of the terms of the Memorandum of Agreement upon the Application presently before the Commission, PNG applied to the Commission on March 27, 2002 to postpone the filing of final argument to a date to be set by the Commission, and to fix a date for an oral hearing of the revised application, and to approve a revised hearing and argument schedule; and
- H. PNG's March 27, 2002 application also explained the revisions to the 2002 Revenue Requirements Application that are required to reflect the terms of the implementation of the new agreement contemplated under the Memorandum of Agreement effective November 1, 2002; and
- I. By Order No. G-20-02 dated March 28, 2002, the Commission approved postponement of the filing of final argument to a date to be fixed by the Commission. That Order also requested that intervenors advise the Commission in writing, by April 2, 2002, whether they consented to PNG filing the revised application and for their position on PNG's proposed timetable; and
- J. On April 2, 2002, intervenor comment letters were received from the British Columbia Public Interest Advocacy Centre ("BCPIAC"); West Fraser Timber Co. Ltd., Canadian Forest Products Co. Ltd. and Eurocan Pulp and Paper Co. Ltd. ("West Fraser *et al.*"); and Alcan Primary Metal Group ("Alcan"). BCPIAC consented to PNG's filing of the revised application and considered the proposed timetable generally acceptable.
- K. In its letter, West Fraser *et al.* objected to the new application on the grounds that it was incomplete, there had not been adequate public notice, it would have a material adverse impact on other customers, it would fundamentally impact the value of PNG, and there was insufficient time in PNG's proposed timetable. The letter requested an appraisal of PNG's assets under Section 55(1) of the Act with a rate design to follow. Alcan did not object to PNG's filing of the revised application but submitted that the proposed hearing date should be delayed to allow for comments on the submission of West Fraser *et al.*; and
- L. On April 3, 2002, PNG provided written comments on the issues raised by West Fraser *et al.*; and
- M. By Order No. G-23-02 dated April 3, 2002, the Commission requested that intervenors and PNG provide comments by April 12, 2002 on the issues raised by West Fraser *et al.* with a reply by West Fraser *et al.* by April 19, 2002; and
- N. The Commission has reviewed the submissions from the intervenors and PNG and will address the submissions in the Reasons for Decision to follow. The Commission considers that an amended regulatory timetable should be established.

NOW THEREFORE the Commission orders as follows:

- 1. The Commission will reconvene the oral public hearing into the PNG 2002 Revenue Requirements Application on Monday May 27, 2002 in Vancouver to review PNG's revised application. A Regulatory Timetable, attached as Appendix A, has been established.
- 2. PNG will publish, as soon as possible, in display-ad format, the Notice of Public Hearing, attached as Appendix B, in such appropriate local news publications as may properly provide adequate notice to the public in its service area.
- 3. New Intervenors and Interested Parties must inform the Commission, in writing or email, by Monday, May 6, 2002, of their intention to intervene and/or to attend the public hearing, and should focus on how PNG's Memorandum of Agreement with Methanex would affect their rates.

4. Intervenors intending to apply for participant assistance must submit a budget estimate by Friday, May 10, 2002 consistent with the Commission's Participant Assistance/Cost Award Guidelines. Copies are available upon request or can be downloaded from the Commission's web site at <http://www.bcuc.com/bcuc/paca.html>.
5. The Application, the March 27, 2002 revision to the Application and supporting material will be made available at public libraries in Prince Rupert, Terrace, Kitimat, Houston, Smithers, Burns Lake, Vanderhoof, and Fort St. James, at the Head Office of PNG at Suite 950, 1185 West Georgia Street, Vancouver, B.C., V6E 4E6 and at the British Columbia Utilities Commission, Sixth Floor, 900 Howe Street, Vancouver, B.C., V6Z 2N3.

DATED at the City of Vancouver, in the Province of British Columbia, this 23rd day of April 2002.

BY ORDER

Original signed by:

Peter Ostergaard
Chair

PACIFIC NORTHERN GAS LTD.
Revised Application for Approval of 2002 Revenue Requirements

REGULATORY AGENDA

<u>Action</u>	<u>Date 2002</u>
Information Requests Issued to PNG by Existing Intervenors and Commission Staff	Wednesday, May 1
Requests Submitted for Registration of New Intervenors and New Interested Parties	Monday, May 6
Information Requests Issued to PNG by New Intervenors	Friday, May 10
Budget Estimates for Participant Assistance Submitted to Commission	Friday, May 10
PNG Responds to Information Requests of Existing Intervenors and Commission Staff	Friday, May 10
PNG Responds to Information Requests of New Intervenors	Friday, May 17
Public Hearing Resumes in Vancouver	Monday, May 27



PACIFIC NORTHERN GAS LTD.
Revised Application for Approval of 2002 Revenue Requirements

NOTICE OF PUBLIC HEARING

Date: Monday, May 27, 2002
Time: 9:00 a.m.
Location: BC Utilities Commission Hearing Room
6th Floor, 900 Howe Street (at Smithe)
Vancouver, B.C. V6Z 2N3

THE APPLICATION

Pacific Northern Gas Ltd. ("PNG") applied to the British Columbia Utilities Commission ("the Commission") for approval to adjust rates, effective January 1, 2002. The Application sought to recover increased revenue requirements associated with delivering natural gas. The Application requested an increase in the gas delivery charge in residential rates of about 16 percent and an increase in the gas delivery charge in small commercial rates of about 14 percent to be effective January 1, 2002. The proposed increases in the gas delivery charge were offset by decreases in the gas commodity costs on January 1, 2002, which resulted in a net decrease in rates to sales customers. A further gas cost decrease was approved effective April 1, 2002.

A public hearing into PNG's Application concluded on March 11, 2002. PNG has applied to resume the public hearing to review a Memorandum of Agreement between PNG and Methanex Corporation ("Methanex") that would take effect on November 1, 2002. The revised Application requests an increase in the gas delivery charge in residential rates of about 19 percent and an increase in the gas delivery charge in small commercial rates of about 17 percent to be effective January 1, 2002.

THE REGULATORY PROCESS

The Commission has scheduled the public hearing for the PNG Application to resume in Vancouver, B.C. on Monday, May 27, 2002 to focus on the revisions to the Application resulting from the Memorandum of Agreement between PNG and Methanex.

PUBLIC INSPECTION OF THE DOCUMENTS

The Application, the March 27, 2002 revision to the Application and supporting material will be made available for inspection at public libraries in Prince Rupert, Terrace, Kitimat, Houston, Smithers, Burns Lake, Vanderhoof, and Fort St. James, at the Head Office of PNG at Suite 950, 1185 West Georgia Street, Vancouver, B.C., V6E 4E6, and at the British Columbia Utilities Commission, Sixth Floor, 900 Howe Street, Vancouver, B.C., V6Z 2N3.

INTERVENTIONS

Persons who expect to actively participate in the PNG proceeding, and who are not currently registered, should write or email the Commission requesting to be registered as intervenors by Monday, May 6, 2002. Intervenors will receive copies of the Application, all correspondence and filed documentation.

Persons not expecting to actively participate, but who have an interest in the PNG proceeding and who are not currently registered, should write or email the Commission requesting to be registered as Interested Parties, by Monday, May 6, 2002. Interested Parties will receive a copy of the Application's Executive Summary and all Orders issued.

PARTICIPANT ASSISTANCE

Intervenors intending to apply for Participant Assistance must submit a budget estimate consistent with the Commission's Participant Assistance/Cost Award Guidelines. Copies are available upon request or on the Commission's web site: <http://www.bcuc.com/bcuc/paca.html>

FURTHER INFORMATION

For further information, please contact Mr. Robert J. Pellatt, Commission Secretary, or Mr. Philip Nakoneshny, Senior Financial Analyst, Rates and Finance as follows:

Telephone: (604) 660-4700
Facsimile: (604) 660-1102

E-Mail: Commission.Secretary@bcuc.com
Telephone: (B.C. Toll Free) 1-800-663-1385

BY ORDER

Original signed by:

Robert J. Pellatt

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

An Application by Pacific Northern Gas Ltd. for
Approval of 2002 Rate Increases

REASONS FOR DECISION
Pursuant to Commission Order No. G-31-02

On April 23, 2002, the British Columbia Utilities Commission (the “Commission”, “BCUC”) issued Order No. G-31-02 with Reasons to follow. These are the Reasons.

1.0 BACKGROUND

An oral public hearing on the Pacific Northern Gas Ltd. (“PNG”) 2002 Revenue Requirements Application (the “Application”) was held in Terrace, B.C. on March 6, 7, and 8, 2002 and completed in Vancouver on March 11, 2002.

At the conclusion of the oral public hearing, the Commission set a timetable for final argument commencing with the filing of final argument by PNG and Methanex on Thursday, March 28, 2002. 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 agreement effective November 1, 2002 (the “New Contract”). The MOA, if approved, would result in the withdrawal of the Methanex Load Retention Rate Application.

Having regard to the impact of the terms of the MOA upon the Application, PNG applied to the Commission on March 27, 2002 to postpone the filing of final argument to a date to be set by the Commission, to fix a date for an oral hearing of the revised application, and to approve a revised hearing and argument schedule (collectively, the “Revised Application”). PNG proposed an amended regulatory timetable that included the resumption of the public hearing on April 17, 2002 and suggested that notice of the revised timetable be provided only to the registered intervenors. The Revised Application also explained the revisions to the Application that would be required to reflect the implementation of the New Contract. By Order No. G-20-02, the Commission postponed the filing of final argument to a date to be fixed by the Commission and requested that by Tuesday, April 2, 2002 intervenors advise the Commission, in writing, of whether they consented to PNG filing the Revised Application and of their position on PNG’s proposed timetable.

On April 2, 2002, intervenor comment letters were received from the British Columbia Public Interest Advocacy Centre (“BCPIAC”); West Fraser Timber Co. Ltd., Canadian Forest Products Co. Ltd. and Eurocan Pulp and Paper Co. Ltd. (the “Mills”); and Alcan Primary Metal Group (“Alcan”). BCPIAC consented to PNG’s filing of the Revised Application and considered the proposed timetable generally acceptable.

In their letter, the Mills objected to the Revised Application on the grounds that it was incomplete, there had not been adequate public notice, it would have a material adverse impact on other customers, it would fundamentally impact the value of PNG, and there was insufficient time in PNG’s proposed timetable. The letter requested an appraisal of PNG’s assets under Section 55(1) of the Act with a rate design to follow. Alcan did not object to the filing of the Revised Application, but submitted that the proposed hearing date should be delayed to allow for comments on the submission of the Mills. On April 3, 2002, PNG provided written comments on the issues raised by the Mills.

Commission Order No. G-23-02 dated April 3, 2002, requested intervenors and PNG to provide comments by April 12, 2002 on the issues raised by the Mills with a reply by the Mills by April 19, 2002. Letters of comment were provided by BCPIAC on April 10, by Alcan on April 11 and by Methanex and PNG on April 12. The Mills replied on April 19, 2002. The Commission also received letters of comment from the District of Kitimat, the Town of Smithers and the Corporation of the Village of Telkwa on April 4, 2002 and the City of Terrace and the District of Fort St. James on April 12, 2002 (the “Municipalities”). The Municipalities did not participate in the earlier hearing.

By Order No. G-31-02, the Commission ordered that the oral public hearing into the Application reconvene on May 27, 2002 in Vancouver to review the Revised Application. Order No. G-31-02 also required PNG to publish a Notice of Public Hearing in local news publications, allowed for the registration of new intervenors and new interested parties and established a regulatory timetable for the issuance of information requests and responses.

2.0 ISSUES

In this section, the Commission considers each of the substantive objections to the Revised Application along with the submissions of all intervenors and other parties.

2.1 Incomplete Application

The Mills considered the Revised Application to be incomplete because the full impact of the MOA could not be understood until examined over a full test year, not just the final two months of 2002. BCPIAC

agreed that it would be helpful to have the impact of the MOA considered over a complete test year and noted that PNG indicated in its April 3, 2003 submission that it would provide that information. Alcan agreed with the Mills regarding the incompleteness of the Revised Application, but believed that much of the additional information could be obtained by way of information requests. PNG submitted that its 2002 Application was complete and stated it is not applying for 2003 rates. In reply, the Mills repeated their position that the Revised Application should illustrate the rate impacts over a 2003 test year. The Mills were also concerned that the MOA would fix the revenue stream from Methanex until 2009 and cost increases over that time period would be passed on to the remaining customers.

In its letter to the Commission of April 3, 2002, PNG stated it would “provide pro forma 2003 scenarios assuming Skeena does not and does operate in 2003”. On April 22, 2002 PNG provided illustrative 2003 test year scenarios based on 2002 forecasts of deliveries and expenses adjusted to reflect the revenue from Methanex under the MOA and alternatives where Skeena Cellulose was operating or was not operating in 2003. PNG proposed that the cover letter and the two scenarios should be entered as Exhibits 35, 35A and 35B in the hearing.

The Commission concludes that intervenors will have the opportunity to address the completeness of the Revised Application by reviewing PNG’s filing of Exhibits 35, 35A and 35B. The amended regulatory schedule allows for information requests to be issued and sufficient time for analysis prior to the resumption of the public hearing on May 27, 2002.

2.2 Inadequate Public Notice

The Mills were concerned that there had not been adequate public notice of the Revised Application and that it was the duty of the Commission to ensure that all interested parties have an adequate opportunity to be heard after they are fully informed. BCPIAC agreed that it would be appropriate to provide an opportunity for comment from parties who did not intervene in the original hearing.

Methanex considered that PNG’s customers were adequately notified of the potential implications of the Revised Application because Methanex had filed a Load Retention Rate Application in December 2000, the PNG 2001 Revenue Requirements Decision dated May 25, 2001 responded to the load retention issue, and Methanex had also filed a Load Retention Rate Application on September 28, 2001. Methanex considered that the MOA was not a new and detrimental situation but was a negotiated compromise that was well within the range of outcomes that was foreseeable at the commencement of proceedings.

Alcan stated that:

“Anyone who attended the 2001 and 2002 hearings and took the time to review the 2002 applications would have known that Methanex was applying for a “load retention rate”. The concept was clearly before the Commission at the March 2002 hearing. However, the actual proposed rate, the impact of the proposed rate, and the key terms and conditions of the proposed agreement were not before the Commission and were not available to registered intervenors or other interested parties.”

Alcan considered that it may be prudent for the Commission to require PNG to publish a supplementary public notice of the MOA.

PNG supported the views of Methanex. In reply, the Mills considered that the circumstances surrounding the Revised Application were extraordinary and, therefore a higher standard of notice should apply.

The Commission agrees that the amendments to the PNG Application are significant and that further public notification is necessary. By Order No. G-31-02, the Commission directed that PNG publish a Notice of Public Hearing in the local news publications in its service area to inform customers of the MOA between PNG and Methanex and provided the opportunity for persons to request registration as intervenors or interested parties.

2.3 Material Adverse Impact on Customers

The Mills had no objection to the MOA if it satisfied the following four conditions:

- (i) it must have no material adverse consequence on other classes of customers;
- (ii) it must generate revenues that would not otherwise be available to PNG;
- (iii) it must compensate PNG for all variable costs of providing service; and
- (iv) it must make a contribution to PNG’s fixed costs.

The Mills considered that the MOA might satisfy conditions (ii), (iii) and (iv) but submitted it is silent regarding condition (i). The Mills stated that PNG proposes to recover the revenue deficiency resulting from the MOA by reallocation to other customer classes, which represents a material adverse consequence for the other customer classes.

BCPIAC opposed Methanex’s Load Retention Rate Application and considered that the MOA is more beneficial to Methanex than to PNG or its other ratepayers. Alcan’s view was that this issue is best left to argument and is not a basis, in and of itself, for refusing to accept the filing of the Revised Application. In reply, the Mills reiterated their objection to PNG’s proposed treatment of the resultant revenue shortfall.

The Commission considers that the resumption of the public hearing allows the intervenors to examine the potential impact resulting from the MOA on revenue deficiency in 2002, and that forecast for 2003. Alternative cost recovery of any revenue deficiency should be addressed in argument.

2.4 Request for Section 55(1) Valuation and Requirement for Rate Design

The Mills argued that the New Contract with Methanex and the closure of Skeena Cellulose have fundamentally affected the value of PNG. They therefore requested the Commission to undertake an appraisal of the value of PNG's assets under Section 55(1) of the Utilities Commission Act. After the appropriate value of the utility's assets was ascertained, they suggested that the Commission undertake a rate design review to fairly allocate the cost of service to all classes of customers.

PNG responded, in submissions of April 3 and April 12, that the Commission has implicitly completed a valuation of PNG's assets in every PNG rate case by approving rates which are based on a test year rate base valued on the original cost of the facilities. Consequently, PNG believes there is no further action required by the Commission, and that there is no basis in law for the suggestion that Section 55 (1) is applicable to the circumstances of this case. PNG stated that there is relatively little impact from the New Contract with Methanex on the 2002 revenue and that it will consider the need for a review of its existing rate design parameters for its 2003 rate case. Methanex submitted that PNG's rates have never been set on the basis of a Section 55 valuation and that the request for a rate design hearing is not relevant to the Revised Application for the reasons provided by PNG.

BCPIAC stated that PNG's ratepayers cannot be expected to indefinitely pay high rates which lead to continued erosion of its customer base and that a new cost of service study for 2003, as proposed by PNG, is desirable. Alcan submitted that the fundamental questions before the Commission are whether it should approve the proposed load retention rate and, if the Commission does approve the rate, under what conditions and who bears the financial consequences.

The Mills' reply stated that the New Contract has the effect of crystallizing a long-term reduction in the value of the facilities used to provide service to Methanex. The Mills noted that the value of a utility's assets is directly relevant in setting rates and they argued that reliance upon an historic, unspecific, implied asset valuation, which ignores significant changes in circumstances that should reasonably be expected to materially and adversely affect the value of the assets, would be an error in law. In support of the request for a rate design review the Mills indicated that the proposed rate for Eurocan would appear to produce a revenue to cost ratio of 1.8 to 1.

The Commission recognizes that the viability of PNG and the appropriate rates to be charged to each class of customer have been ongoing concerns since the inception of utility service, and that the consequences of the New Contract to other ratepayers cannot be ignored. For the MOA to be approved PNG must demonstrate that it is, when taken as a whole, a more beneficial financial arrangement for the other ratepayers and shareholders than any other available option.

The Commission concludes that the request for a Section 55 (1) valuation is premature. The value of a utility's assets may be reduced for reasons including: (a) removal of specific assets from the rate base if they are determined to be no longer used and useful, (b) the sale of a utility at a price below the depreciated book value of the rate base, or (c) the permanent impairment of the revenue generation ability of the utility such that recovery of the depreciated book value is not possible. In addition, the recent submissions of the Mills indicate that they may argue that certain assets should be specifically allocated to the New Contract.

At this time the information base is not sufficient to allow a Section 55(1) valuation to proceed on the premise implied by the Mills – i.e. that the revenue generation capability of approved rates for PNG will be insufficient to support the depreciated book value of the assets. However, a Section 55(1) valuation may become relevant in 2003 depending on the Commission's determinations with respect to the current application. **Therefore, the request for a Section 55 valuation is not approved at this time. If parties wish to argue that an approval of the MOA by the Commission will foreclose the option for a Section 55 valuation they may present that argument in the hearing.**

The Commission has considered the arguments concerning rate design analysis and finds that, given the magnitude of the rate impacts for 2002 and the benefits of completing the review of the current Application in a timely manner, a rate design process is not necessary at this time. The Commission expects PNG to file a complete cost of service study and rate design analysis as part of its 2003 revenue requirements application.

2.5 Insufficient Time

The Mills were concerned that the Revised Application was incomplete, that they would not have sufficient time to develop an understanding of the MOA through information requests to adequately prepare for a public hearing on April 17, 2002, and that a one day hearing might not be sufficient.

Methanex submitted that the regulatory timetable including a public hearing on April 17, 2002 was adequate. Alcan's view was that a revised hearing schedule must balance all interests and must not be unduly delayed. In reply, the Mills submitted that the Commission could move expeditiously to approve

the MOA without a final determination of the allocation of the revenue deficiency amongst PNG's shareholders, debt holders and remaining customers.

The Commission considers that the regulatory schedule established by Order No. G-31-02 provides sufficient time for intervenors to prepare for a review of the Revised Application and to participate effectively in the public hearing scheduled to commence on May 27, 2002.

2.6 Retroactive Rate Making

The Mills submitted that the Revised Application was materially based on a subsequent event, the MOA, and involved a request for retroactive rate making. The Mills further submitted that the Commission would be acting outside of its jurisdiction if it purports to approve rates on a retroactive basis.

Methanex submitted that the rates proposed in the Revised Application are prospective, PNG's current rates are interim effective January 1, 2002 and circumstances that occur subsequent to the filing of a revenue requirements application are matters that are proper and relevant for Commission consideration under Section 60 of the Utilities Commission Act. PNG stated that its 2002 rates are currently interim and considered the Mills' suggestion of retroactivity to be entirely without foundation in law. Alcan and BCPIAC submitted that the issue of retroactivity should be dealt with in argument.

In reply, the Mills submitted that even though 2002 rates are currently interim, customers made their energy use decisions based on facts as they existed. The Mills observed that Methanex's current rates have been interim from October 1, 2001 and that if impacts from the MOA are to be flowed back in time they should apply to all interim rates.

The Commission considers that the issue of retroactive rate making should be addressed in final argument.

3.0 COMMISSION DETERMINATIONS

These Reasons for Decision amplify the determinations and instructions contained in Order No. G-31-02 dated April 23, 2002.