



LETTER NO. L-19-06

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May 17, 2006

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Dear Sirs:

Re: Pacific Northern Gas Ltd. – West Division ("PNG-W")
Negotiated Settlement
2006 Revenue Requirements Application

The purpose of this letter is to seek from parties who have submitted written argument further specific written submissions from those parties based on the evidentiary record established in this proceeding.

Background

On March 31, 2006 a proposed Settlement Agreement for PNG-W's 2006 Revenue Requirements Application, including letters of support or comment, was made public and submitted to the Commission and all Intervenor. The deadline for submissions from non-participating intervenors regarding the proposed Settlement Agreement was set for April 6, 2006. The BC Old Age Pensioners Organization et al. ("BCOAPO") in its letter of comment dated March 29, 2006 did not accept the Settlement Agreement and in particular Item 1 which according to BCOAPO "represents the fundamental gist of the agreement in that it purports to transfer the entire shortfall arising from Methanex leaving the PNG-West system to the residential and small commercial customers." BCOAPO had no objection to the remainder of the agreement. BCOAPO suggested that the issue can be resolved in a written hearing process with an additional round of information requests to PNG-West to ensure that all

necessary and appropriate evidence is before the Commission. Mr. Childs' comments were similar to those of BCOAPO, except that he recommended that "the 06/01/01 Interim Rates remain in effect until a Final Commission Ruling is made".

The Commission reviewed the proposed Settlement Agreement, the letters of comment and by Order No. G-40-06 established a further process to review and consider Item 1, "Methanex Termination Payment", of the proposed Settlement Agreement. Order No. G-40-06 also established a timetable for an additional round of Intervenor information requests, information responses, submissions by PNG and the Intervenor and a PNG reply. The Commission received information requests and submissions from BCOAPO and Mr. Childs, with PNG providing information responses and submissions and a reply.

PNG states in its April 28, 2006 submission that: "...there is a statutory obligation upon the Commission to fix rates that permit PNG the opportunity to recover all of its costs of providing service, including the fair rate of return on common equity approved for PNG by the Commission. Rates that are insufficient to enable a utility to recover its cost, including a fair and reasonable return, are unjust and unreasonable under the Utilities Commission Act." (the "Act") PNG cites the leading case authority of *Hemlock Valley Electrical Services v. British Columbia (Utilities Commission)* (1992), 66 B.C.L.R. (2d) 1 (C.A.) which in turn is based on the Supreme Court of Canada's decision in *British Columbia Electric Railway Co. Ltd. v. Public Utilities Commission of BC*, [1960] S.C.R. 837 ("*Hemlock Valley*" and "*B.C. Electric*", respectively). In PNG's view these decisions focused on what are now substantially provisions found in Sections 59(1), (4), (5) and 60(1) of the Act (PNG April 28, 2006 submission, pp. 1-2).

PNG also quoted the Commission's findings from a 2002 PNG Revenue Requirements Decision with respect to a 2002 revenue reduction from the 2001 methanol plant shutdown and a new negotiated agreement with Methanex (the "2002 Decision"). The 2002 Decision noted that the allocation of the revenue deficiency from Methanex to the other customers is consistent with previous actions of the Commission. The 2002 Decision also found that rates to all customer classes remain affordable at this time (PNG April 28, 2006 submission, p. 7).

BCOAPO agrees that *Hemlock Valley* and *B.C. Electric* are applicable to the regulation of utilities in British Columbia; however, it submits that the Commission must consider how these decisions should be applied to a utility in PNG's situation. BCOAPO quotes from the judgment of Martland J. in *B.C. Electric* where he states, in part, "The rate to be imposed shall be neither excessive for this service nor insufficient to provide a fair return on rate base. There must be a balancing of interests." (BCOAPO May 4, 2006 submission, pp. 7-8)

Questions

1. Referencing the case law, PNG states in its Reply Submission, at paragraph 17, that the balancing of interests is carried out when the cost of providing service, including the fair rate of return, is determined.
 - (i) Is it the fact that parties have agreed to all aspects of the proposed Settlement Agreement, but for Item 1, that brings *Hemlock Valley* into operation?
 - (ii) Or, would the fact that the Commission has not at this time ruled on the proposed Settlement Agreement or any aspect of it give the Commission some latitude to consider a balancing of interests and potential apportionment between the remaining ratepayers and PNG shareholders of the revenue deficiency resulting from Item 1. If not, why not? If so, how could that be accomplished based on the record established in this proceeding? Is there any scope for the Commission to consider the issue of allocation of the revenue deficiency from Item 1 in isolation to, or in advance of, the establishment of the cost of service?
2. Parties have referred to previous decisions of the Commission which have dealt with the issue of the allocation of a revenue shortfall resulting from the loss of a customer or a bypass agreement. These decisions found it appropriate, in the circumstances before the various Commission panels, to allocate the revenue shortfall to PNG's remaining customers, each essentially finding *inter alia* that the rates remained affordable at that time. Most recently, in its 2004 Decision, the Commission, in dealing with the shortfall arising from the PNG/West Fraser Mills Memorandum of Agreement, stated:

The Commission Panel finds that PNG can collect the resulting revenue reduction from other customers (except Methanex) as long as there is room to do so. The Commission Panel considers the bill impacts for other customers to be manageable at this time.

PNG, too, appears to accept that customer rate impacts or 'affordability' is a consideration, arguing in its submission dated April 28, that "the rate impact to other customers is modest and manageable" (paragraph 20).

 - (i) The Commission Panel seeks to clarify whether it is PNG's view that *Hemlock Valley* would preclude in all circumstances any consideration whatsoever of customer impacts once the cost of service has been established and the revenue requirement has been determined.
 - (ii) If so, how does this accord with the Commission's previous considerations and comments related to the affordability of rates?

- (iii) If not, when and how could the Commission be in a position to make adjustments should it be persuaded that the rate increase for PNG's customers has or will become unaffordable?
- 4. PNG's April 28, 2006 submission concludes that to allocate any of the net revenue deficiency resulting from the termination of the Methanex contract to PNG's shareholders, as advocated by BCOAPO, would contravene sections 59 and 60 of the Act and be inconsistent with previous Commission decisions. In the PNG 2005 Revenue Requirements proceeding, Transcript Volume 4 at pages 303-304, Mr. Gathercole asked at page 303, lines 1-4 about the tension between paying investors the allowed fair rate of return and keeping customers' rates from rising in relation to a proposed 51 percent equity component. Mr. Dyce replied at page 304, lines 6-9, that "if it meant or indicated that we were going to lose customers, then the Board of Directors of PNG would have to step into it and do something, whether it's reducing rates, whatever."
- (i) By what authority and under which section of the Act would PNG apply to the Commission to reduce rates to facilitate any such possible action by the Board of Directors? Please explain.
 - (ii) If the Commission considers that the rates to be set under section 59 of the Act would be unaffordable, does the Commission have the authority under the Act to reduce rates to a level that it considers to be fair and reasonable?
 - (iii) If the Commission were to conclude that the rates to be set under section 59 of the Act would result in a potential significant loss of customers, does the Commission have the authority under the Act to reduce rates to a level that it considers to be fair and reasonable?
- 5. BCOAPO states that it has consistently taken the position that, should Methanex leave the PNG-West system, the resulting revenue requirement deficiency should not be for the sole account of the ratepayers (March 29 letter). In the Conclusion section of its Reply Argument, BCOAPO submits that approval of Item 1 of the Settlement Agreement would result in rates to residential customers which are not just and reasonable and that the Commission should not approve Item 1 (paragraphs 45 and 46). It is unclear from BCOAPO's Reply Argument whether BCOAPO is now suggesting that all of the revenue requirement deficiency related to Item 1 should be for the sole account of the PNG shareholders or whether it intends that the Commission apportion the deficiency on some basis.
 - (i) If it is the latter, the Commission remains unclear and seeks clarification related to the level of apportionment that BCOAPO suggests would be appropriate, the principles or methodology BCOAPO suggests should be applied, and the evidentiary basis on the record of this proceeding upon which BCOAPO relies to allow the Commission to do so.

- (i) The Commission Panel also would like to understand whether there would be any detrimental effects to PNG or its customers were the Commission to approve BCOAPO's, or Mr. Child's suggestions at page 7 of his May 3 filing?
6. BCOAPO states that the Commission must address how section 59 of the *Utilities Commission Act* is properly applied to PNG and whether in its present and projected circumstances, section 59 mandates the Commission to allocate all of the Methanex revenue shortfall now and in the future to remaining ratepayers (paragraph 44).
- (i) Is it the view of parties that the Commission Panel's decision can and should deal definitively with any revenue shortfall arising from the loss of Methanex both now and in the future?

The Commission Panel requests that PNG and BCOAPO, as appropriate, file further written responses to the questions that relate to their written submissions, by Monday, May 29, 2006 and that BCOAPO and Mr. Childs, if he so wishes, file a response by Friday, June 2, 2006. PNG may file a reply by Wednesday, June 7, 2006.

The Commission Panel will consider these additional submissions based on the evidentiary record for this proceeding prior to making a decision on PNG's Revenue Requirements Application and the proposed Negotiated Settlement.

Yours truly,

Original signed by:

Robert J. Pellatt

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cc: Registered Intervenors (PNGW-2006RR-RI)
Pacific Northern Gas - 2006 Revenue Requirements