BRITISH COLUMBIA
UTILITIES COMMISSION

ORDER
NUMBER G-163-06

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

and

An Application by Stargas Utilities Ltd.
for Approval to Alter Rates

**BEFORE:** L.F. Kelsey, Commissioner December 14, 2006
L.A. Zaozirny, Commissioner

**O R D E R**

**WHEREAS:**

A. The Commission, by Order No. C-4-00, approved a Certificate of Public Convenience and Necessity for Stargas Utilities Ltd. ("Stargas", "the Company") to operate a natural gas distribution system at the resort community of Silver Star; and

B. On August 4, 2006, Stargas applied to the Commission for approval to decrease residential rates by $2.05 per gigajoule ("GJ") and decrease commercial rates by $2.06/GJ for the combined delivery and commodity cost components in rates, effective November 1, 2006 ("the Application"). The decrease in residential and commercial rates are the result of lower commodity costs and higher delivery charges; and

C. The lower commodity costs are the result of decreases in the cost of natural gas and the amortization of a Gas Cost Variance Account ("GCVA") credit balance of $10,184 at May 31, 2006. The Application requests approval to decrease the commodity charge, including the amortization of the GCVA, by $2.54/GJ for residential customers and by $2.55/GJ for commercial customers; and

D. The Application also requests Commission approval to increase the residential and the commercial delivery charges by $0.49/GJ due to increases in operating and maintenance expenses; and

E. The Commission, by Order No. G-101-06, established a written hearing process to review the Application; and

F. The Commission issued Information Request ("IR") No. 1 on August 17, 2006 and Stargas responded on August 27, 2006. In the response to IR No.1, Stargas discussed its working capital estimate and loan guarantee fee of $4,125; and

G. The Commission issued IR No. 2 on October 23, 2006 and Stargas responded on October 26, 2006; and

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H. The Commission, by Order No. G-131-06, approved for Stargas an interim refundable increase in the delivery rates for all classes of customers, as filed in the Application, effective November 1, 2006. The Order also approved an interim refundable decrease in the commodity charges for all classes of customers, as filed in the Application, effective November 1, 2006; and

I. The Commission has reviewed the Application by Stargas to Alter Rates and the evidence adduced thereon, all as set forth in the Reasons for Decision attached as Appendix A.

**NOW THEREFORE** pursuant to Sections 60 and 61 of the Utilities Commission Act, the Commission orders as follows:

1. The Commission approves the $2.05/GJ decrease in residential rates and the $2.06/GJ decrease in commercial rates for the combined delivery and commodity cost components in rates on a permanent basis, effective November 1, 2006.

2. The Commission approves the increase in the residential and the commercial delivery charges by $0.49/GJ on a permanent basis, effective November 1, 2006.

3. The Commission approves the amortization of the Gas Cost Variance Account credit balance of $10,184 in F2007.

4. The Commission approves the Stargas request to retain the difference between the residential and commercial gas cost recovery charge and reduce the difference from $0.22/GJ to $0.21/GJ.

5. The Commission continues to hold the view that a regulated utility, such as Stargas, should not be paying fees that are in excess of comparable market rates. Accordingly, the rate for management, regulatory and other executive services that is allowed for recovery in rates, when adjusted for inflation, is limited to $125 per hour.

6. Stargas is directed to comply with Commission Order No. G-107-05 and revise the amortization of the 2006 debt replacement transaction cost accordingly.

7. Stargas is directed to include working capital of $44,302 in its F2007 rate base.

8. The Commission denies the Stargas request for the approval of loan guarantee fees.

9. Stargas is directed to exclude “notional equity” from its capital structure in F2007 and future applications.

10. The Commission denies the Stargas request for the approval of a return on notional equity.

11. Stargas is directed to pay a dividend on its outstanding cumulative preferred shares at a rate of 9.55 percent in F2007 and to provide a reconciliation of this payment for the Commission’s review in a timely manner.

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12. Stargas is directed to separately identify shareholder loans and the amounts due to affiliated companies in the Company's capital structure.

13. The Commission accepts the 6 percent interest rate applied to current loans from affiliated companies.

14. Stargas is to provide, subject to timely filing, amended Gas Tariff Rate Schedules in accordance with this Order.

15. Stargas is to comply with all determinations and instructions set out in the Reasons for Decision that is issued concurrently with this Order.

**DATED** at the City of Vancouver, in the Province of British Columbia, this 18th day of December 2006.

BY ORDER

*Original signed by:*

L.F. Kelsey
Commissioner

Attachment

**STARGAS UTILITIES LTD.**
**2006 APPLICATION TO ALTER RATES**

**REASONS FOR DECISION**

## 1.0 INTRODUCTION

### 1.1 The Application

On August 4, 2006 Stargas Utilities Ltd. ("Stargas", "the Company") applied to the Commission for approval to decrease residential rates by $2.05 per gigajoule ("GJ") and decrease commercial rates by $2.06 per GJ for the combined delivery and commodity cost components in rates, effective November 1, 2006. Stargas also requested approval to retain the difference between commercial and residential gas cost recovery rates ("the Application"). The change in the rates is the result of a $0.49 per GJ increase in the residential and commercial delivery charges, a $2.54 per GJ decrease in the residential commodity charge and $2.55 per GJ decrease in the commercial commodity charge.

The decrease in the commodity charges are due to decreases in the cost of natural gas and amortization of a credit balance in the Gas Cost Variance Account ("GCVA"). The increase in the delivery charge is the result of higher management fees and the amortization of 2006 debt replacement transaction costs. Other issues in the Application include the amount of working capital included in rate base, loan guarantee fees, the amount of equity and debt in the Company's capital structure, and preferred share dividends.

### 1.2 Background

Silver Star Mountain Resorts Ltd. ("the Resort") is the primary developer and ski hill operator in the resort community located north-east of Vernon. The Resort created a subsidiary, now known as Stargas, which acquired the existing propane grid from its parent. By Order No. C-4-00, the Commission granted a Certificate of Public Convenience and Necessity for Stargas to operate a natural gas distribution system at the Resort. Stargas is a small utility with a rate base of less than $1 million and approximately 212 customers.

The Stargas rates are based on the price of alternative energy sources (electricity and propane) and in the short-term are not intended to fully recover costs, or provide a return on investment. Over time, the Company hopes to earn a full return. Currently, both residential and commercial natural gas rates are lower than propane rates. The price of residential electricity is slightly lower than natural gas, while the price of commercial electricity is higher.

## 2.0 THE WRITTEN HEARING PROCESS

In determining the appropriate process to review the Application, the Commission considered the complexity of the Application, the need for public participation and the cost associated with the process selected. The Application is routine in nature and no Intervenors or Interested Parties registered to participate in the proceeding. Stargas is a small utility with limited resources and a protracted regulatory process would be onerous. Given the cost of an oral hearing and the absence of Intervenors, the Commission determined that a written process should be used to examine the Application. On August 22, 2006 Commission Order No. G-101-06 established a written public hearing to review the Application.

## 3.0 GAS COST

### 3.1 Gas Cost

Stargas forecasts gas cost purchases to increase from 34,273 GJ in F2006 to 35,355 GJ in F2007. Due to lower commodity costs, the cost of gas before GCVA amortization and contractor charge backs for lost gas, commodity costs will decrease from $381,357 in F2006 to $366,864 in F2007. The forecasted decrease in commodity costs reflects current market trends. **The Commission accepts the Stargas F2007 gas cost forecast.**

### 3.2 Gas Cost Variance Account

The GCVA accumulates the difference between the gas cost recovered in rates and the actual cost incurred in purchasing the commodity. As a result of gas cost recovered in rates exceeding the actual cost incurred in purchasing the commodity, Stargas has a $10,184 GCVA credit balance at May 31, 2006. Stargas has requested Commission approval to amortize the entire GCVA credit balance of $10,184 in F2007.

The $10,184 GCVA credit represents less than 3 percent of the total cost of gas in F2007 and the amortization will have nominal impact on the F2007 cost of gas and customer rates. Given the modest impact of the GCVA amortization, **the Commission approves the Stargas request to amortize the $10,184 GCVA credit balance in F2007.**

### 3.3 Commercial and Residential Gas Cost Recovery Charge Difference

Since the original Stargas tariff, the commercial gas cost recovery charge has been higher than the residential charge. In 2002, Stargas committed to eliminating the difference between residential and commercial rates in the long term. The Stargas 2005 Application to Alter Rates, Make Additional Deferrals and Levy Administrative Charges-Reasons for Decision ("the 2005 Application") reduced the difference between residential and commercial rates from $0.40 per GJ to $0.22 per GJ. The current Application proposes to reduce the difference between residential and commercial rates from $0.22 per GJ to $0.21 per GJ. In the current Application, Stargas requests approval to retain the existing difference between commercial and residential rates. The one cent per GJ reduction in the current Application is significantly smaller than the reduction in the 2005 Application, but it does support Stargas' commitment to reduce the difference between residential and commercial rates in the long term. Considering the large reduction in the previous year, **the Commission approves the Stargas request to retain the difference between residential and commercial gas cost recovery charge and reduce the difference from $0.22 per GJ to $0.21 per GJ.** The one cent per GJ reduction is not material and **the Commission directs Stargas to provide a plan in its next revenue requirements application for the complete elimination of the difference between residential and commercial gas cost recovery charge.**

## 4.0 OPERATING AND ADMINISTRATIVE EXPENSES

### 4.1 Management Fees

In the Stargas 2005 Application the Commission reduced the amount recoverable in rates for management, regulatory and other executive services from $250 per hour to $120 per hour, which was shown in the evidence provided as the rate for a KPMG account manager. The current Application includes fees of $74,368 for executive and non-executive management services provided by Okanagan Funding Ltd. ("OKF"), a company owned by Mr. Morley Blumes and his wife Carol Iles-Blumes. C.I.M. Holdings (1998) Inc., an investment holding company controlled by Mr. Blumes, owns 50 percent of Stargas' common shares. The fees paid to OKF include charges of $37,250 (149 hours at $250 per hour) for executive management services. Stargas submits that the rate of $250 per hour is appropriate given Mr. Blumes and Mr. Youell's business experience. Supporting material in the Application for the $250 per hour rate includes the work histories of Mr. Blumes and Mr. Youell, and a letter from W.C. Corbett, a KPMG partner. The letter from W.C. Corbett states that a reasonable rate for Mr. Blumes' consulting services would match the $300 to $500 per hour rate of a KPMG partner in Kelowna.

The issue before the Commission is the determination of an appropriate level of compensation for the management of a small utility, not a rate for consulting services for a partner of a consulting firm. The Commission continues to hold the view that a regulated utility, such as Stargas, should not be paying fees that are in excess of comparable market rates for such management services. Accordingly, the rate for management, regulatory and other executive services that is allowed for recovery in rates, when adjusted for inflation, is limited to $125 per hour.

### 4.2 Amortization of 2006 Debt Replacement Transaction Cost

By Commission Order No. G-107-05, the Commission approved the Stargas application to replace its Canadian Imperial Bank of Commerce debt with TD Canada Trust debt. Commission Order No. G-107-05 also approved the associated transaction costs related to the debt replacement, but reduced the hourly rate for OKF allowed for recovery in customer rates from $250 per hour to $120 per hour. On page 2 of the Application, Stargas states that the "TD Bank loans #1 and #2 are recorded net of the un-amortized balance of the $23,350 costs of arranging and completing the 2006 fiscal year refinancing". The $23,350 costs of arranging and completing the 2006 fiscal year refinancing does not reflect the reduction in the hourly rate for OKF allowed for recovery in customer rates from $250 per hour to $120 per hour in Commission Order No. G-107-05. S**targas is directed to comply with Commission Order No. G-107-05 and revise the amortization of the 2006 debt replacement transaction cost accordingly.**

### 4.3 Working Capital and Guarantee Fees

In response to BCUC IR No. 1, Question 1.3 Stargas submitted two estimates of working capital, the first estimate of $75,546 is based on 10 percent of F2007 revenues and the second estimate of $44,302 is based on a lead lag study. Stargas stated that 10 percent of revenues is often used by smaller utilities to estimate working capital and that 10 percent of revenues would approximate the working capital required by the Company on a stand-alone basis. Given the seasonality of its operations Stargas considers the lead lag study estimate of working capital inappropriate.

The Stargas submission that small utilities often use 10 percent of revenues as an estimate of working capital could not be substantiated. The small regulated natural gas/propane utilities at Panorama, Sun Rivers and Big White do not use 10 percent of revenues to estimate working capital. As noted in the Stargas' Fiscal 2006 Annual Report, the Company is not a stand-alone entity. Rundle Investment Ltd. owns Silver Star Club Resort Ltd. ("SSCRL") and 50 percent of Stargas' common shares. Stargas provides natural gas service to SSCRL. The controlling shareholder of SSCRL also has an interest in the development served by the Ridge main extension.

Since Stargas is not a stand-alone Company and the working capital estimate based on 10 percent of revenues could not be confirmed, **Stargas is directed include working capital of $44,302 based on the lead lag study in its F2007 rate base.**

In the response to BCUC IR No.1, Question 1.3, the Company further submits that, if the Commission did not approve the $75,546 working capital estimate, a $4,125 loan guarantee fee should be included in the F2007 revenue requirements as a financing cost. The loan guarantee fee is based on an exposure of $275,000 at a rate of 1.5 percent. Stargas states that without the personal guarantees of shareholders and the companies controlled by those shareholders Stargas would require additional working capital.

Like several small utilities in British Columbia, Stargas is part of a group of affiliated companies. The small utilities are often economically dependent upon financing provide by affiliated companies. The Commission is unaware of any instances where an affiliated company has charged a loan guarantee fee for providing financing. Given that other utilities do not pay loan guarantee fees for financing from affiliated companies, **the Commission denies the Stargas request for the approval of loan guarantee fees.**

## 5.0 CAPITAL STRUCTURE

### 5.1 Equity

In the Application, Stargas included "notional equity" of $298,523 in its capital structure and a return on "notional equity" of $26,986 in its F2007 revenue requirements. The amount of "notional equity" was calculated by subtracting the F2007 mid-year debt from F2007 mid-year rate base. Stargas has a negative equity balance in F2007 due to losses in prior periods. For ratemaking purposes, equity is equal to the sum of shareholders investments and retained earnings. "Notional equity" is not a recognized component in a utility's capital structure. Stargas is directed to exclude "notional equity" from its capital structure in F2007 and future applications. Given that "notional equity" is excluded from Stargas' capital structure, **the Commission orders that the $26,986 return on "notional equity" is excluded from the F2007 revenue requirements.**

### 5.2 Cumulative Preferred Shares

Stargas' shareholders are not allowed to earn a return on "notional equity", but they are allowed to earn a return on preferred shares. On August 15, 2002, the Company applied to the Commission for approval to issue cumulative preferred shares in order to absorb cumulative losses in excess of $615,000 and recognize the "time value" of the shareholders' investment. Commission Order No. G-80-02 approved the issuance of $400,000 of cumulative preferred shares with a dividend rate equal to the Commission's annual benchmark return on equity plus 75 basis points. In order to provide a return to its shareholders, **Stargas is directed to pay a dividend on its outstanding cumulative preferred shares at a rate of 9.55 percent (the 2006 benchmark return on equity of 8.80 percent plus 75 basis points) in F2007.**

### 5.3 Shareholder Loans

Stargas' F2007 capital structure also includes shareholder loans of $161,095 with an annual interest rate of 6 percent. In its response to BCUC IR No. 2, Question 6.1 Stargas stated "our accountants classify amounts to due affiliated companies ($94,220) as such, while for regulatory filings we do not make what we believe to be a minor distinction". Stargas' shareholders and the affiliated companies that they control are separate legal entities; therefore shareholder loans and the amounts due to affiliated companies should be separately identified in the Company's capital structure. **The Commission accepts a 6 percent interest rate applied to shareholder loans and current loans from affiliated companies.**

### 5.4 Interim and Permanent Rates

Commission Order No. G-101-06 directed Stargas to refund the difference between the F2007 permanent rates and interim rates, if the permanent F2007 rates were lower than the interim rates.

At the proposed rates in the Application, residential and commercial customers are expected to receive annual savings compared to the cost of competitive fuels - propane and electricity. These Reasons for Decision contain adjustments to the Stargas cost of service for fiscal 2007. However, even with these adjustments, the Company has a negative equity balance and will not earn its allowed return during the fiscal 2007 period; therefore no adjustment to the proposed rates is required.

**The Commission approves the $0.49 per GJ increase in the delivery charge for residential and commercial customers, the $2.54 per GJ decrease in the residential commodity charge and the $2.55 per GJ decrease in the commercial commodity charge on a permanent basis effective November 1, 2006.**