BRITISH COLUMBIA UTILITIES COMMISSION

FORTISBC ENERGY INC. 2016 RATE DESIGN APPLICATION
BCUC Project No. 3698899

COSA STUDIES AND REVENUE TO COST RATIOS

STREAMLINED REVIEW PROCESS

ARGUMENT OF TECK RESOURCES LIMITED, DOMTAR INC., WEYERHAEUSER COMPANY LIMITED, AND ZELLSTOF CELGAR LIMITED PARTNERSHIP (COLLECTIVELY "INDUSTRIAL CUSTOMER GROUP") (ICG)

25 SEPTEMBER 2017

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I. INTRODUCTION

1. This argument is submitted on behalf of Teck Resources Limited, Domtar Inc., Weyerhaeuser Company Limited, and Zellstof Celgar Limited Partnership (collectively referred to as the "Industrial Customer Group") on the following aspects of the FortisBC Energy Inc. ("FEI") 2016 Rate Design Application (the "Application"), as set out in the Commission's procedural direction for the Streamlined Review Process for 12 September 2017[1]:

    a. FEI's Cost of Service Allocation ("COSA") studies included in the Application; and

    b. Whether the revenue-to-cost ("R:C") ratio; the margin-to-cost ("M:C") ratio; or a combination of both R:C and M:C ratios should be used to guide rate design and the corresponding range(s) of reasonableness of the selected ratio(s).

2. The members of the Industrial Customer Group are large industrial customers on the Inland Service area of the FEI system, so these submissions reflect their customer experience and perspective.

3. The Industrial Customer Group argue the following:

    a. <u>FEI COSA Study</u>: The Industrial Customer Group will defer its argument in this area to the rate design and rate rebalancing portion of the hearing, as FEI has proposed.

    b. <u>Revenue-to-Cost ratio</u>:

        i. The range of reasonableness should be set to unity – i.e. 100 percent. FEI's range of 90 to 110 percent is based on a historic precedent that can no longer be justified on principles of fairness. FEI arguments about the imprecision

[1] Exhibits A-11 and A-14

in the COSA analysis are in fact arguments to aim for the centre of the target, not the edge.

ii. The R:C ratio or M:C ratio issue is more about how the ratio is calculated, and less about the label. Revenue-to-Cost ratio should be calculated with all flow-through cost items removed, the biggest of which is the cost of gas. Removing the flow-through cost items would give a better understanding of the true revenue-to-cost ratios for each customer class in relation the service that FEI is providing.

4. Further elaboration follows.

II. COST OF SERVICE ("COSA") STUDIES

5. On page 12, FEI argues that any change to the COSA treatment of industrial customers is a rate design decision that should be determined at a later stage of this proceeding.

6. At page 13, FEI argues that

   a. its treatment of Rate Schedules 22A in FEI's COSA is consistent with the Commission determination to close these rate schedules in its 1993 Phase B Rate Design Decision.

   b. Rate Schedules 22A and 22B are grandfathered with respect to their terms and conditions of service and also with respect to how FEI <u>generally</u> allocates costs to them in the COSA. [underlining added.]

   c. Changing the cost allocation to Rate Schedules 22A and 22B is a rate design issue that could be determined by the Commission in the rate design component of this proceeding.

   d. The issue of rebalancing of Rate Schedules 22A and 22B is also outside the scope of this component of the proceeding.

7. The Industrial Customer Group disputes FEI's assertion that the COSA allocation to the industrial customer group is consistent with the Commission's directions on Rate Schedule 22A and the grandfathering of the terms and conditions of that rate schedule. FEI acknowledges that the terms and conditions are grandfathered, but not the rates.[2]

8. Further, the argument against rebalancing Rate Schedule 22A cannot be justified on fairness principles, and defies FEI's own COSA analysis and justification for that analysis. By FEI's own COSA analysis, Rate Schedule 22A is paying more than its fair share of the its costs.[3]

9. Nonetheless, the Industrial Customer Group is willing to revisit these issues during the subsequent part of the hearing that deals with rate design and rate rebalancing, when FEI is willing to explore the issues. The issues have profound economic implications for the Industrial Customer Group members and merit an engaged discussion.

III. REVENUE TO COST RATIOS – RANGE OF REASONABLENESS

A. Historic precedent – not a compelling reason to be cling to the past

10. At page 17 of its argument, FEI argues that "A range of reasonableness of 90 to 110 percent for the R:C ratio has been consistently used by the Commission in past rate designs for FEI." While this statement is true, it has no weight as an argument. Dogged reliance on past practice dooms us to inertia and stifles progress.

11. When the 90 to 110 range of reasonableness was set by the Commission in the FEI (formerly BC Gas) 1993 Phase B Rate Design Decision, the existing technology and analytic tools were much different. The Internet of Things was an emerging and novel idea. Email was emerging as a business tool. Smart phones did not exist. FEI's

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[2] See Transcript v. 5 at page 441.

[3] See Transcript v. 5 at page 442.

communication with its customers was based on paper. In sum, FEI's ability to assemble and assess the information relevant for a COSA study was far less than today.

12. Beyond question, FEI has far more analytical capacity today to track customer and system information than in 1993. Elenchus also notes the improvement generally in utility capacity related to COSA study work.

> Elenchus has not conducted an historical review of the standards of utility load and costing data related to COSA studies over the past 25 years.
>
> Nevertheless, Elenchus noted that it is generally expected that as utilities and regulators use COSA studies over the years and as a result of technological improvements, (e.g. information technology), the utility load and costing data would improve over the years and Elenchus expects this improvement would also apply in British Columbia.[4]

13. Further, FEI's and the Commission's experience with COSA studies and rate-setting has also developed greatly over the last 25 years.

B. The greater the uncertainty, the greater the need to aim for 100 percent

14. At page 18 of its argument, FEI refers to Mr. Gosselin's discussion of "the types of assumptions, estimates, simplifications, judgments and generalizations involved in the COSA". The uncertainty in many of these tasks is cited a reason to continue to use a wide range of 90 to 110 percent.

15. If FEI is correct on the level of uncertainty, then this fact underscores the importance of aiming for 100 percent – the centre of the range. The level of uncertainty should be symmetrical for all customer groups, those above 100 percent and those below. Setting the

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[4] Exhibit A2-9 Elenchus Response to the Industrial Customer Group

range to 100, or at the very least 95 to 105 percent, will help narrow the disparity between customer group results and help reduce the customer class variance in the COSA results.

16. No-one can credibly argue that it is unfair to aim for 100 percent. If the COSA analysis distributes the uncertainty fairly, then all customer groups benefit by setting the range to 100. The FEI system benefits by sending better economic price signals through the rates. Every time a COSA study and rate rebalancing occurs, it is fair to true all customer groups to 100 percent to be on equal footing related to the uncertainty.

17. The argument that a R:C ratio of 90 is the same as a R:C ratio of 110 ignores the economic reality that the customer at 110 percent is paying higher rates than necessary based on the COSA results. All customers would prefer to be at the lower end of the range. The uncertainty associated with the range of 90 to 110 percent means that the true R:C ratio could vary greatly for customers at both ends of the range. The economic risk to the customer at the high end is greater than the economic risk to the customer at the low end. Rebalancing the rates to 100 percent is the only practical way to be fair in the face of the uncertainty.

18. The historical pattern shows that the residential group Rate Schedule 1 has historically been below 100 percent in all the FEI COSA studies since the early 1990's.[5] The remarkable consistency of the pattern reveals a systemic bias, and indicates this outcome is by design. The policy choice to keep residential customers below 100 is at the expense of other customer groups who are above 100 percent cannot be justified as fair.

19. The wider the range of reasonableness the greater the inequity between rate classes. The result has serious cost implications for all customers. The theoretical arguments about equivalency between 90 percent and 110 percent is masking the economic reality for customers. In 2017, FEI and the Commission should end this false equivalence.

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[5] See Exhibit B-17, page 2, FEI response to Industrial Customer Group

C. The range of reasonableness in other jurisdictions and other utilities in British Columbia is narrower – 100 percent (unity) or 95 to 100 percent

20. Table 4 at page 33 of the Elenchus Rate Design Report (Exhibit A2-10) shows the range of reasonableness set for six other natural gas utilities in Canada.

Table 4: R:C Ratio Range of Reasonableness

Utility	Range of Reasonableness
AltaGas[61]	95% to 105%
ATCO[62]	95% to 105%
Union Gas[63]	Close to unity[64]
Enbridge[65]	Close to unity
Centra Gas[66]	100%
SaskEnergy[67]	95% to 105%

21. In response to Industrial Customer Group information request IR #1.5[6], Elenchus also notes that the Commission directed BC Hydro to use a range of reasonableness of 95 to 105 percent.

22. In response to these relevant examples, FEI can only cite its own decisions as examples where the 90 to 110 percent range is maintained. FEI must rely on this internal and circular justification because the external trend is inescapably towards a narrower range of reasonableness, both in British Columbia and in other provinces.

23. On pages 24 and 25, FEI attempts to distinguish these other examples, but is only speculating on possible distinctions. Note that in each reason, FEI argues "it may be …", "there may be factors …", "there may be circumstances …". FEI has not reviewed these

[6] Exhibit A2-9

examples, despite having ample opportunity to do so. Instead, FEI tries to divert the Commission's attention away from those examples with speculative musings.

24. Public utility regulators in other jurisdictions and the Commission in British Columbia are moving towards a narrower range of reasonableness. Fairness supports this trend, and calls for this outcome for FEI.

25. Elenchus stated the following at page 29 or its COSA Report[7]:

> Based on Elenchus experience, revenue to cost ratios that are within a range of acceptable values are considered to indicate that the customer class is paying its fair share of costs and that there is no need to realign cost responsibility. The usual revenue to cost range of acceptable ratios that Elenchus has observed is between 0.90 and 1.10 or a narrower range of 0.95 to 1.05. A narrower range of 0.95 to 1.05 is usually used by regulators and utilities in instances when there is good load and costing data available to be used in a COSA study and the utility and regulator have had experience and history in using COSA studies in order to set rates. [Underlining added]

26. Since 1993, FEI has spent many millions on information technology and has far greater capacity to assemble and assess COSA data. If not, the money spent on the technology has been wasted.

27. Further, FEI and the Commission have 25 more years of experience and history using COSA studies to set rates for FEI and other utilities since 1993. The Commission recognized this circumstance for BC Hydro in 2007 and narrowed the range of reasonableness. The time has come to narrow the range of reasonableness for FEI.

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[7] Exhibit A2-2

D. Revenue-to-cost versus margin-to-cost – exclude flow-through cost items

28. Whether we use the label "revenue-to-cost" or "margin-to-cost", the threshold issue is whether the ratio is properly measuring the revenue contributed by a customer class versus the cost to serve that customer class. Flow-through cost items should be excluded since they do not reflect the cost of serving a customer. In the FEI case, the biggest flow-through cost item is the gas cost, and it should be excluded.

29. In the SRP hearing, Mr. Todd explained the rational for the M:C ratio (at page 436 of the Transcript, v. 5).

> I think is worth emphasizing in terms of our position, make sure it's not misunderstood. The M:C ratio has merit as a primary reference. Our bias is, you've got to -- you have to have one as a primary reference. The M:C ratio excludes things that are pass-throughs. Therefore, it makes sense to use the M:C ratio. And I note that in other jurisdictions where they've got something they call the revenue-to-cost ratio, they do the revenues and costs for the distribution function and exclude the pass-throughs. So others have done it in the same way as FEI's margin to cost ratio.
>
> The advantage of that, as pointed out in the report, is one, the margin -- the pass-throughs vary across different classes. So using an MC ratio for all the classes as the primary measure, in a sense, makes more sense when you're comparing classes.

IV. CONCLUSION

30. FEI's capability to collect and assess customer information has dramatically improved with the massive changes in technology, communication and information systems in the last 25 years. It is time to recognize that reality in the FEI approach to COSA studies and the range of reasonableness.

31. Basic fairness calls for a range of reasonableness that is at 100 percent, or close to it. It is the only way to distribute the uncertainty risk fairly among the customer classes and avoid any systemic bias in the COSA and associated rate-setting approach. Economic efficiency also calls for setting the rates to send the right price signals related to the service.

32. The Industrial Customer Group will pursue its issues related to the COSA study and how the range of reasonableness is applied (or not applied) to industrial customers during the rate design and rate rebalancing part of this review.

All of which is respectfully submitted on 25 September 2017 on behalf of the Industrial Customer Group by its counsel.

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