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July 4th, 2019

Commission Secretary
Sixth Floor, 900 Howe Street
Vancouver, BC, V6Z 2N3

Via: upload to www.BCUC.com
Commission.Secretary@bcuc.com

RE: Nelson Hydro – 2019 Rural Rate Application – Final Argument

Nelson Hydro is respectfully submitting our final argument with respect to our 2019 Rural Rate Application currently before the Commission.

Sincerely,

A handwritten signature in blue ink, appearing to read "Alex Love".

Alex Love
General Manager

Nelson Hydro

2019 Rural Rate Application - Project No. 1598997

NELSON HYDRO - FINAL ARGUMENT

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I. OVERVIEW OF APPLICATION

Nelson Hydro's 2019 Rural Rate Application ("Application") was submitted to the British Columbia Utilities Commission ("BCUC" or "Commission") on March 8, 2019 (Exhibit B-1) seeking adjustments to Nelson Hydro's rates for Rural service area in order to recover the projected costs of supplying Rural service area customers in 2019. Subsequently, Nelson Hydro provided supplemental information (Exhibit B-2 and Exhibit B-2.1) and responses to two rounds of information requests (IRs) from the BCUC (Exhibit B-3 and Exhibit B-4).

In summary, the Application seeks approval of a 2.94% general rate increase to all Rural classes effective April 1, 2019 through December 2019 (a nine-month period). This is equivalent to an annual (twelve-month period) rate change of 2.03%.

To the extent that the Commission examined specific issues with respect to particular parts of Nelson Hydro's Application through IRs, Nelson Hydro's responses addressed the issues raised. This Final Argument furthers Nelson Hydro's position that the proposed Rural rate increase is warranted. As explained below, the Rural rate increase is justified, at a minimum, because it is needed to cover Nelson Hydro's operating expense associated with the provision of Rural service. Furthermore, the Rural rate increase is also justified because the City of Nelson, as the shareholder, is entitled to recover a dividend from its provision of Rural service, and currently there is no anticipated dividend for 2019 for such service. Accordingly, the proposed rural rate increase is warranted.

II. THE TIMING OF NELSON HYDRO'S APPLICATION

In its IRs, the BCUC highlighted that the Application's proposed rate increase seeks the recovery of the shortfall for twelve months over a nine-month period, April 2019 through December 2019.

In response to First Round IR 3.3.1, Nelson Hydro explained why the Application was filed in March 2019 and why the proposed rate increase has been adjusted to recover for a twelve-month period. Specifically, Nelson Hydro was not able to file the Application until March 2019 because of the following events:

- In December 2019, the City of Nelson swore in a new Council. In order to allow for the new Council to familiarize themselves with the Cost of Service Analysis (COSA), rate application and regulatory process, Nelson Hydro anticipated that the rate application filing would occur in January 2019. This was communicated to the Commission on or about December 21, 2019.
- On January 22, 2019 further discussions took place with the Commission surrounding Nelson Hydro's upcoming Open House (which was scheduled for February 7, 2019) with regard to the rate increase in which several weeks advanced notice was required. The Open House was required to be completed prior to filing the Application along with a report back to Council on public feedback solicited and recommendations from Nelson Hydro. Subsequently, Council was given the opportunity to review and approve the Application prior to submission to the Commission.
- Nelson Hydro then intended to file the Application by March 1, 2019. However, after further discussions with the Commission, more information and clarification on the Application was required. In order to meet these requirements, the Application was filed on March 8, 2019.
- Finally, while the Application was being assembled, there were several staffing changes at Nelson Hydro and unanticipated matters requiring the attention of the General Manager and other staff involved with assembling the Application. These events also contributed to the delay in filing. Nelson Hydro kept the Commission apprised of the above noted circumstances.

As detailed below, the Rural rate increase sought by Nelson Hydro is necessary to provide safe and reliable services and forecasted to recover only operating costs and cost of debt for 2019, without inclusion of return on capital investments or related amortization expenses. Failure to receive a full 2019 rate increase as proposed would result in the inadequate recovery of basic operating and interest costs. Accordingly, it is reasonable for Nelson Hydro to collect the revenue shortfall for all of 2019 over a nine-month period, from April 1 to December 31, 2019.

III. THE PROPOSED RURAL RATE INCREASE IS JUSTIFIED

Nelson Hydro's proposed Rural rate increase is justified, at a minimum, because the Rural rates should cover Nelson Hydro's operating expense associated with the provision of Rural service. Just and reasonable rates require the allocation of total costs to the various customer classes based on their usage characteristics. At this time, as fully set out in Nelson Hydro's Application, Rural service area rates are not recovering the full cost of service to those areas. Accordingly, the proposed Rural rate increase is designed to raise Rural rates to allow for adequate cost recovery.

During the review of Nelson Hydro's 2017 Rate Application, Nelson Hydro noted [response to 1st Round IR 13.1-13.3] that it was in the process of developing a cost of service study, including distinguishing between the municipal and non-municipal (Rural) customers as well as a fair and reasonable contribution towards the City's ownership from the Rural service area. The review of the 2015 through 2018 time period showed that rural rates were mostly recovering maintenance costs and cost of debt, while dividend and capital reserve transfers were almost entirely recovered through Urban revenues.

The BCUC, in its Order G-119-17, Appendix A, page 11 of 23, also acknowledged that:

The relative compact size of the municipal area as opposed to the relative expanse of the non-municipal area and the need for additional equipment to service this larger area would seem to support this assertion. The Panel accepts that the existing revenue to cost ratios likely favour non-municipal customers and if rate re-balancing were to occur, the rates charged to non-municipal customers would likely increase compared to municipal customers.

The review by Nelson Hydro showed that Rural service area revenues were not recovering the full cost to serve based on a fair allocation of costs between Urban and Rural service areas. As the first step towards cost recovery (or a phase-in step), Nelson Hydro has proposed a rate increase to "catch up" so that Rural service area rates for 2019 recover at least operating costs, including the cost of debt. Therefore, under the proposed rates, the shareholder (the City of Nelson), would not fully recover a return provision of electric service in the Rural service area, but only recover operating costs and cost of debt. Accordingly, the proposed Rural rate increase is justified because the Rural rates need to be raised in order to allow for reasonable cost recovery. It should be further noted, as set out in the Application, pp. 3-4, the proposed Rural rate increase maintains competitive rates as compared to BC Hydro and Fortis BC.

Nelson Hydro's Approach to Cost allocation is Reasonable

Nelson Hydro acknowledges that there is no universal "right way" to approach cost allocation between its Urban and Rural service areas. The cost of service study used the approach where the costs are allocated

to Urban, Rural and common costs and then further allocated based on usage characteristics. For the 2019 Rural Rate Application Nelson Hydro used detailed cost allocation based on allocation factors for each work order (BCUC IR 23.1 Attachment 1). As indicated in response to First Round IR 11.1.1, the variances between allocated costs under a cost of service, and allocation based on allocation factors, are not significant (difference in O&M expenses at about \$0.014 million or 0.6%).

Nelson Hydro reviewed the outcome of the COSA study (allocation factors aggregated) at the February 7, 2019 public open house. Nelson Hydro also printed copies of the COSA report for the public to take away with them. Nelson Hydro also made available the COS on its website at <http://www.nelson.ca/218/Electrical-Services-Nelson-Hydro> [please see 2019 Hydro Open House Presentation and Nelson Hydro COSA Study December 2018].

The outcome of the allocation of the costs using allocation factors is a reasonable, fair and transparent method to set the rates for 2019 for Rural service area as proposed by Nelson Hydro.

Operating Costs Benefit the Rural Service Area

Like other utilities seeking to provide safe and reliable service while maintaining reasonable rates, Nelson Hydro faces operational challenges and cost pressures. With aging infrastructure and increased requirements for vegetation management activities, cost pressures are felt in both capital investments and operating and maintenance costs. Nelson Hydro is engaged in careful and appropriate planning efforts to continue providing safe and reliable service. Nelson Hydro has been proactively upgrading its infrastructure including generation, transmission and distribution systems without any deferral of these costs to the future. Like Urban service area customers, the Rural service area customers benefit from such investments and therefore the Rural rates should, at a minimum, cover the cost of service.

For example, the Rural 2019 vegetation management budget was increased by \$100,000, which is the single largest budgetary increase in Nelson Hydro's 2019 budget. Notably, the Rural service area requires a disproportionate amount of vegetation management relative to the number of customers in the service area as compared to the Urban service area (i.e. the rural service areas has much more vegetation to manage due to the lower density of customers).

Nelson Hydro experienced a drop in reliability of service in 2017 and 2018 as compared to previous years. There appear to be a strong weather / climate impact to all utilities in BC. The outages caused by trees amounted to 39% of the total outage time in 2018. The increase in vegetation management budget is part of the measures being undertaken in order to improve reliability, and will greatly benefit Rural service areas. All other operating costs are within the range of actual costs for the previous years.

Cost of Debt

The cost of debt included in the 2019 Rural service area rate calculation reflect repayments of long-term debt borrowed to finance capital projects. No new debt borrowing was included in the 2019 rate calculations. Total cost of debt for 2019 makes up about 2% of total costs.

IV. THE SHAREHOLDER IS ENTITLED TO A DIVIDEND FROM RURAL AREA SERVICE

As any other utility owner, the City of Nelson is entitled to a fair return on its investment in the utility, including from its service to the Rural service area. In 2019, Nelson Hydro is not projecting that it will recover any dividend from service to the Rural service area.

In the development of the requested 2019 Rural service area rates, however, Nelson Hydro considered customer impacts as part of moving towards full cost recovery, including a fair return on investment. A full and fair return on investment would have resulted in higher rate increases for Rural service area. Therefore, as a first step towards cost recovery (or a phase-in step), Nelson Hydro has proposed a rate increase to “catch up” so Rural service area rates for 2019 recover at least operating costs, including cost of debt.

In the future, Nelson Hydro anticipates that it will file an application to address a fair return to the shareholder investments to the Rural service area.

V. CONCLUSION

The record in this proceeding establishes that the requested Rural service rate increase is warranted. The rate increase is in the interests of the ratepayer as it is a key part of being able to provide safe and reliable service, and in ensuring fairness in the treatment of Nelson Hydro’s different customer groups. Recovery of the Rural operating and interest costs allows the utility to be financially secure for 2019, to provide reliable and safe services, and to move towards a fair return on investment.

The Application’s proposed 2019 rate increase reflects only the most basic reasonable costs required for Nelson Hydro to supply Rural customers in 2019. The proposed rate adjustments are required to recover the forecast revenue shortfalls related to the operating and maintenance costs, and cost of debt. Without approval of the proposed rate increase, Nelson Hydro would not be able to recover the costs that are required to provide service, as well as putting more pressure for future rate increases and potentially leading to rate shocks.

In conclusion, Nelson Hydro submits that:

- The rural rate increase at 2.94% effective April 1, 2019 is justified because, at a minimum, the increase is required to offset the operating expense associated with the provision of rural service.
- Nelson Hydro is engaged in careful and appropriate planning efforts as evidenced by budgeting for an increase in vegetation management to improve reliability of service to all service areas including Rural service areas.
- The rural rate increase is justified because in the long run, the shareholder is entitled to a return on investment and there is no dividend currently planned from 2019 service to the Rural service area.