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Via E-file

July 27, 2020

B.C. Utilities Commission
Suite 410, 900 Howe Street
Vancouver, BC V6Z 2N3

File No.: 4.2.7(2020)

Attention: Marija Tresoglavic
Acting Commission Secretary

Dear Ms. Tresoglavic:

**Re: Pacific Northern Gas (N.E.) Ltd.
Fort St. John/Dawson Creek and Tumbler Ridge Divisions
2020-2021 Revenue Requirements Application
Applicant's Reply Argument**

Accompanying, please find the Reply Argument of Pacific Northern Gas (N.E.) Ltd. in the referenced proceeding.

Please direct any questions regarding the application to my attention.

Yours truly,

Original on file signed by:

Verlon G. Otto

Enclosure

PACIFIC NORTHERN GAS (N.E.) LTD.

**APPLICATION
to the
BRITISH COLUMBIA UTILITIES COMMISSION**

**FOR APPROVAL OF THE
FORT ST. JOHN/DAWSON CREEK
AND
TUMBLER RIDGE DIVISION
2020-2021 REVENUE REQUIREMENTS**

APPLICANT'S REPLY ARGUMENT

July 27, 2020

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1. INTRODUCTION

1. This is the Reply Argument of Pacific Northern Gas (N.E.) Ltd. (PNG(NE)) for the 2020-2021 Revenue Requirements Application (Amended Application)¹ filed with the British Columbia Utilities Commission (BCUC) for the Fort St. John/Dawson Creek (FSJ/DC) and Tumbler Ridge (TR) divisions seeking, among other things, approval, on a permanent basis, of delivery rate changes effective January 1, 2020 and January 1, 2021, pursuant to sections 58 to 61 of the *Utilities Commission Act* (UCA).

2. On July 20, 2020, the British Columbia Old Age Pensioner's Organization, Active Support Against Poverty, Council of Senior Citizen's Organizations of BC, Disability Alliance BC, Tenants Resource and Advisory Center and Together Against Poverty Society, known collectively as BCOAPO et al. (BCOAPO), filed its Final Argument in this proceeding.

3. In the discussion that follows, PNG(NE) provides its response to matters raised in the Final Argument of BCOAPO.

2. REPLY SUBMISSIONS

4. The BCOAPO Final Argument focused on six areas: (i) COVID-19 Impacts; (ii) Unaccounted for Gas (UAF) Volumes; (iii) Forecast Interest Rates; (iv) Pipeline Integrity Costs; (v) Distribution Mains Capital Forecasts; and (vi) Shared Corporate Services Costs (SCSC). The balance of this reply will focus on points made by BCOAPO in regard to each of these matters.

2.1 COVID-19 Impacts

5. PNG(NE)'s Final Argument included a summary of COVID-19 pandemic impacts on items specifically queried in the course of this proceeding, including impacts on customer demand, financing costs, capital expenditures and return on equity.

2.1.1 Forecast Demand and Forecast Expenditures

6. In its Final Argument, BCOAPO provided an overview of its expectations of the impacts

¹ Exhibit B-2

of the COVID-19 pandemic on PNG(NE)'s demand and planned expenditures. BCOAPO shared its expectations that the pandemic conditions would contribute to increased Residential demand primarily due to sheltering requirements, and contribute to decreased Commercial and Industrial demand due to curtailment of activities.

7. While PNG(NE) acknowledges that the BCOAPO's assertions may be reasonable given the circumstances, with the limited data available,² PNG(NE) was unable to conclusively assess the impacts. PNG(NE)'s evidence indicates that, to date, there has not been a decrease in deliveries against forecast but rather total actual deliveries are generally in line with forecast deliveries. That said, as reiterated in PNG(NE)'s Final Argument, deferral account mechanisms are in place to capture the impacts of most demand variances, including use per account variances related to residential and small commercial customers (Rate Stabilization Adjustment Mechanism (RSAM)) and load variances for some industrial customers (Industrial Customer Deliveries Deferral Accounts (ICDDA)), thereby providing ratepayers protection from the impacts of such variances.

2.1.2 Transfer of Risk

8. The Final Argument of BCOAPO also addresses the matter of the appropriateness of PNG(NE)'s approved Return on Equity (RoE) given the pandemic situation, and clarifies the intent of BCOAPO IR 1.9 on this matter, that being: (i) to address protections provided to PNG(NE) by various deferral mechanisms; and (ii) to suggest that PNG(NE) is held harmless from COVID-19 impacts by virtue of the COVID-19 Deferral Account approved under BCUC Order G-147-20. BCOAPO suggests that established deferral accounts for items such as interest rate variances, Unaccounted for Gas (UAF) variances, weather variances (RSAM), etc. transfer forecast risk from the shareholder to ratepayers and provide volatility protection to the utility. BCOAPO goes on to say that the utility has the ability to come to the regulator at any time to seek protection from exogenous factors that threaten the utility's stability or solvency, for example, in the case of COVID-19.

9. In reply, PNG(NE) asserts that the protections provided by the established deferral

² Exhibit B-7, BCOAPO IR 1.2

mechanisms in place, including those noted by the BCOAPO for interest rate variances, unaccounted for gas (UAF) variances, and weather variances (RSAM), are not one-way and favourable solely to the benefit of the utility. To this end, PNG(NE) observes that there have been instances where these deferral accounts have experienced both debit and credit positions, which might be considered to be to the benefit of the utility and ratepayers, respectively.

10. PNG(NE) notes that it has provided an update to its business risk assessment as an appendix to the Amended Application.³ This update focuses on the seven key risk areas that were addressed in the 2012 Generic Cost of Capital (GCOC) Stage 2 Decision, with the conclusion that the current business risks are similar to the levels noted in 2018 but have trended slightly higher since the 2012 Stage 2 GCOC Decision. However, PNG(NE) is not proposing any changes to its cost of capital components at this time.

11. As to the COVID-19 Deferral Account, PNG(NE) observes that, similar to the mechanisms noted in the preceding paragraph, protection is provided to both the shareholder and ratepayers as the deferral account is to capture not only unrecoverable revenues and incremental expenditures, but also – to the BCOAPO’s points on COVID-19 impacts on expenditures – to capture cost savings that may be realized during this uncertain period.

12. To close on this matter, PNG(NE) observes that the establishment of the noted mechanisms are subject to BCUC review and approval, and submits that the approvals granted for implementation of these mechanisms indicates that they are considered to be prudent by the regulator.

2.2 Unaccounted for Gas (UAF) Volumes

13. In its Final Argument, BCOAPO has expressed concern regarding the volume of UAF and the cost responsibility in respect of UAF. BCOAPO submitted that the shareholder should bear UAF risk based on its belief that UAF losses are most likely due to leakages from pipelines and further, given that PNG(NE) operates and maintains the pipelines, losses due to leakages should be the responsibility of PNG(NE) given that costs of operation and maintenance are

³ Exhibit B-2, Appendix B

included in the rates charged by PNG(NE) and are therefore paid by customers.

14. PNG(NE) notes that in the Amended Application it has sought to maintain existing mechanisms in place related to: (i) accounting for the unaccounted for gas (UAF) component of Company use gas; and (ii) the approved UAF loss caps in place. In reply to concerns noted by BCOAPO, as illustrated in the preamble to BCUC IR 5.2, PNG(NE) observes that a significant number of estimates are utilized in the calculation of UAF, and that factors impacting UAF may include inaccuracies in the metered natural gas receipts and in metered and estimated natural gas deliveries, as well as errors in the estimated quantities of gas lost through venting and blowdowns, and estimated changes in linepack.⁴ PNG(NE) submits that it is working on measures to improve these estimates and has committed to complete a review and examination of data and calculations influencing monthly UAF volumes.⁵

2.3 Forecast Interest Rates

15. PNG(NE)'s Final Argument identified financing costs as being an item that may be specifically impacted as an outcome of COVID-19. In response to BCUC IR 46.1,⁶ PNG(NE) noted that the BMO forecast underpinning PNG(NE)'s short- and long-term interest rate forecasts had been updated in March 2020, showing a decrease in the forecast 90-day treasury bill rates for 2020 and 2021 compared to BMO's November 2019 forecast rates embedded in the Amended Application. PNG(NE) observed that it has established deferral accounts in place to capture variances in short-term and long-term interest rates and indicated that it would rely on these deferral accounts to capture any differences in financing costs that may arise for Test Years 2020 and 2021.

16. In Final Argument, BCOAPO submitted that, as a matter of principle, the preference should be to make use of the most recent forecast available and on record when calculating the interest rates embedded in the cost of service. On this basis, BCOAPO submitted that the March 2020 BMO forecast be reflected in the determination of final approved debt costs and

⁴ Exhibit B-3, BCUC IR 5.2

⁵ Exhibit B-7, BCOPA IR 9.1

⁶ Exhibit B-3, BCUC IR 46.1

rates for 2020 and 2021.

17. In reply, PNG(NE) submits that, although it believes the interest rate deferral account mechanism in place will achieve a comparable result, it is amenable to the recommendation by BCOAPO to reflect the BMO March 2020 forecast interest rates in the regulatory schedules and in the determination of final approved rates. PNG(NE) notes that this specific matter was not addressed in the final arguments on the Pacific Northern Gas Ltd. PNG-West division 2020-2021 revenue requirements application and, given the integrated nature of the financial models for PNG(NE) and PNG-West, if approved to do so, PNG(NE) submits that the implementation of this change would most appropriately be applied to the final regulatory schedules for both entities.

18. Lastly, in response to the BCOAPO's observation that the established deferral accounts hold "the shareholder harmless while ratepayers are ultimately 100% responsible for all variances in interest rates," PNG(NE) reiterates that the protections provided by the deferral accounts are not one-way and are not favourable solely to the utility, as the mechanism captures both negative and positive variances in interest expense.

2.4 Pipeline Integrity Costs

19. In its Final Argument, BCOAPO has summarized its shifting views on the representations of PNG(NE) as to increased costs pertaining to pipeline integrity-related activities. Based on evidence on record, BCOAPO concluded that it accepts the integrity spending proposals put forth by PNG(NE).

20. In reply, PNG(NE) submits that the rationale and basis for the increased costs for integrity-related activities are supported by evidence entered on the record of this proceeding, and reiterates that these costs are necessary to address planned pipeline integrity management activity, including incremental activities to ensure compliance with pipeline integrity-related codes, standards, and regulations, and to address aging infrastructure concerns and heightened public and stakeholder expectations.

2.5 Distribution Mains Capital Forecasts

21. The Final Argument of BCOAPO addresses the matter of variances between approved and actual capital expenditures for distribution mains, observing that actual capital

expenditures for the period 2015 to 2019 were only 52.8% of amounts approved.⁷ BCOAPO observes that revenues are collected from ratepayers by PNG(NE) to recover return, taxes and depreciation on approved amounts, and as the underlying costs have not been incurred, that ratepayers are paying to recover capital costs on “phantom assets” which do not exist.

22. BCOAPO acknowledges that while PNG(NE)’s distribution mains capital expenditures have been severely over forecast, actual total capital spending over the period 2015 to 2019 slightly exceeded approved amounts,⁸ consequently the identified ratepayer exposure from the under forecast on distribution mains has effectively been mitigated. To conclude on this matter, BCOAPO observes that consideration should be given by PNG(NE) as to the appropriateness of its forecasting methodology for distribution mains capital expenditures.

23. In reply on this matter, PNG(NE) observes that capital expenditures are one element of the rate base calculation that gets incorporated into the cost of service. Further, PNG(NE) notes that under the cost of service methodology employed, it is impossible for actual results to be exactly equal to forecast amounts and that there will be variances from actual for most cost of service components as well as in customer deliveries, and that these variances may be favourable or unfavourable to either ratepayers or the utility. PNG(NE) appreciates the BCOAPO’s understanding of this fact, as evidenced by the consideration given to the noted variance in overall capital expenditures for 2015 to 2019 in comparison to the over forecast for distribution mains. PNG(NE) notes that there can be challenges to forecasting distribution mains projects given the close connection and high correlation between local economic activity and oil and gas prices and oil and gas activity in the Peace River region. That said, PNG(NE) acknowledges that the magnitude of the variance for distribution mains is noteworthy and commits to further review and refine its forecast methodology for this item in advance of its next revenue requirements application.

2.6 Shared Corporate Services Costs (SCSC)

24. The final item addressed in the Final Argument of BCOAPO is the proposed level of recovery of TriSummit Utilities Inc. (TSU, formerly AltaGas Canada Inc. (ACI)) Shared Corporate

⁷ Exhibit B-7, BCOAPO IR 12.1

⁸ Exhibit B-7, BCOAPO IR 12.2

Services Costs (SCSC) allocated to the consolidated PNG-West/PNG(NE) divisions. BCOAPO states that it takes no position on matters related to: the allocation of SCSC amongst divisions; the split between amounts collected in test period rates and those proposed for deferral; the applicable interest rate to deferred amounts; and the various proposed mechanisms for amortization of deferred amounts. BCOAPO submits that consideration of these matters is premature given the issue of the total quantum sought for recovery in years 2020 and 2021, observing that these amounts bear no relation to any amount of similar charges approved by the BCUC for recovery from ratepayers in prior regulatory proceedings.

25. BCOAPO's Final Argument includes a summary of past approved SCSC recoveries, as well as excerpts on the matter of SCSC recoveries from the BCUC decisions for each of the PNG-West 2016-2017 and 2018-2019 revenue requirements applications. Based on these past determinations, BCOAPO's position is that PNG(NE) (and in parallel, PNG-West) should, at most, be allowed an inflationary increase in SCSC recoveries above what was determined by the BCUC in the 2018-2019 revenue requirements application, and then only if the BCUC Panel determines that there is sufficient evidence on record to justify this increase. BCOAPO concludes on the SCSC matter by noting that, should the BCUC disagree with its position on this issue, BCOAPO supports the use of a deferral account to smooth the impact to ratepayers of the increased SCSC recoveries over a future period. Further, BCOAPO submits that interest on deferred amounts should not exceed the minimum interest required so as to minimize the impact on ratepayers.

26. In reply on this matter, PNG(NE) acknowledges the proposed increase in SCSC recoveries over those approved in prior periods is significant. Further, PNG(NE) is mindful of the BCUC's previous determinations on this issue. PNG(NE) also acknowledges the divergence of impacts from increased SCSC recoveries for the ratepayers of PNG-West and PNG(NE), specifically in light of potential near-term growth opportunities in the PNG-West division while the PNG(NE) divisions are forecasting low or near zero growth in load. Lastly, while PNG(NE) has provided a summation of its position on issues pertaining to SCSC recoveries in its Final Argument, PNG(NE) observes that this matter was more comprehensively reviewed as part of the regulatory proceeding to review the PNG-West 2020-2021 revenue requirements application.

27. PNG(NE) reiterates that, while historically the BCUC has generally capped recoveries of SCSC to a historic amount plus inflationary increases, PNG(NE) has represented that it expects to seek recovery of all costs allocated by its parent company. At this time, PNG(NE)

considers it appropriate to seek recovery of all costs allocated from TSU as PNG(NE) benefits from the use of TSU's SCSC. Prior to the formation of TSU, the SCSC allocated by AltaGas Ltd. to its subsidiaries were incurred to support a significantly larger operation that included utilities as well as large scale natural gas and renewable power generation assets, and midstream gas assets. TSU's SCSC are specifically incurred to support its wholly-owned utilities and are considered fair, reasonable and prudently incurred. This efficient structure is beneficial to PNG(NE) because it is able to share the costs associated with the necessary corporate services, without incurring the full standalone costs of those services on its own. This results in significant cost savings to the customers of PNG(NE). Because of TSU incurring certain corporate services costs on behalf of the whole group, based on the estimates provided in the KPMG report, on a consolidated basis, PNG-West and PNG(NE) will have cost savings of approximately \$2.236 million in 2020 and \$2.281 million in 2021, compared to the costs had they been a standalone operation. As stated in PNG(NE)'s Final Argument, PNG(NE) would not realize the benefits associated with the shared corporate services model if it were not part of TSU group of companies. Therefore, PNG(NE) reiterates that to achieve a fair and reasonable result in respect of recovery of necessary costs of services for both customers and PNG(NE)'s shareholder, full recovery of prudent and reasonable SCSC from TSU is appropriate.

3. CONCLUSION

28. The BCUC has a statutory obligation to fix rates that permit PNG(NE) the opportunity to recover all of its costs of providing service, including the fair rate of return on common equity already approved for PNG(NE) by the BCUC. PNG(NE) recognizes that increases in the delivered cost of gas impacts its customers and has taken reasonable and prudent measures to control its costs.

29. PNG(NE) submits that there are no unnecessary, unreasonable or excessive costs in its applied-for 2020 and 2021 cost of service. PNG(NE) further submits that the evidence in this proceeding demonstrates that the rates sought by PNG(NE) for 2020 and 2021 are supported by sound forecasting methods and are required so that PNG(NE) may recover the costs of serving FSJ/DC and TR customers. PNG(NE) submits that the approvals sought are just and reasonable and in the public interest and should be granted.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

Dated at Vancouver, British Columbia this 27th day of July 2020.

PACIFIC NORTHERN GAS (N.E.) LTD.

Original on file signed by:

Gordon Doyle

Vice President, Regulatory Affairs, Legal & Gas Supply