



ORDER NUMBER

G-274-19

IN THE MATTER OF

the *Utilities Commission Act*, RSBC 1996, Chapter 473

and

Nelson Hydro
2019 Rural Rate Application

BEFORE:

R. I. Mason, Panel Chair
A. K. Fung, QC, Commissioner
T. A. Loski, Commissioner

on November 7, 2019

ORDER

WHEREAS:

- A. On March 8, 2019, Nelson Hydro filed an application with the British Columbia Utilities Commission (BCUC) for approval of a 2.94 percent general rate increase to all rural customer classes, effective April 1, 2019 (Application);
- B. Nelson Hydro is owned and operated by the City of Nelson and is exempt from regulation under the *Utilities Commission Act* (UCA) to the extent it is serving customers within its municipal boundaries. Accordingly, the BCUC's review of the Application pertains solely to Nelson Hydro's non-municipal, or rural, ratepayers;
- C. By Order G-60-19 dated March 15, 2019, the BCUC approved Nelson Hydro's requested 2.94 percent rate increase that applies to all Rural customer classes on an interim and refundable basis, effective April 1, 2019. The BCUC also established an initial regulatory timetable by Order G-70-19 dated March 26, 2019, which included intervener and interested party registration and one round of BCUC intervener information requests (IR);
- D. By Order G-111-19 dated May 23, 2019, the BCUC established a further regulatory timetable which included a second round of BCUC IRs;
- E. By Order G-142-19 dated June 25, 2019, the BCUC established a further regulatory timetable which included final and reply arguments. In accordance with Order G-142-19, final and reply arguments were submitted;
- F. By Order G-164-19 dated July 26, 2019, the BCUC established that reopening the evidentiary record of this proceeding was warranted to allow for Panel IRs, responses to Panel IRs, and for the parties to submit final and reply arguments regarding the responses to the Panel IRs. Accordingly, the BCUC established a further regulatory timetable;

- G. On August 6, 2019, the BCUC submitted Panel IR No. 1 to Nelson Hydro;
- H. By letter dated August 8, 2019, Nelson Hydro requested an extension from August 13 to August 19 to file its responses to Panel IR No. 1.;
- I. By Order G-189-19 dated August 9, 2019, the BCUC amended the regulatory timetable to allow for the extension for Nelson Hydro to file its responses to Panel IR No. 1 by August 19, 2019;
- J. By letter dated August 19, 2019, Nelson Hydro requested a further extension from August 19 to August 21 to file its responses to Panel IR No. 1.;
- K. By Order G-193-19 dated August 20, 2019, the BCUC amended the regulatory timetable to allow for the extension for Nelson Hydro to file its responses to Panel IR No. 1 by August 21, 2019; and
- L. The BCUC has reviewed the evidence, letters of comment and arguments in the proceeding and makes the following determinations

NOW THEREFORE pursuant to sections 59-61 of the UCA, the BCUC orders as follows:

- 1. A 2019 general rate increase of 1.5 percent is approved on a permanent basis for all Rural customer classes, effective April 1, 2019, as outlined in the reasons for decision attached as Appendix A to this order.
- 2. Nelson Hydro is directed to file, within 30 days of the date of the reasons for decision attached as Appendix A to this order, tariff pages reflecting permanent 2019 rates for all Rural customer classes.
- 3. Nelson Hydro is directed to file as a compliance filing, for review and approval by this Panel, within 30 days of the date of this Order, the calculations for the adjustments to the 2019 rates for Rural customers resulting from the difference between interim and permanent rates.
- 4. Nelson Hydro is directed to refund \$19,222 to its Rural customers on a one-time basis including accrued interest on or before December 31, 2019, and to file as a compliance filing, for review and approval by this Panel before January 15, 2020, the calculations for this one-time adjustment for Rural ratepayers and to confirm the payment of this refund to Rural customers.
- 5. Nelson Hydro is directed to submit as part of its 2020 rate application a “fully reasoned calculation and approach to determining the City’s ‘allowed return’”, as was requested by the BCUC in 2017 and directed again by the BCUC in 2018. This filing must include detailed supporting calculations on the issues including, but not limited to: an assessment of the utility’s credit rating and risk profile, the ability of the utility to attract capital at reasonable costs and any impact to the utility’s financial integrity. Nelson Hydro must also include a discussion on how any future application for an allowed return will impact and/or reconcile with the current method of the dividend transfer.
- 6. Nelson Hydro is directed to include, in its next rate application, a discussion on the merits and timing of a multi-year rates application and a consideration of any regulatory efficiency that may be gained.

DATED at the City of Vancouver, in the Province of British Columbia, this 7th day of November 2019.

BY ORDER

Original signed by:

R. I. Mason
Commissioner

Attachment

Nelson Hydro

2019 Rural Rate Application

Reasons for Decision

November 7, 2019

Before:
R. I. Mason, Panel Chair
A. K. Fung, QC, Commissioner
T. A. Loski, Commissioner

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1.0 Introduction

1.1 Background and Jurisdiction

On March 8, 2019, Nelson Hydro filed a rate application with the British Columbia Utilities Commission (BCUC) for approval of Electrical Utility Amendment Bylaw No. 3340, 2016 as it applies to its non-municipal (Rural) customers (Application). This bylaw proposes to amend Nelson Hydro's electric rate schedules to implement a general rate increase of 2.94 percent to all Rural customer classes, effective April 1, 2019.

The BCUC reviews applications for changes to rates and rate schedules in accordance with sections 59 to 61 of the *Utilities Commission Act* (UCA). However, Nelson Hydro is in part exempt from regulation under the UCA as it is owned and operated by the City of Nelson (City) and therefore any services provided within the City's boundaries do not fall within the UCA's definition of a public utility. Therefore, the BCUC's review of the Application pertains solely to Nelson Hydro's Rural ratepayers.

1.2 Review of the Application and Regulatory Process

By order G-60-19 dated March 15, 2019, the BCUC approved the applied-for 2.94 percent rate increase on an interim and refundable basis effective April 1, 2019 pending the outcome of the proceeding.

By Order G-70-19, dated March 26, 2019, the BCUC established a preliminary regulatory timetable for review of the Application which included intervener and interested party registration and one round of BCUC and intervener information requests (IR). By Order G-111-19 dated May 23, 2019, the BCUC established an updated regulatory timetable, which provided for a second round of IRs. By Order G-142-19 dated June 25, 2019, the BCUC established a regulatory timetable for the remainder of the proceeding. The timetable set dates for written final and reply arguments.

By Order G-164-19 dated July 26, 2019, the BCUC established that reopening the evidentiary record of this proceeding was warranted to allow for Panel IRs, responses to Panel IRs and for the parties to submit final and reply arguments regarding the responses to the Panel IRs, and established a further regulatory timetable.

By letter dated August 8, 2019, Nelson Hydro requested an extension from August 13 to August 19, 2019 to file its responses to Panel IR No. 1. By Order G-189-19 dated August 9, 2019, the BCUC amended the regulatory timetable to allow for an extension for Nelson Hydro to file its responses to Panel IR No. 1 by August 19, 2019.

By letter dated August 19, 2019, Nelson Hydro requested a further extension from August 19 to August 21, 2019 to file its responses to Panel IR No. 1. By Order G-193-19 dated August 20, 2019, the BCUC amended the regulatory timetable to allow for an extension for Nelson Hydro to file its responses to Panel IR No. 1 by August 21, 2019.

One individual, David Okros (Okros), participated as an intervener, and six other individuals registered as interested parties. The BCUC received 28 letters of comment from various individuals and parties to the proceeding.

1.3 Matters Arising from the 2017 and 2018 Rate Applications

2017 Decision

On August 8, 2017, the BCUC issued Order G-119-17 with reasons for decision (2017 Decision) setting the 2017 rate for Nelson Hydro's Rural ratepayers. As the BCUC observed at that time:

This is the first time in over two decades that a public proceeding has been held with a designated panel to review Nelson Hydro's non-municipal customer rates. Public concerns have been raised with respect to the increase in rates and other issues which are further articulated in the letters of comment received during the course of this proceeding. These concerns, and the desire for a more transparent review process allowing for greater public participation, led to the [BCUC] proceeding with a public process for review of the Nelson Hydro 2017 Rate Application.¹

In the 2017 Decision, the BCUC examined in detail the components of Nelson Hydro's annual budget which differ from more traditional rate regulated utilities: the transfers to the City, including the dividend, water licence payment and contribution to the Community Complex; and the transfer to the Capital Reserve Fund². While the BCUC approved the 2017 budget for these transfers so far as they related to Rural ratepayers, the BCUC had concerns about the "lack of a method to reasonably allocate the determined return between the City and the regulated rural areas"³, the allocation of a proportion of positive net variances in operating expenses to the City⁴, and Nelson Hydro's over-forecasting of power purchase expense⁵.

As a result of its concerns, the BCUC issued a number of directives to Nelson Hydro:

- The [BCUC] directs Nelson Hydro to apply all future variances in budget versus actual net operating income, as these variances pertain to non-municipal ratepayers, to the Capital Reserve Fund only unless otherwise specifically approved by the [BCUC]⁶
- [The BCUC] directs Nelson Hydro to provide more details regarding its power purchase forecasting methodology as part of its 2018 rate application, and, if similar variances exist for 2017 power purchase expenses as have occurred for years 2014 through 2016, the [BCUC] expects Nelson Hydro to consider revising its forecasting method for 2018 and in the future⁷
- Going forward, the [BCUC] directs Nelson Hydro to file its rate applications at least 30 days in advance of the start of the applicable calendar year in accordance with normal regulatory practice, thereby allowing the [BCUC] to approve rates (whether interim or permanent) effecting the full calendar year.

¹ 2017 Rate Application, Order G-119-17 with Reasons for Decision dated August 8, 2017, p. 3.

² Ibid., p. 4.

³ Ibid., p. 11.

⁴ Ibid., p. 15.

⁵ Ibid., p. 18.

⁶ Ibid., p. 15.

⁷ Ibid., pp. 18-19.

- Accordingly, Nelson Hydro is to file its 2018 rate application at least 30 days in advance of January 1, 2018⁸

The BCUC also listed five issues for which Nelson Hydro was to address in a “detailed and well-reasoned manner” in its next (i.e. the 2018) rate application:⁹

- The calculation and approach to determining the City’s “allowed return”, or dividend payment,
- The appropriateness and valuation of the water licence reserve payment,
- The calculation of the amount transferred to the Capital Reserve Fund (notwithstanding the additional transfer of net operating income which is also transferred to the Capital Reserve Fund),
- The appropriateness of Nelson Hydro’s power purchase forecasting method and whether adjustments should be made to the forecast going forward, and
- Details regarding the District Energy project and the Community Solar Garden project (if at all).

2018 Decision

With regard to the five issues identified by the BCUC in the 2017 Decision, in the reasons for decision attached to Order G-124-18 regarding Nelson Hydro’s 2018 rate application and Order G-149-18 varying decision G-124-18 (together the 2018 Decision), the BCUC:

- Examined the allowed return and noted the failure of Nelson Hydro to submit the COSA that it had indicated in 2017 would address the matter. The BCUC approved a dividend in 2018 but rejected the two percent increase over the 2017 amount for which Nelson Hydro had applied.¹⁰
- Was satisfied that Nelson Hydro’s justification for the water licence payment was reasonable¹¹.
- Was satisfied that Nelson Hydro’s rationale for the Capital Reserve Fund balance was reasonable but encouraged the utility to “prioritize the establishment of clear guidelines around the appropriate minimum and maximum capital reserve balance to better inform ratepayers, and requests that Nelson Hydro provide an update on the development of these guidelines in its 2019 rate application”¹².
- Made no comment on Nelson Hydro’s power purchase forecasting method, and
- Was satisfied with Nelson Hydro’s rationale for its budgeted expenses for the Community Solar Garden¹³.

In concluding the 2018 Decision, the BCUC directed Nelson Hydro “to file the COSA study and to fully address all issues identified by the BCUC in the 2017 Decision as part of the 2019 rate application.”¹⁴

⁸ 2017 Rate Application, Order G-119-17 with Reasons for Decision dated August 8, 2017, p. 22.

⁹ Ibid., p. 22.

¹⁰ 2018 Rate Application, Order G-124-18 with Reasons for Decision dated July 11, 2018, p. 5.

¹¹ Ibid., p. 6.

¹² Ibid., p. 8.

¹³ 2018 Rate Application, Order G-124-18 with Reasons for Decision dated July 11, 2018, p. 11.

¹⁴ Ibid., p. 12.

2.0 Key Issues

The Panel explored in depth in this proceeding the following issues: filing of the Cost of Service Allocation (COSA), differential Rural and Urban rates, and Nelson Hydro's total expenses.

2.1 Filing of the COSA

At the time the 2018 Decision was issued, Nelson Hydro was in the process of completing a COSA study and expected to have the study complete by the end of June 2018. In the 2018 Decision, the BCUC was concerned that some of the issues raised in the 2017 Decision had not yet been addressed, in part because the COSA had not yet been filed¹⁵. While some of the issues raised in the 2017 Decision were addressed by Nelson Hydro in the 2018 application, the lack of a "fully reasoned calculation and approach to determining the City's allowed return"¹⁶ remained unresolved. Thus, in the 2018 Decision, the BCUC directed Nelson Hydro "to file the Cost of Service Allocation study and to fully address all issues identified by the BCUC [in the 2017 Decision] as part of the 2019 rate application."¹⁷

Nelson Hydro includes a COSA study dated December 2018 with an amendment dated February 28, 2019 (together the 2017 COSA Study) as Appendix A of the Application. However, Nelson Hydro states that the 2017 COSA Study is "the subject of a separate filing", that the results are provided in the Application "for information purposes rather than a rational [sic] for the 2019 rate change"¹⁸ and that there is "no impact from [the] Cost of Service Study filed by Nelson Hydro to the rate increase sought in the current application for [the] Rural service area."¹⁹ Nelson Hydro adds that it anticipates filing a COSA and rate design application in "late 2019 for the year 2020."²⁰

The Panel finds that Nelson Hydro has failed to comply with the BCUC directive in the 2018 Decision to file a COSA. The clear intention of the BCUC's directive to Nelson Hydro to file a COSA study was for the BCUC to have the ability to review and examine the issues of "ROE, utility return, and other regulatory matters."²¹ Including the COSA as an appendix to the Application and stating that approval for the COSA is not being sought constitutes a failure to address the substance of this BCUC directive.

The Panel also notes that the 2018 Decision did not issue a "recommendation"²² to file a COSA, as Nelson Hydro asserts in its Application; the BCUC issued a directive. The Panel reminds Nelson Hydro that BCUC directives to public utilities have the force of law under the UCA, and that the UCA empowers the BCUC to impose administrative penalties for failure to comply with BCUC orders.

¹⁵ 2018 Rate Application, Order G-124-18 with Reasons for Decision dated July 11, 2018, p. 12.

¹⁶ 2017 Rate Application, Order G-119-17 with Reasons for Decision dated August 8, 2017, p. 22.

¹⁷ 2018 Rate Application, Order G-124-18 with Reasons for Decision dated July 11, 2018, Directive 4.

¹⁸ Exhibit B-1, p. 10.

¹⁹ Exhibit B-4, BCUC IR 2.21.2, p. 2.

²⁰ Exhibit B-3, BCUC IR 1.13.2, p. 22.

²¹ 2018 Rate Application, Order G-124-18 with Reasons for Decision dated July 11, 2018, p. 12.

²² Exhibit B-1, p. 11.

2.2 Differential Rural and Urban Rates

In both its 2017 and 2018 rate applications, Nelson Hydro applied for rate increases for its Rural customers which were the same as the increases Nelson Hydro applied to its Urban customers. Further, in both the 2017 and 2018 rate applications to the BCUC, Nelson Hydro applied for rate increases on the basis of increases in its total costs. No previous consideration was given by the BCUC to allocating costs between Rural and Urban ratepayers, since Nelson Hydro did not present any such allocation as the basis for its proposed rate increases.

Nelson Hydro's current Application breaks with this practice and applies for a different rate increase for its Rural customers than the rate increase applied to its Urban customers in 2019. Specifically, Nelson Hydro applies for a rate increase of 2.94 percent for its Rural customers, versus a rate increase of 1.5 percent for its Urban customers (a decision over which the BCUC has no jurisdiction).

As already noted, Nelson Hydro has not filed an application for approval of a COSA study or a rate design and states that this will not be forthcoming until late 2019. In the absence of an approved COSA and rate design for Nelson Hydro, the Panel does not consider it appropriate to approve a different rate increase for Rural customers than Nelson Hydro has applied to its Urban customers. The BCUC has not had the opportunity to examine the basis on which Nelson Hydro's total costs might be allocated between different customer classes, including the proposed allocation between Rural and Urban customers, and whether such allocation is just and reasonable, as Nelson Hydro has not applied to the BCUC for such an examination.

In the absence of a sound evidentiary basis for examining costs allocated to Rural customers, the Panel considers the only reasonable basis on which to set a rate for Rural customers is an examination of Nelson Hydro's total costs, as was done in both 2017 and 2018. The Panel addresses this in Section 3.0.

Although it has not filed a COSA for review, Nelson Hydro nevertheless provides, in its responses to BCUC IRs, information on how it allocates costs between Rural and Urban customers in determining the rate increase applied for in the Application. As stated immediately above, the Panel does not consider it appropriate to use Nelson Hydro's proposed allocations for determining the rate increase for Rural customers in 2019 in the absence of a COSA. However, to assist Nelson Hydro in the future filing of its COSA and rate design, the Panel offers below an analysis of certain cost allocations made by Nelson Hydro in the current Application, with observations on issues and problems associated with those allocations.

2.2.1 Energy Purchase Costs

Nelson Hydro asserts that power purchase costs attributable to Rural customers are \$5,032,143, out of a utility-wide total of \$6,698,722²³. Nelson Hydro expands on this by stating that power purchase costs comprise three cost categories: energy purchases, demand purchases and POD purchases (or customer charges), of which Rural customers incur 82.3 percent, 67.7 percent, and 42.3 percent respectively, and Urban customers incur the balance²⁴.

²³ Exhibit B-8, Panel IR No. 1, Attachment No. 2.

²⁴ Exhibit B-3, BCUC IR 1.11.1, p. 16.

Okros argues that Nelson Hydro allocates a “disproportionate amount of the much more expensive purchased power” to Rural customers, and that Nelson Hydro should allocate its power purchase costs more equitably.

In response, Nelson Hydro explains that the proportion of energy purchases allocated to Urban customers is lower because it assumes that Urban customers use the energy from Nelson Hydro’s generating facility, and only when that is insufficient do Urban customers use power purchased from FortisBC Inc. (FBC). Rural customers, on the other hand, only have access to energy from Nelson Hydro’s generating facility if it is surplus to the requirements of Urban customers and must otherwise rely on power purchased from FBC. Nelson Hydro justifies this approach on the basis that Nelson Hydro’s generating facility was built with City funds, “which represents the investment of its urban residents, and for the core purpose of providing the City of Nelson Residents (urban service area) with electricity.”²⁵

The Panel does not consider this to be an appropriate allocation methodology for power purchase costs and agrees with Okros that Nelson Hydro’s proposed allocation is disproportionate and disadvantageous to Rural customers. Nelson Hydro has one integrated electrical distribution system which serves all of its customers regardless of their location. Energy from Nelson’s generating facility and energy purchased from FBC is pooled and indistinguishable once it enters that distribution system. All Nelson Hydro customers share all the energy whether it comes from Nelson’s generating facility, from FBC or from other sources. Further, the total energy costs have in the past been pooled and shared equally between Rural and Urban customers. The Panel is not persuaded that it is reasonable for Nelson Hydro to arbitrarily assign the higher cost power purchased from FBC predominately to Rural customers.

2.2.2 Energy Production Costs

Nelson Hydro incurs energy production costs related to its generating facility, and in the Application allocates these costs between Rural and Urban customers in the ratio of 12.2 percent and 87.8 percent, respectively²⁶.

As stated above, Nelson Hydro assumes that Urban customers use the energy from its generating facility, and only when there is surplus capacity at this facility is it used by Rural customers. For this reason, Nelson Hydro argues that the majority of the costs of its generating facility should be allocated to Urban customers.

The Panel does not consider this to be an appropriate allocation of costs between Rural and Urban ratepayers. Unlike power purchase costs, which appear disproportionately allocated to Rural customers, the Panel considers that Rural customers are not being allocated a sufficient percentage of the costs of the generating facility, whose energy they share on a pooled basis with Urban customers. The Panel is not persuaded that it is reasonable for Nelson Hydro to arbitrarily assign the energy production costs predominately to Urban customers.

²⁵ Nelson Hydro Reply Argument, p. 5.

²⁶ Exhibit B-3, BCUC IR 1.11.1, p 16.

2.2.3 Dividend / Return on Equity

In the 2017 Decision, the BCUC agreed with Nelson Hydro that its owner, the City, is “well within its rights to expect to earn a return on its assets.”²⁷ The BCUC approved the amount of the dividend payment Nelson Hydro proposed in 2017, but was troubled by “the lack of supporting information for how the \$2.7 million dividend payment was arrived at by Nelson Hydro.”²⁸ In the 2018 Decision, the BCUC again approved a dividend payment, but rejected the proposed two percent increase in the amount compared to 2018 on the ground that it was “not justified.”²⁹

In the 2019 Application, Nelson Hydro allocates a dividend payment of \$0 to Rural ratepayers, out of a total dividend payment of \$2,837,000³⁰. Nelson Hydro explains that including a return to the City would increase the rate increase already requested in this Application and adds that it will submit a proposal to the BCUC in the future regarding a return on investments by the City.

The Panel considers that the allocation of no dividend payment to Rural ratepayers is unreasonable. All ratepayers have benefited from the investments made by Nelson Hydro, and section 59(5)(b) of the UCA states that a rate is unjust or unreasonable if it is “insufficient to yield a fair and reasonable compensation for the service provided by the utility, or a fair and reasonable return on the appraised value of its property.” Collecting no dividend from Rural ratepayers is clearly not a fair and reasonable return on Nelson Hydro’s investment. The Panel is not persuaded that it is reasonable for Nelson Hydro to arbitrarily assign the dividend exclusively to Urban customers.

2.2.4 Transfer to Capital Reserve

In the 2017 Decision, the BCUC approved the applied-for transfer to the Capital Reserve and accepted Nelson Hydro’s practice of financing its capital expenditures primarily through the use and management of this fund. The BCUC noted that Nelson Hydro had established the practice of returning any variances in net operating income, whether positive or negative, to this fund, and the BCUC found this to be reasonable. The BCUC directed Nelson Hydro “to apply all future variances in budget versus actual net operating income, as these variances pertain to non-municipal customers, to the Capital Reserve Fund only unless otherwise specifically approved by the Commission.”³¹

The Panel considers that making no allocation to the Capital Reserve Fund by Rural ratepayers is unreasonable. The Capital Reserve Fund is set aside for future investments in the generating and distribution network for the benefit of all Nelson Hydro ratepayers and has been contributed to by both Rural and Urban ratepayers in the past. Further, the Capital Reserve Fund is used to hold any variance in net operating income and any surpluses, less any deficits, have been contributed by both Rural and Urban ratepayers. The Panel expects that the Capital Reserve will continue to provide these functions for Rural ratepayers, so for Rural ratepayers not to contribute

²⁷ 2017 Rate Application, Order G-119-17 with Reasons for Decision dated August 8, 2017, p. 7.

²⁸ Ibid., p. 12.

²⁹ Ibid., p. 5.

³⁰ Exhibit B-8, Panel IR No. 1, Attachment No. 2

³¹ 2017 Rate Application, Order G-119-17 with Reasons for Decision dated August 8, 2017, pp. 14, 15.

to the Capital Reserve would contravene the provision of section 59(5)(b) of the UCA that requires rates to be sufficient to yield “a fair and reasonable compensation for the service provided by the utility”, as Rural ratepayers would not be contributing to the fund that will be used in future years to maintain and enhance the system which they use. The Panel is not persuaded that it is reasonable for Nelson Hydro to arbitrarily assign the Capital Reserve transfer exclusively to Urban customers.

2.2.5 Transfer to Water Licence Reserve

In the 2018 Decision, the BCUC found the water license reserve payment to be reasonable, as it represents “compensation from the BC Government and BC Hydro to the City in the form of water flows as opposed to cash compensation, and that this compensation is received by the City through the generation of power from Nelson Hydro.”³² The BCUC was also satisfied that the valuation of the payment, using FBC’s energy and capacity rate as a proxy, was reasonable.

The water licence reserve payment is a transfer of value from Nelson Hydro, on behalf of the BC Government and BC Hydro, to the City and may be viewed as a flow-through payment unrelated to Nelson Hydro’s costs of operating the utility. Therefore, the Panel considers that making no allocation of transfers to the water licence reserve by Rural ratepayers is unreasonable. Rather, the transfer should be made from all ratepayers. The Panel is not persuaded that it is reasonable for Nelson Hydro to arbitrarily assign the Water Licence Reserve transfer exclusively to Urban customers.

2.2.6 Contribution to Community Complex

In the 2017 Decision, the BCUC found that Nelson Hydro’s expense related to the Community Complex was reasonable “as a means of promoting the utility as a good corporate citizen in the community.”³³ The BCUC approved an identical amount in 2018.

The Panel considers that allocating nothing on behalf of Rural ratepayers for the Community Complex is unreasonable. The benefits of this promotion accrue to all ratepayers and thus, it is just and reasonable that the Rural ratepayers pay their share of the expense. The Panel is not persuaded that it is reasonable for Nelson Hydro to arbitrarily assign the contribution to the Community Complex exclusively to Urban customers.

2.3 Total Expenses

Having found that Nelson Hydro’s proposed allocation of costs between Rural and Urban ratepayers does not yield just and reasonable rates for Rural ratepayers, the question for the Panel is: on what basis should Rural ratepayers’ rates be set?

Nelson Hydro has stated that it is “not seeking a blended rate increase for the whole utility”³⁴. However, UCA section 60 (1) (b.1) states that the BCUC may use “any mechanism, formula or other method of setting the rate that it considers advisable.” In the absence of a BCUC-approved COSA which allocates costs to Rural ratepayers

³² 2018 Rate Application, Order G-124-18 with Reasons for Decision dated July 11, 2018, p. 6.

³³ 2017 Rate Application, Order G-119-17 with Reasons for Decision dated August 8, 2017, p. 7.

³⁴ Exhibit B-8, Panel IR No. 1, p. 1.

on a just and reasonable basis, the Panel considers it appropriate to use the total expenses for the utility in determining an appropriate rate for Rural customers. This practice is consistent with recent history, being the approach taken by Nelson Hydro in its 2017 and 2018 applications.

The most recent forecast of total expenses in 2019 submitted by Nelson Hydro is \$18,733,654, comprising debt servicing, operating expenses, power purchases and transfers³⁵. The Panel examines each of these categories from the perspective of whether the forecast amounts would yield “just and reasonable” rates for Rural ratepayers.

Panel IR No. 1 Attachment 2 - IR 1.1.1

Application Page 8 Information (December 2018)				Panel IR 1.1.1 (Corrected IR 11.4)			
	Rural (December 2018)	Urban (December 2018)	Nelson Hydro (December 2018)	Rural (Aug 2019)	Urban (Aug 2019)	Nelson Hydro (Aug 2019)	
Debt Serv. Total	\$169,660	\$329,340	\$499,000	\$171,382	\$327,982	\$499,364	
Op Exp. Total	\$2,293,016	\$2,803,645	\$5,096,661	\$2,279,534	\$2,794,668	\$5,074,202	
Power Purchase Total	\$5,032,846	\$1,667,154	\$6,700,000	\$5,032,143	\$1,666,579	\$6,698,722	
Transfers							
Transfer - Dividend Pymt.	\$0	\$2,837,000	\$2,837,000	\$0	\$2,836,000	\$2,836,000	
Transfer - Major Capital Reserve	\$0	\$3,000,000	\$3,000,000	\$0	\$2,877,100	\$2,877,100	
transfer - Water License Reserve	\$0	\$658,000	\$658,000	\$0	\$658,266	\$658,266	
Contribution to Community Complex	\$0	\$90,000	\$90,000	\$0	\$90,000	\$90,000	
Transfers total	\$0	\$6,585,000	\$6,585,000	\$0	\$6,461,366	\$6,461,366	
Expense total	\$7,495,522	\$11,385,139	\$18,880,661	\$7,483,059	\$11,250,595	\$18,733,654	
Revenue - Other total	-\$159,909	-\$340,091	-\$500,000	-\$159,898	-\$342,755	-\$502,653	
Revenue - Rates Fcst. (pre rate change)	-\$7,171,071	-\$11,075,929	-\$18,247,000	-\$7,171,071	-\$11,075,929	-\$18,247,000	
Revenue total	-\$7,330,980	-\$11,416,020	-\$18,747,000	-\$7,330,969	-\$11,418,684	-\$18,749,653	
2018 Dividend Returned	-\$19,220		-\$19,220	-\$19,220	\$19,220	\$0	
Grand Total Shortfall (Surplus)	\$145,322	-\$30,881	\$114,441	\$132,870	-\$148,869	-\$15,999	
Revenue from Rates Rqd.	-\$7,316,393	-\$11,045,048	-\$18,361,441	-\$7,303,941	-\$10,927,060	-\$18,231,001	
Revenue from Rates Change Rqd.	2.03%	-0.28%	0.63%	1.85%	-1.34%	-0.09%	
Rate Change Rqd. (Apr 01)	2.94%	-0.40%	0.91%	2.69%	-1.95%	-0.13%	
	\$19,220	\$0	\$19,220	\$19,220	-\$19,220	\$0	

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2.3.1 Debt Service Total

Nelson Hydro submits that its debt service expense of \$499,364³⁷ reflects payments of long-term debt borrowed to finance its capital projects³⁸. The debt service expense is composed of \$251,900 in principal and \$247,500 in interest³⁹, and the total figure has not changed since 2015.

³⁵ Exhibit B-8, Panel IR No. 1, Attachment No.2.

³⁶ Ibid. In this submission, Nelson notes that its proposed increase for Rural customers would be 2.69 percent rather than 2.94 percent, however it does not amend its application to request this lower increase.

³⁷ Exhibit B-8, Panel IR No. 1, Attachment No.2.

The Panel is satisfied that the debt service expense is reasonable.

2.3.2 Operating Expenses

Nelson Hydro submits that its total operating expense for the utility in 2019 will be \$5,074,202, an increase of \$333,018 or 7.02 percent over the 2018 budget, and an increase of \$154,330 or 3.13 percent over the preliminary actuals for 2018⁴⁰.

The largest increase in operating expense is in the “distribution” category, which is forecast to increase by \$204,735 or 14.86 percent over the 2018 budget. Nelson Hydro explains that this increase is due in part to an increase of \$150,000 in vegetation management costs, and that otherwise the budgeted distribution costs for 2019 are close to the average of the 2015-2017 years (\$1,088,000)⁴¹. Nelson Hydro explains that tree-related incidents made up 39 percent of the total outage time in 2018, and that the additional budget for vegetation management is to fund tree trimming in addition to the normal trim cycles to improve service reliability⁴².

The second-largest increase is in the “electrical administration” category, which is forecast to increase by \$59,587 or 5.24 percent over the 2018 budget. Nelson Hydro explains this as reflecting increases in the cost of general administration such as “office supplies, safety meeting, trades/professional staining [sic], consulting costs, labour costs for electrical administration except staff.” Nelson Hydro adds that these costs are “not discretionary because these services are necessary for Nelson Hydro and would need to be obtained from third parties if not shared from the City of Nelson, therefore, Nelson Hydro considers those services as legitimate services provided to Nelson Hydro.”⁴³

The third-largest increase is in the “electrical supply” category, which is forecast to increase by \$50,905 or 11.14 percent over the 2018 budget. Nelson Hydro explains that the most significant reason for the increase is a one-time cost of \$26,000 for contracted electrical maintenance work, and that the projected 2019 budget is less than the preliminary estimate of the 2018 actual cost in this category.

Based on the evidence provided, the Panel is satisfied with the justification for Nelson Hydro’s applied-for increase in operating costs.

2.3.3 Power Purchases

Nelson Hydro submits that its power purchase expense for 2019 will be \$6,698,722⁴⁴. This is a 0.54 percent increase over the 2018 budget of \$6,662,610⁴⁵ and a 3.93 percent increase over the most recent forecast for 2018 of \$6,445,354.⁴⁶

³⁸ Nelson Hydro Final Argument, p.4.

³⁹ Exhibit B-3, BCUC IR 1.13.6, p. 25. (figures do not quite add to \$499,364 due to rounding).

⁴⁰ Exhibit B-1, Appendix B.

⁴¹ Exhibit B-3, BCUC IR 1.5.4, p. 8.

⁴² Exhibit B-1, p. 5.

⁴³ Exhibit B-3, BCUC IR 1.7.1, p. 10.

⁴⁴ Exhibit B-8, Panel No. 1, Attachment No.2.

The most significant component of the power purchase costs is the cost of energy (\$3,518,236). Nelson Hydro forecasts this figure to be an average of the previous 5 years' actual costs, plus an escalation of 0.25 percent for growth. The second most significant component of the power purchase costs is the demand-related wires charge (\$1,928,977), which is estimated to be an average of the previous 5 years' actuals costs, plus an escalation of 0.1 percent for growth.

Nelson Hydro explains that it does not use the same forecast load to estimate its revenues as it does to estimate its power purchases, as it has not found a clear enough correlation with changes to revenues only loosely related to changes in load. It attributes the differences to other factors which affect revenues, such as customer mix, temperature and other variations.

Based on the evidence provided, the Panel is satisfied that the forecast of power purchase expense is reasonable.

2.3.4 Dividend Payment

Nelson Hydro submits that its total dividend transfer in 2019 will be \$2,836,000, a 2.98 percent increase over the forecast figure for 2018.⁴⁷

In 2018, the BCUC directed Nelson Hydro to submit a COSA which would "fully address all issues identified by the BCUC in [the 2017 Decision]", one of which was, "a fully reasoned calculation and approach to determining the City's 'allowed return'". Nelson Hydro has failed to comply with this directive and has not submitted a COSA to the BCUC. The Panel, therefore, does not have an ideal basis on which to determine whether the proposed dividend transfer for 2019 is just and reasonable.

The Panel acknowledges that the proposed dividend transfer is an increase over the proposed figure from 2018 and that in 2018, the BCUC rejected Nelson Hydro's proposed increase over the figure from 2017. However, the dividend to the City was not increased from 2016 to 2017 and the BCUC rejected the increase between 2017 and 2018 to the extent that it affected Rural ratepayers. The proposed increase of 2.98 percent from 2018 to 2019 is considerably less significant when one considers that this is the only increase from 2016 to 2019, at least to the extent that it is attributable to Rural ratepayers. Therefore, even in the absence of a fully reasoned calculation of the appropriate dividend, the Panel is willing to accept Nelson Hydro's proposed dividend for 2019.

2.3.5 Capital Reserve

Nelson Hydro forecasts that its transfer to the Capital Reserve in 2019 will be \$2,877,100, an increase of 15.72 percent over the 2018 budget.⁴⁸ The utility's forecast capital spending in 2019 is \$3,531,875,⁴⁹ which when

⁴⁵ Exhibit B-1, Appendix B.

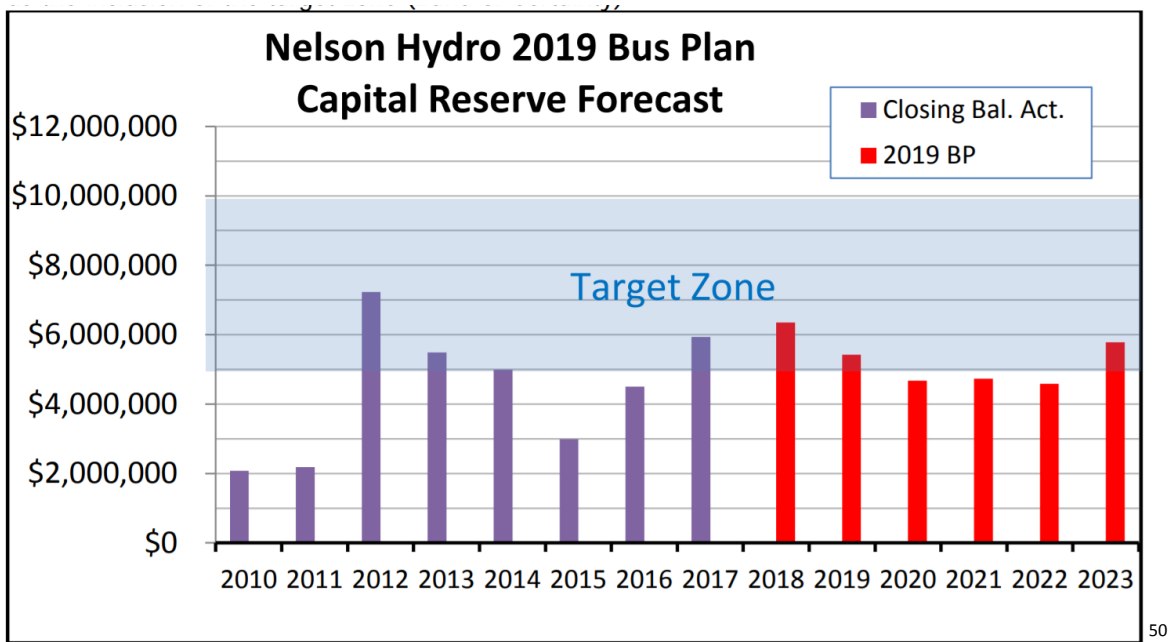
⁴⁶ Exhibit B-8, Panel IR No. 1, p. 5. $\$6,698,722 / \$6,445,354 = 1.0393$

⁴⁷ Exhibit B-1, Appendix B.

⁴⁸ Exhibit B-1, Appendix B.

⁴⁹ Ibid.

combined with the proposed transfer into the Capital Reserve will reduce the forecast balance in the Capital Reserve but leave it within the “target zone” of \$5 million to \$10 million.



The Panel accepts that capital expenditures can be “lumpy”⁵¹ and that the use of a Capital Reserve can serve to smooth out fluctuations in rates that would otherwise be required to match the timing of capital spending. While the proposed transfer to the Capital Reserve in 2019 is not sufficient to cover the forecasted capital expenditures in the year, the Panel is satisfied that the amount of the transfer is reasonable, as the balance of the Capital Reserve is forecasted to remain in the target zone at the end of the year.

2.3.6 Water Licence Reserve

Nelson Hydro submits that the transfer to the City for the water licence payment in 2019 is \$658,266, the same amount as was budgeted for 2018⁵².

The BCUC found in the 2018 Decision that the water licence payment “represents compensation from the BC Government and BC Hydro to the City”, and that Nelson Hydro’s method for valuing the compensation was reasonable.⁵³

For these reasons, the Panel considers that the transfer to the water licence reserve is reasonable.

⁵⁰ Exhibit B-1, p. 9.

⁵¹ Exhibit B-3, BCUC IR 1.15.1, p. 29.

⁵² Exhibit B-1, Appendix B.

⁵³ 2018 Rate Application, Order G-124-18 with Reasons for Decision dated July 11, 2018, p. 7.

2.3.7 Contribution to Community Complex

Nelson Hydro submits that the transfer to the Community Complex in 2019 shall be \$90,000, the same amount as was budgeted in 2018⁵⁴.

In the 2017 Decision, the BCUC found that the contribution of \$90,000 was reasonable as a “means of promoting the utility as a good corporate citizen in the community” and that the amount was reasonable as the City had contributed an approximately similar amount (\$94,000).⁵⁵

For these reasons, the Panel finds that the transfer to the Community Complex is reasonable.

3.0 Panel Determination on Proposed 2019 Rate Increase

Based on the evidence filed in the proceeding and for reasons provided above, the Panel finds the forecast total expenses for Nelson Hydro of \$18,733,654 in 2019 to be reasonable. Based on this forecast, Nelson Hydro projects a small surplus of revenues over expenses of \$15,999.

As noted in section 2.3 above, the Panel does not consider there to be a sound basis for Nelson Hydro’s proposed allocation of expenses between Rural and Urban customers, and therefore, the Panel has examined Nelson Hydro’s total expenses as to whether they are reasonable for the purposes of determining a just and reasonable rate for Rural ratepayers.

Nelson Hydro has stated it intends to file for approval a COSA and rate design in late 2019. Should it make such a filing, the BCUC will examine in detail Nelson Hydro’s proposed allocation of costs between different classes of customers, including the proposed allocation between Rural and Urban customers. At the present time, however, the Panel considers it appropriate not only to reject such cost allocations proposed in this Application, but also to ensure that no other decisions are made that would differentiate between Rural and Urban customers until the COSA and rate design are reviewed and approved.

Notwithstanding that it expects a small surplus of revenues over costs, Nelson Hydro has imposed a 1.5 percent rate increase on its Urban customers. As already noted, the Panel has no jurisdiction to review that decision. Nelson Hydro justifies the 1.5 percent rate increase as rate smoothing for Urban customers, on the basis that it expects to require rate increases of 2.75 percent up to 2023⁵⁶.

As the BCUC has directed in the 2018 Decision, any surplus in budget versus actual net operating income must be retained in the Capital Reserve Fund. If the Panel were to approve a different rate increase for Rural customers in 2019 to the rate increase of 1.5 percent already applied to Urban customers, the two groups of customers would contribute disproportionately to the Capital Reserve Fund. This would make more difficult any future separation of the accumulated balance in the Capital Reserve Fund that Nelson Hydro might propose. More importantly, though, different rate increases for Rural and Urban customers would cause Rural and Urban

⁵⁴ Exhibit B-1, Appendix B.

⁵⁵ 2017 Rate Application, Order G-119-17 with Reasons for Decision dated August 8, 2017 p. 7.

⁵⁶ Exhibit B-1, p. 3.

customers to contribute disproportionately to the fund, which has served all their interests and presumably will continue to do so.

For these reasons, **the Panel approves for 2019 a permanent rate increase of 1.5 percent for Nelson Hydro's Rural customers, effective April 1, 2019. Nelson Hydro is directed to file, within 30 days of the date of these Reasons for Decision, tariff pages reflecting permanent 2019 rates for all Rural customer classes. Nelson Hydro is also directed to file as a compliance filing, for review and approval by this Panel, the calculations for the adjustment to the 2019 rates for Rural customers resulting from the difference between interim and permanent rates as part of this compliance filing.** While this rate increase is not necessary to recover the forecast expenses anticipated by Nelson Hydro in 2019, the Panel is satisfied that any surplus of revenues over expenses contributed by Rural ratepayers will be retained to the benefit of all Nelson Hydro ratepayers in the Capital Reserve Fund. **The Panel reminds Nelson Hydro that it has already been directed to retain any operating surplus or deficit in the Capital Reserve Fund, and that this directive continues to apply.**

On another matter, Nelson Hydro continues to owe \$19,222 to its Rural customers as a result of the 2018 Decision in which the BCUC directed a \$54,000 reduction to the 2018 dividend payment. In this Application, Nelson Hydro proposed refunding this amount as part of its allocation of costs between Rural and Urban customers, which this Panel has previously rejected. To resolve this matter without applying a different rate increase to Rural and Urban customers, **the Panel directs that Nelson Hydro refund \$19,222 to its Rural customers on a one-time basis including accrued interest on or before December 31, 2019. Nelson Hydro is directed to file as a compliance filing, for review and approval by this Panel, on or before January 15, 2020 the calculations for this one-time adjustment for Rural ratepayers and to confirm the payment of this refund to Rural customers.**

4.0 Future Rate Applications

Nelson Hydro describes its current Application as a “first step towards cost recovery (or a phase-in step),”⁵⁷ and stated its intention of filing a COSA and rate design before the end of 2019. The Panel has expressed concerns about whether certain classes of the utility's total costs have been appropriately allocated to Rural customers, for example the power purchase costs, energy supply costs, capital reserve transfer, water license reserve transfer, community complex contribution and the dividend transfer. The Panel recommends that Nelson Hydro considers addressing these concerns when it files its COSA and rate design application(s).

However, the Panel also notes that the BCUC has in the past approved rate increases for Rural customers on the basis of the utility's increase in total costs for all customers. This alternative is still open to Nelson Hydro in future years and would likely be the only option available for setting 2020 rates in the absence of an approved COSA and rate design.

If Nelson Hydro decides to continue with the past practice of setting rates for the Rural customers based on the forecast costs of the utility as a whole, then the Panel suggests Nelson Hydro consider making a request for

⁵⁷ Nelson Hydro Final Argument, p. 3.

reconsideration of the 2018 Decision directive 4⁵⁸ for Nelson Hydro to submit a COSA study, in accordance with the BCUC's Rules of Practice and Procedure⁵⁹, as this directive is still outstanding. On the other hand, if Nelson Hydro wishes to differentiate rates between Rural and Urban customers at some time in the future, a detailed COSA study (as previously directed) is required and necessary.

Whether or not Nelson Hydro wishes to continue to file future rate applications based on forecasts for the utility's total costs, the Panel is not satisfied with Nelson Hydro's basis for calculating the dividend transfer to the City. **The Panel directs that Nelson Hydro submit as part of its 2019 rate application a "fully reasoned calculation and approach to determining the City's 'allowed return'", as was requested by the BCUC in 2017 and directed again by the BCUC in 2018.** In this filing, the Panel expects that Nelson Hydro will include a sound justification for any departure from the current practice of using the BCUC allowed benchmark return and/or a premium or reduction to the benchmark return. This filing must include detailed supporting calculations on the issues including, but not limited to: an assessment of the utility's credit rating and risk profile, the ability of the utility to attract capital at reasonable costs and any impact to the utility's financial integrity. Nelson Hydro must also include a discussion on how any proposed allowed return application will impact and/or reconcile with the current method of the dividend transfer, which the BCUC has previously accepted as a proxy calculation to a reasonable return for the utility.⁶⁰

All 28 letters of comment received by the BCUC in this proceeding were critical of the Application, and none explicitly recommended its acceptance. The concerns expressed in the letters of comment include the differentiation of rates between Rural and Urban customers, and moving away from "postage stamp rates", the allocation of total utility costs between Rural and Urban customers, the independence of Nelson Hydro from its owner, the City, and the forecast surplus and consequently the justification for any rate increase. The Panel believes these comments may reflect insufficient engagement by Nelson Hydro with its Rural ratepayers and recommends that the utility consult more fully with its Rural customers before it files any application for differentiated rates.

Nelson Hydro filed its 2019 rate application with the BCUC on March 8, 2019 and filed its 2018 rate application on December 8, 2017. Contrary to the BCUC's directive in Order G-119-17, Nelson Hydro failed to file the 2018 and 2019 rate applications at least 30 days in advance of January 1st of the year in which each of those applications was to be effective. Going forward, the Panel reminds Nelson Hydro to file its rate applications at least 30 days in advance of the start of the applicable calendar year in accordance with normal regulatory practices, and to remain in compliance with 2017 Decision directive 3, thereby allowing the BCUC to approve rates (whether interim or permanent) affecting the full calendar year. As the Panel has already noted, the UCA requires utilities to comply with BCUC orders and empowers the BCUC to levy administrative penalties for failure to comply with such orders.

⁵⁸ 2018 Rate Application, Order G-124-18 with Reasons for Decision dated July 11, 2018, Directive 4.

⁵⁹ Rules of Practice and Procedure, Order G-15-19 dated December 17, 2018, Section 26.02. While the BCUC Rules of Practice and Procedure state that requests for reconsideration are normally expected to be submitted within 60 days, the BCUC may give permission for such a request to be made at any time.

⁶⁰ 2017 Rate Application, Order G-119-17 with Reasons for Decision dated August 8, 2017, p. 13.

As a final point, Nelson Hydro is directed to include a discussion in its next rate application on the merits and timing of a multi-year rates application and a consideration of any regulatory efficiency that may be gained. The Panel considers that Nelson Hydro and its ratepayers may benefit from having rates set for multiple years rather than one year at a time, and thus mitigating the regulatory burden of an annual proceeding.