



OPEN HOUSE – November 6, 2019
Rate Design Presentation

Presentation Outline

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CITY OF NELSON

B.C.'s Regulatory Framework

The British Columbia Utilities Commission

- Independent government agency that draws its authority from the Utilities Commission Act (UCA).
- Regulates gas and electricity utilities (Fortis, BC Hydro, Nelson Hydro etc.)
- Mission statement of the BCUC:

*The BCUC's mission is to ensure that ratepayers receive safe, reliable and non-discriminatory energy services at **fair rates** from the utilities it regulates, and that shareholders of those utilities are afforded a reasonable opportunity to earn **a fair return** on their invested capital.*



B.C.'s Regulatory Framework

The Municipal Exemption:

The Utilities Commission Act (UCA) exempts from regulation a municipality providing service within its boundaries but does not exempt a municipality providing service outside its boundaries.

Specifically, the UCA does not include municipalities as part of the definition of a “public utility”. UCA, Section 1.



B.C.'s Regulatory Framework

- ▶ Accordingly, the BCUC only regulates Nelson Hydro's non-municipal ratepayers. For example, BCUC has stated:
 - *"Nelson Hydro is in part exempt from regulation under the UCA as it is owned and operated by the City of Nelson and therefore any services provided within the City's boundaries to not fall within the UCA's definition of a public utility."*

See BCUC Order G-119-17, Nelson Hydro 2017 Application.

- ▶ The BCUC has recognized that this could result in different rates in the municipal v. non-municipal rate areas.
- ▶ Nelson Hydro had 10,614 total customers in 2019, with approximately 42.9% in the non-municipal (BCUC regulated) area and 57.1% in the municipal (City Council regulated) area.
- ▶ City Council provides oversight with regard to municipal ratepayers.

BCUC Procedural Considerations

- ▶ Decisions regarding non-municipal ratepayers (i.e. rates, rate of return etc.) requires approval by BCUC.
- ▶ Procedural Considerations:
 - Applications are submitted to BCUC by NH;
 - Interested parties and interveners are able to join proceeding;
 - BCUC and interveners are able to solicit information from Nelson Hydro by way of information requests (IRs);
 - BCUC considers applications, IRs, arguments, and issues a Decision.

BCUC Regulatory Framework

In 2017 BCUC decided to add more rigor to reviewing Nelson Hydro's (NH) rate application for its non-municipal customers.

“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”

- ▶ See BCUC Order G-119-17.

BCUC Key Decisions 2017 & 2018

BCUC made a number of decision & provided guidance regarding Nelson Hydro's rates in 2017 (Order G-119-17) and 2018 (Order G-124-18):

- ▶ Nelson Hydro to adopt a traditional cost of service approach: this allows Nelson Hydro to recover costs and to earn a fair and reasonable rate of return.
- ▶ The application of a debt to equity ratio at current NH levels is a fair and reasonable approach versus industry standard because of NH's unique circumstances as a municipality.
- ▶ That NH doesn't pay income taxes is a benefit to ratepayers.

BCUC Key Decisions 2017 & 2018

- ▶ Did not preclude Nelson Hydro from seeking changes in the future to dividend payments based on the Cost of Service review including a fully reasoned approach to determining the City's "allowed return".
 - ▶ Accepts the 265 cfs (Water Licence Reserve) represents compensation from the BC Government and BC Hydro to the City of Nelson, not the Nelson Hydro ratepayer.
 - ▶ Accepted that the \$90,000 contribution to the NDCC is consistent with other regulated utilities and is therefore reasonable.
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BCUC Key Decisions 2017 & 2018

- ▶ Accepted the contributions to the Solar Garden, Selkirk College DES are reasonable.
- ▶ Accepted that Nelson Hydro's approach to budgeting operating expenses is reasonable and notes that Nelson Hydro applies a rigorous and methodological approach to budgeting.
- ▶ Identified that the proxy rate of return is FortisBC (FBC) with a return on equity (ROE) of 9.15%
 - If NH was to make a case for having a higher risk than FBC the result could be a higher ROE for NH
 - It is common for utilities to include a provision for working capital in its rate base.

BCUC Rate of Return Guidance

BCUC has stated that traditional utilities apply the following formula in calculating an allowed return:

Equity percentage x Rate Base x Return on Equity = Allowed Return

Although not determinative, BCUC accepted that Nelson Hydro calculated its rate of return using an 18 percent debt to 82 percent equity ratio and the Fortis BC benchmark return on equity rate of 9.15 percent, although recognizing NH might be able to argue for a higher ROE.



COSA Studies

Cost of Service Analysis (COSA)

- A COSA is a study used to assign or allocate a fair share of total cost or revenue requirement of a utility to its various customer classes.
- Prepared to determine the extent to which all customers are paying an “equitable share of costs”.
- All utilities undertake a COSA periodically.



COSA & The Rate Design Process

Cost of Service Analysis	Determine the cost that each customer class is responsible for
Revenue Requirement	Determine the total dollars that must be collected
Rate Design	Use this information to set rates appropriately



COSA & The Rate Design Process

1. Cost of Service Analysis
 - Functionalize costs and services;
 - Production, transmission, distribution, customer.
 - Classify costs;
 - Allocate costs among customer classes
2. Determine Rate Base (i.e. Assets and Debt municipal v. non-municipal)
3. Determine Capital Structure (Debt v. Equity or Capital Reserves).
4. Determine Rate of Return
5. Determine the revenue requirement of the utility.
6. Rate Design Application to BCUC.



Nelson Hydro COSA Study

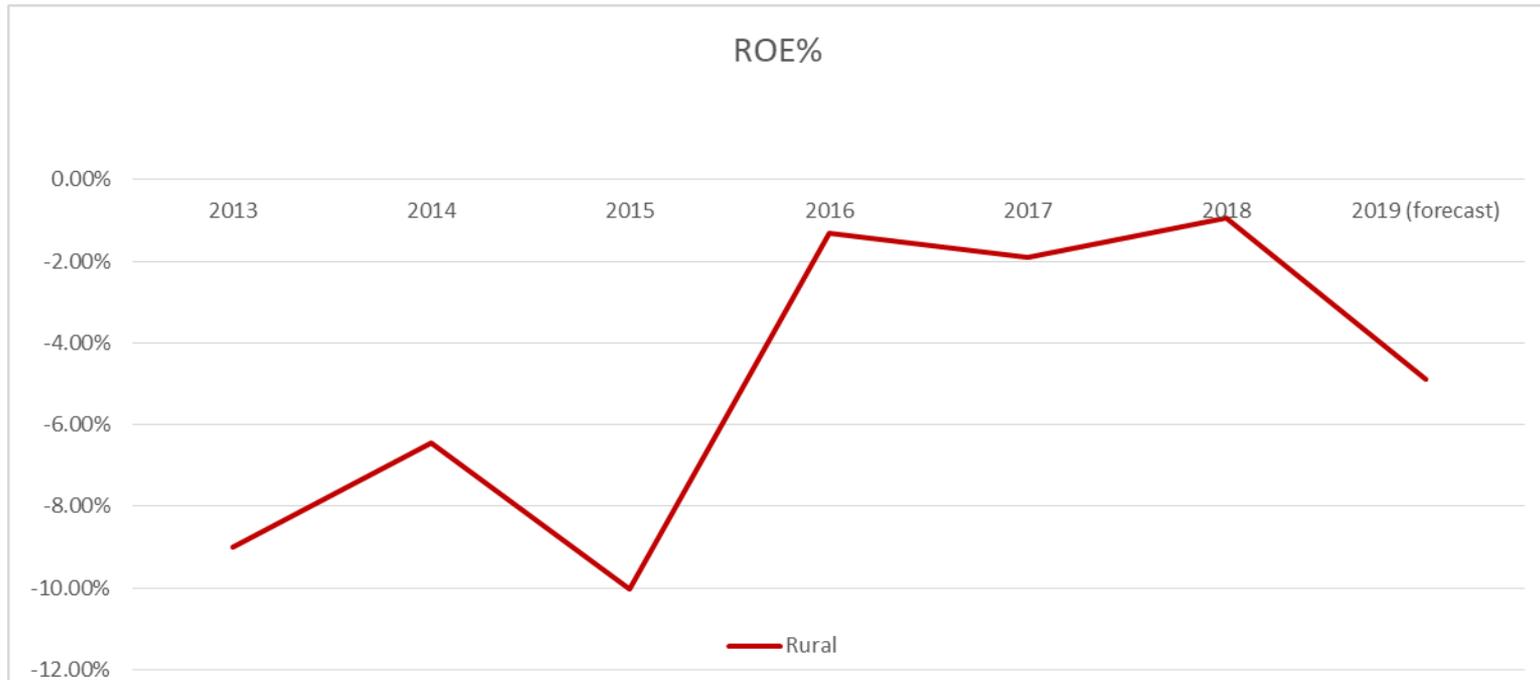
Nelson Hydro's Cost of Service Analysis (COSA)

- Prepared by consultant in December 2018 and filed along with 2019 Rate Application.
- Based on direction from BCUC the results of the COSA has been translated into a standard cost of service approach including adopting the FBC proxy Rate of Return
- COSA shows that under current rates, non-municipal customers are effectively paying no net return to City (and is in fact resulting in a net deficit of revenue compared to allocated costs)



Return on Equity 2013–2019

Non-Municipal



Application of BCUC Directions

	Non-municipal 2018 Act	Required Revenues to meet ROE	Revenue Requirement	Rate Increase Required
Revenues	<u>7,468,220</u>	<u>8,752,651</u>	<u>1,284,431</u>	<u>17.2%</u>
Expenses				
Power Purchases	5,106,242	5,106,242		
O&M Expenses	2,053,004	2,053,004		
Depreciation	348,323	348,323		
Interest exp.	<u>119,786</u>	<u>119,786</u>		
Total Exp.	<u>7,627,355</u>	<u>7,627,355</u>		
Net Profit	<u>(159,135)</u>	<u>1,125,295</u>		
Net Rate Base	<u>12,298,311</u>	<u>12,298,311</u>		
Return on Equity	<u>-1.30%</u>	<u>9.15%</u>		

Strategies to moderate electricity costs to customers

While still being consistent with the Nelson Hydro's Cost of Service Analysis (COSA) and the orders on rates by BCUC, NH is proposing to moderate future rate increases to non-municipal customers through the following actions:

- Adopting the FBC Proxy ROE and not seeking a higher risk based increase at this time.
- No contribution of non-municipal customers to capital reserves
- Increasing non-municipal customer debt to its upper range (up to 25%)



Strategies to moderate electricity costs to customers

- Transmission rate power purchase benefits to all of its ratepayers (15%)
- Implementing programs to mitigate future power purchase cost increases (VOLT VAR)
- Prudent capital asset replacement policies
- Eco-Save program (reduce use)
- Long-term NH rates projected to be $<$ FBC (capital replacement cycle, no deferral accounts, other)



2020 Rate Design Application

Rate Design is the next logical step that comes after the COSA.

Based on the COSA, and consistent with the BCUC's regulatory principles, Nelson Hydro is preparing a Rate Design Application for approval by the BCUC in 2020.

The Application will seek to phase in a rate increase for non-municipal customers to comply with the orders and directions of the BCUC to set rates that are fair to customers and achieve a fair rate of return to the shareholder (The City of Nelson).



Conclusion & Questions

- Nelson Hydro's non-municipal service is subject to regulation from the BCUC.
- The BCUC has provided clear direction and guiding principles with regard to appropriate rate setting.

“What is most important is that a utility receives a rate of return that allows it to continue to exist as well as attract capital and investors while treating ratepayers reasonably.”

See BCUC Order G-119-17.

