

**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER G-84-10**

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IN THE MATTER OF
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473

and

Pacific Northern Gas Ltd. and Pacific Northern Gas (N.E.) Ltd.
Application for Capital Structure and Equity Risk Premium

BEFORE: L.A. O'Hara, Commissioner
M. R. Harle, Commissioner

May 20, 2010

O R D E R

WHEREAS:

- A. By letter dated July 16, 2009, Pacific Northern Gas Ltd. (PNG-West Division) and Pacific Northern Gas (N.E.) Ltd. (Fort St John/Dawson Creek and Tumbler Ridge Divisions) [collectively (PNG)] filed with the British Columbia Utilities Commission (the Commission), an application for Capital Structure and Equity Risk Premium (CAP/ROE Application); and
- B. Specifically, PNG is applying to have the common equity ratio for the PNG-West Division established at 47.5 per cent and to have the common equity ratios for both divisions of PNG (N.E.) set at 42.5 per cent. PNG is also applying to have the rates of return on common equity set at 75 basis points above the Commission's low-risk benchmark utility return on common equity (ROE) for all three divisions; and
- C. Commission Order G-174-08 dated November 27, 2008 determined that the Initial Option Fee and Option Extension Fee related to PNG deactivated assets be reviewed by the Commission as part of the 2009 revenue requirements application. PNG is reapplying in this CAP/ROE Application to recover from the Option Fee and Option Extension Fee the foregone return to date as it believes that it is most efficient to consider this matter during the public hearing into the capital structure and equity risk premium issues; and
- D. PNG requests that the Commission approves a deferral account to record the difference between the approved 2009 cost of service used for rate making purposes and the 2009 cost of service based on the higher common equity thickness and equity risk premium for PNG-West. The CAP/ROE Application also states that PNG (N.E.) is not applying for Commission approval of a common equity deferral account but would do so if there are any adjustments to the benchmark utility ROE in 2009; and

**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER G-84-10**

2

- E. By letter dated August 6, 2009, the Commission replied to PNG and indicated that the Commission would not commence a review of the Application until after the submission of written Arguments in the Terasen Utilities ROE and Capital Structure proceeding then underway; and
- F. By letter dated December 21, 2009, PNG filed its Amendments to the CAP/ROE Application (Amended Application) to reflect the impact of the Commission's determinations in the December 16, 2009 Decision on Terasen Utilities' ROE and Capital Structure Application; and
- G. By Order G-172-09 dated December 24, 2009, the Commission ordered PNG to establish separate deferral accounts for its three divisions to record potential differences in approved cost of service and 2009 cost of service based on higher equity risk premium and equity thickness. The Order also established a Procedural Conference to be held on January 19, 2010; and
- H. By Order G-13-10 dated January 19, 2010, the Commission established a regulatory timetable for a written hearing process but the timetable also provided parties with the opportunity for the review to go to a negotiated settlement process (NSP) if required. By Commission Letter L-28-10 dated April 1, 2010, the Commission accepted the preferences expressed by the major parties and varied the regulatory timetable established in Order G-13-10 to enable an NSP to take place commencing April 26, 2010; and
- I. On February 8 and 9, 2010, negotiations took place in relation to the review of two PNG applications on 2010 revenue requirements for PNG (RR Applications). These negotiations had resulted in two respective agreements for PNG-West and the two divisions for PNG (N.E.); and
- J. The Commission issued Orders G-33-10 and G-34-10 approving respectively the negotiated delivery rates for PNG West and PNG (N.E.) as interim until the review of the CAP/ROE Application is completed. The Interim NSA attached to Order G-33-10 expressly referenced that the issue of the recovery by PNG of legal fees from the MLCI option fees deferral account, the issue of applying the principal balance of the MLCI option fees as a credit to the 2010 cost of service, and the issue of the level of the deferred income taxes draw down in 2010 as issues to be discussed in the context of the CAP/ROE Application; and
- K. The NSP discussions for this CAP/ROE Application took place on April 26 and 27, 2010. A Negotiated Settlement Agreement (NSA) was reached among the participants and circulated to all Registered Interveners and the Commission on May 12, 2010. No comments were received from Interveners who had not participated in the NSP; and
- L. The Commission has reviewed the NSA and considers that approval is warranted.

**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER** G-84-10

3

NOW THEREFORE the Commission orders as follows:

1. The Negotiated Settlement Agreement dated May 6, 2010 and attached as Appendix A to this Order, is approved.
2. PNG will file revised regulatory schedules which would be reviewed and confirmed as part of the process to finalize the interim NSP 2010 revenue requirement Applications settlement agreements approved by Commission Orders G-33-10 and G-34-10.

DATED at the City of Vancouver, in the Province of British Columbia, this 20th day of May, 2010

BY ORDER

Original signed by:

L.A. O'Hara
Panel Chair/Commissioner



WILLIAM J. GRANT
Consultant TO BCUC
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Log No. 32203

VIA EMAIL

May 12, 2010

To: Registered Interveners
(PNG CAP/ROE)

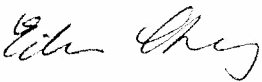
Re: Pacific Northern Gas Ltd. (PNG-West Division) and Pacific Northern Gas (N.E.) Ltd.
(Fort St. John/Dawson Creek and Tumbler Ridge Divisions), [collectively (PNG)]
Project No. 3698566/Order G-172-09
Application for Capital Structure and Equity Risk Premium
Negotiated Settlement Agreement

Enclosed with this letter is the proposed settlement package for the PNG Application for Capital Structure and Equity Risk Premium (CAP/ROE Application).

This CAP/ROE Application settlement package is now public and is being submitted to the Commission and all Interveners. Also enclosed are Letters of Support and Comment received to date from the participants in the negotiated settlement process.

Prior to consideration by the Commission, Interveners who did not participate in the settlement negotiations will be requested to provide to the Commission their comments on the settlement package by Wednesday, May 19, 2010. Thereafter, the Commission will consider the settlement package. A public hearing may not be required unless there is significant opposition to the proposed settlement.

Yours truly,


for and on behalf of
William J. Grant

EC/dg

Attachments

cc: Mr. Craig Donohue
Director, Regulatory Affairs and Gas Supply
Pacific Northern Gas Ltd.
(cdonohue@png.ca)

**Pacific Northern Gas Ltd. (PNG-West Division) and
Pacific Northern Gas (N.E.) Ltd.
(Fort St John/Dawson Creek and Tumbler Ridge Divisions) [collectively (PNG)]**

CAPITAL STRUCTURE AND EQUITY RISK PREMIUM APPLICATION

NEGOTIATED SETTLEMENT AGREEMENT

Introduction

British Columbia Utilities Commission (Commission) staff, representatives of PNG and the British Columbia Old Age Pensioners' Organization *et al.* (BCOAPO) met on April 26 and April 27, 2010 for the purpose of negotiating a settlement of the Capital Structure and Equity Risk Premium Application jointly filed by PNG-West and PNG (N.E.) with the Commission on July 16, 2009 (CAP/ROE Application). The CAP/ROE Application NSP is part of a three stage process as follows:

1. Interim settlement of the PNG-West and PNG (N.E.) 2010 revenue requirements applications (RR Applications) on February 9, 2010.
2. Settlement of the CAP/ROE Application on April 27, 2010.
3. Final settlement of the RR Applications following Commission approval of this CAP/ROE Application Negotiated Settlement Agreement (NSA).

For continuity purposes and to put in context the CAP/ROE Application settlement terms set forth herein, the following reproduces the last two paragraphs of the regulatory process section of the interim NSP 2010 RR Applications settlement agreements:

“Assuming a settlement is negotiated in respect of the CAP/ROE Application, PNG would update its regulatory schedules to reflect both the terms set forth in the interim NSP 2010 revenue requirements settlement agreement and those agreed to under the CAP/ROE Application NSP process. The parties would then meet to ensure there is agreement on the resulting rates for 2010 having regard to the terms agreed to through both NSP processes. If required, the parties would discuss at this meeting the level of deferred income taxes draw down in 2010 and the disposition of the Merrill Lynch option fees deferral account. In addition, other revenue requirements matters of a housekeeping nature primarily resulting from the impact of year end 2009 balances on the 2010 revenue requirements calculation would be confirmed at this final NSP meeting.

The interim NSP 2010 revenue requirements settlement agreement would then be updated to address all items agreed to for the purpose of setting 2010 rates. The final comprehensive agreed to NSP 2010 settlement agreement document would be distributed by Commission staff to the parties for review and comment. The draft NSP 2010 settlement agreement would then be finalized and made available for public comment and review by the RR Application Commission panel. Upon Commission approval of the final NSP 2010 revenue requirements settlement agreement, PNG would file the tariff sheets required to document the agreed to permanent rates effective January 1, 2010.”

This NSA details the agreement between the parties with respect to the CAP/ROE Application.

CONFIDENTIAL
May 6, 2010

The following individuals participated in a negotiated settlement process held in the Commission Hearing Room on April 26 and April 27, 2010:

B. Grant	BCUC facilitator
E. Cheng	BCUC staff
D. Chong	BCUC staff
F. Metcalfe	BCUC contract staff
J. Quail	BCOAPO <i>et al.</i>
E. Kung	BCOAPO <i>et al.</i>
C. Donohue	PNG
K. Teitge	PNG

Context

On July 16, 2009, PNG filed the CAP/ROE Application to have the common equity ratio for the PNG-West division established at 47.5 percent from 40 percent, and to have the common equity ratio for both divisions of PNG (N.E.) set at 42.5 percent from 36 percent. In the Application, PNG also applies to have the rate of return on common equity (ROE) set at 75 basis points above the BCUC low-risk benchmark utility return on common equity for all three divisions. The existing ROE premium is 65 basis points for PNG-West, 40 basis points for Fort St. John/Dawson Creek (FSJ/DC) division and 65 basis points for Tumbler Ridge (TR) division.

In the CAP/ROE Application, PNG also applied for Commission approval so that PNG-West can recover from option fees paid to PNG-West by Merrill Lynch Commodities Inc. (MLCI) and eventually from any annual firm revenue from MLCI the foregone return on facilities previously deactivated.

By letter dated August 16, 2009, the Commission informed PNG that it would not commence review of the CAP/ROE Application until after the filing of written submissions in the proceeding on Terasen Utilities' Application on Return on Equity and Capital Structure (Terasen ROE Application) then underway. The Commission rendered its decision on the Terasen ROE Application on December 16, 2009 and PNG filed amendments with the Commission to its July 16, 2009 Application.

This CAP/ROE Application is reviewed by an NSP pursuant to Commission Order G-13-10 and Commission Letter L-28-10.

Settlement Terms

The settlement terms will be addressed by subject matter in the following order:

- Common Equity Thickness and Equity Risk Premiums
- Common Equity Deferral Accounts
- Foregone Return on Deactivated Assets
- MLCI Option Fees Deferral Account
- Level of PNG-West Drawdown of Deferred Income Taxes
- Other

1.0 Common Equity Thicknesses and Equity Risk Premiums

The parties agreed that the common equity thickness and equity risk premiums for the PNG-West division (effective January 1, 2009) and PNG (N.E.)'s FSJ/DC and TR divisions (effective January 1, 2010) would be as follows:

	PNG-West Division	Fort St. John/Dawson Creek Division	Tumbler Ridge Division
Common Equity Thickness	45 percent	40 percent	40 percent
Equity Risk Premiums	65 basis points	40 basis points	65 basis points

The above parameters are intended to reflect current business, financial and regulatory risks in each service area and should circumstances change, any party may request the Commission to make adjustments accordingly. In this regard, PNG agreed to review the reasonableness of the deemed common equity thicknesses and equity risk premiums no later than 2013. The equity risk premiums are relative to the benchmark utility return on equity (ROE) of 9.50 percent that became effective July 1, 2009 resulting in the following ROE's in 2009 and 2010 for each division:

Year	PNG-West Division	Fort St. John/Dawson Creek Division	Tumbler Ridge Division
2009	9.63 percent	9.38 percent	9.63 percent
2010	10.15 percent	9.90 percent	10.15 percent

The 2009 ROE's are lower than 2010 due to the fact the benchmark ROE of 9.50 percent was made effective July 1, 2009.

2.0 Common Equity Deferral Accounts

The following agreements on the common equity deferral accounts were reached on the understanding they would be reflected in the final NSP 2010 RR Applications settlement agreements. The foregoing recognizes that another party participated in the RR Applications settlement process and the Commission panel that approved the interim NSP 2010 settlement agreements has to approve the final NSP 2010 RR Applications settlement agreements. The parties have made these agreements in order to resolve the NSP process and in recognition of the unique circumstances arising in the present CAP/ROE and RR Applications. They are not intended to establish whether a utility is or should be entitled to defer recovery of its authorized ROE to a future period.

The parties agreed that the year end 2009 balances recorded in the common equity deferral accounts approved by the Commission under Order No. G-172-09 would be determined on the basis of the common equity thicknesses and relative risk premiums agreed to under the CAP/ROE Application NSP settlement agreement. It was noted this would reduce the PNG-West year end 2009 balance from approximately \$1.57 million to approximately \$1.16 million on a before tax basis to reflect the decrease in the applied for common equity thickness from 47.5 percent to 45.0 percent and the decrease in the relative risk premium from 75 to 65 basis points. It was also acknowledged that the year end 2009 figures recorded in the FSJ/DC and TR divisions common equity deferral accounts to reflect the impact of the increase in the benchmark ROE effective July 1,

2009 would not change because they agreed to higher 40 percent common equity thickness for PNG(N.E.)'s divisions is effective January 1, 2010.

The parties discussed the fact the interim rates effective January 1, 2010 are based on forecast 2010 costs of service using common equity thicknesses and ROE's that are less than the agreed to common equity thicknesses and ROE's using the higher benchmark ROE. For this year, it is agreed that the interim rates would be made permanent and the difference between: (i) the 2010 gross margins using the interim rates; and (ii) the costs of service based on the parameters agreed to under this CAP/ROE Application NSP and under the RR Applications NSP 2010 settlement would be recorded in the common equity deferral accounts for future disposition.

PNG will file revised regulatory schedules to show the calculation of the amounts to be recorded in the common equity deferral accounts as a result of making the interim 2010 rates permanent for 2010. The parties agreed the regulatory schedules would be reviewed and confirmed as part of the process to finalize the interim NSP 2010 RR Applications settlement agreements.

3.0 Foregone Return on Deactivated Assets

Under the CAP/ROE Application PNG applied for Commission approval to recover the foregone return to the end of 2010 on the assets that were deactivated when the Methanex Corporation methanol/ammonia complex closed in late 2005. PNG was seeking approval to recover the foregone return out of the \$2.5 million of option fees that MLCI has paid PNG to date. PNG agreed to defer its application for recovery of the foregone return until there is certainty the deactivated assets will be reactivated. The source of funding any potential foregone return on deactivated assets would be decided as part of the process to review any potential foregone return.

4.0 MLCI Option Fees Deferral Account

PNG has recorded \$2.5 million in option fees paid by MLCI to PNG in 2009 in the MLCI option fees interest bearing deferral account. The \$2.5 million was paid for a nine month option ending December 31, 2009 and a six month option ending June 30, 2010. MLCI has yet to advise PNG if the option will be extended for a further six months upon payment of another \$1 million option extension fee due by June 30, 2010. Under the interim NSP 2010 RR Applications settlement agreement, the parties agreed that the imputed interest credit in 2009 and 2010 would be credited to the 2010 cost of service through amortization of the credit interest in 2010. In addition the parties agreed that amortization of any of the principal balance of the MLCI option fees deferral account as a credit to the 2010 cost of service and to be used by PNG to recover its unbudgeted legal fees incurred in respect of the Maverick lawsuit against MLCI would be addressed under the CAP/ROE Application review process. The following sets out the parties' agreement with respect to these matters.

The parties agreed that any recovery of PNG's legal fees from the MLCI option fees deferral account was subject to PNG providing material in confidence to the parties to the CAP/ROE Application NSP settlement discussions that:

- a) Shows PNG used reasonable efforts to recover the legal fees from the parties to the lawsuit provided that any recovery from these efforts would be credited to the legal fees before recovering the balance from the MLCI option fees deferral account; and
- b) Establishes the legal fees were incurred prudently and are reasonable having regard to the legal services provided to PNG.

The parties agreed that PNG may offset the balance in the PNG-West common equity deferral account with the MLCI option fees principal balance at an appropriate time depending on the status of the arrangements between PNG and MLCI. PNG will advise the parties to the NSP settlement discussions and the Commission when PNG decides to do so. The parties agreed that the foregoing is subject to confirmation by the parties that participate in the process to finalize the PNG-West interim NSP 2010 RR Application settlement agreement.

5.0 Level of PNG-West Drawdown of Deferred Income Taxes

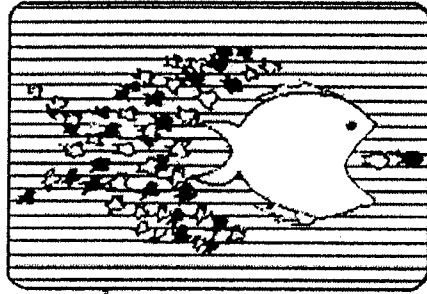
PNG-West has drawn down \$900,000 of deferred income taxes as a credit to income tax expense annually for the past few years. The interim rates effective January 1, 2010 are based on this level of draw down. Given the parties agreement to recommend that the interim rates be made permanent, the parties also agreed to the \$900,000 level of deferred income taxes draw down for 2010. The parties' noted however that the agreement regarding the level of deferred income taxes draw down is subject to confirmation by the parties that participate in the process to finalize the PNG-West interim NSP 2010 RR Application settlement agreement.

6.0 Other

The parties agreed that making the 2010 interim rates permanent was not to be deemed a precedent for rate making purposes. The parties acknowledged that the Commission has the ultimate authority to set rates and the utilization of the common equity deferral accounts and deferred income taxes to enable the interim rates to be made permanent is at the discretion of the Commission.

The
British Columbia
Public Interest
Advocacy Centre

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Valerie Conrad 687-3017
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James L. Quail 687-3034
Ros Salvador 488-1315
Leigha Worth 687-3044

Barristers & Solicitors

Peggy Lee
Article Student

Our file: 7446

May 6, 2010

VIA EMAIL

Erica M. Hamilton
Commission Secretary
BC Utilities Commission
6th Floor - 900 Howe Street
Vancouver, BC V6Z 2N3

BCUC Log # 33551

RECEIVED

MAY 7 2010

Routing _____

Dear Mesdames/Sirs:

Re: PNG (PNG W and PNG NE) Application for Capital Structure and Equity Risk Premium

We are counsel for BCOAPO et al in this proceeding, in which our clients represent the interests of the utility's residential ratepayers. In that capacity, we participated actively in the Negotiated Settlement Process in this matter. We are satisfied that the Negotiated Settlement Agreement draft dated May 5, 2010, fully captures the successful outcome of the NSP in line with the consensus of the participants.

On behalf of our clients we endorse the Negotiated Settlement Agreement and consent to it becoming the substance of an Order of the Commission.

Yours truly,

BC PUBLIC INTEREST ADVOCACY CENTRE

Jim Quail
Executive Director

Encl.



Craig P. Donohue
Director, Regulatory Affairs & Gas Supply

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Via E-Mail and Mail

May 10, 2010

B.C. Utilities Commission
6th Floor - 900 Howe Street
Vancouver, B.C.
V6Z 2N3

File No.: 4.2.23.2

Attention: William J Grant
Consultant to BCUC

Dear Sir:

**Re: Project No. 3698566
PNG-West/PNG(N.E.) CAP/ROE Application
Negotiated Settlement Agreement Confidential Draft dated May 6, 2010**

Further to your e-mail dated May 6, 2010 requesting written confirmation of acceptance of the draft Negotiated Settlement Agreement marked Confidential and dated May 6, 2010 (the "NSA"), Pacific Northern Gas Ltd. hereby confirms its acceptance of the NSA.

Please direct any questions regarding this letter to my attention.

Yours truly,

A handwritten signature in black ink, appearing to read 'C.P. Donohue', written in a cursive style.

C.P. Donohue

cc. BCOAPO – Jim Quail