

Order No. 136/16

**AN APPLICATION BY STITTCO UTILITIES MAN LTD.
NON-COMMODITY COSTS
EFFECTIVE NOVEMBER 1, 2016
INTERIM APPROVAL**

October 27, 2016

**BEFORE: Robert Gabor, Q.C., Chair
Marilyn Kapitany, B.Sc., (Hon), M.Sc., Member**

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1.0 EXECUTIVE SUMMARY

By this Order, The Public Utilities Board (Board) approves the non-commodity rates for Stittco Utilities Manitoba Ltd. (Stittco) effective November 1, 2016 on an interim basis. Non-commodity rates will decrease by approximately 0.7% effective November 1, 2016.

Non-commodity costs include costs incurred by Stittco for the distribution of propane to customers. In accordance with Board Order 141/08, non-commodity costs are reviewed annually and recovered in rates through a basic monthly charge and a delivery charge. Delivery charges are assigned based on a customer's monthly consumption of propane.

The Board accepts Stittco's projected annual non-commodity cost of \$2,037,657 for the year ending July 31, 2017. This is an increase of \$26,478 over the last non-commodity cost approved by the Board in Order 106/15 which was \$2,011,179.

The Board also approves Stittco's rate base of \$2,229,502 which is an increase of \$258,047 from \$1,971,455 approved in Order 106/15. Rate base is the value of property upon which the utility is allowed to earn a specified rate of return. The Board will approve a rate of return of 10% on Stittco's rate base.

The Board notes that customer distribution rates for the years ending July 31, 2014 through 2016 may have been higher than necessary due to an error in the calculation of annual revenues from basic monthly charges. The Board will require Stittco to file a schedule of what distribution rates should have been for the years ending July 31, 2014, 2015 and 2016 and corresponding amounts of customer overpayment charges to the residential and commercial customer. Stittco is also asked to file what their return on rate base would have been for each of these years with corrected distribution rates. This information should be filed with the Board by November 14, 2016. Upon receipt of this information, the Board will determine how it wishes to proceed.

Propane commodity costs are set quarterly, pursuant to the Board approved Quarterly Rate Setting (QRS) process. Commodity costs, including transportation to Thompson, are passed on to customers with no mark-up. Variances are tracked in a Propane

Purchase Variance Account (PPVA), and are either refunded to customers (when rates charged are higher than the actual cost of propane) or collected from customers (when rates charged are lower than actual cost of propane). The PPVA is reviewed at each quarterly rate setting application.

The table below compares the propane commodity and non-commodity rates over the last year and provides the revised non-commodity rates effective November 1, 2016:

Table 1 Non-commodity rates - 12 month history					
	Nov 1/15	Feb 1/16	May 1/16	Aug 1/16	Nov 1/16
Basic Monthly Charge	\$10.00	\$10.00	\$10.00	\$10.00	\$10.00
Volumetric Charges per m³:					
Commodity Cost Recovery	\$0.4646	\$0.4646	\$0.5322	\$0.7037	\$0.9731
Non-Commodity Cost Recovery - Delivery Charge (monthly volumes)					
first 100 m ³	\$1.40555	\$1.40555	\$1.40555	\$1.40555	\$1.3960
next 400 m ³	\$1.25358	\$1.25358	\$1.25358	\$1.25358	\$1.2450
next 1000 m ³	\$1.18618	\$1.18618	\$1.18618	\$1.18618	\$1.1781
next 2500 m ³	\$0.96097	\$0.96097	\$0.96097	\$0.96097	\$0.9544
over 4000 m ³	\$0.73723	\$0.73723	\$0.73723	\$0.73723	\$0.7322

- Notes to Table: 1/ Non-Commodity costs for November 2015 and February, May and August of 2016 were approved in Board Order 106/16
2/ The Commodity cost for November 1, 2016 was approved in Board Order 135/16

2.0 INTRODUCTION

On July 14, 2016 Stittco applied to the Board seeking approval for an approximate 0.68% decrease in rates for the recovery of non-commodity costs effective November 1, 2016.

Non-commodity costs are costs incurred by Stittco for the distribution of propane to its customers. These costs include operating expenses (salaries, materials and supplies, administrative costs, etc.), depreciation, a provision for corporate income tax and a return on Stittco's rate base for its owners.

The Board last approved non-commodity rates by Order 106/15 issued on October 29, 2015.

Stittco's non-commodity rate application for the year ending July 2017 was managed using a paper-based review process to minimize regulatory costs to the utility and to Stittco customers. Customers were advised of Stittco's Application in August of 2016 by including the Board's Public Notice of proposed non-commodity rate revisions in Stittco's August billings. The Board did not receive any oral or written customer responses from the Public Notice.

Commodity rates for propane are adjusted quarterly using the Quarterly Rate Setting (QRS) process approved by the Board in Order 141/08 and 45/09. The QRS adjusts Stittco's commodity price for propane August 1, November 1, February 1, and May 1 of each year.

Variations between actual propane costs and estimated propane costs embedded in commodity rates are tracked in a Purchase Price Variance Account (PPVA) and either refunded to customers (when rates charged are higher than the actual cost of propane) or collected from customers (when rates charged are lower than the actual cost of propane). Regular adjustments to commodity prices help to minimize balances in this account.

Rates established by the QRS are approved on an ex parte basis. That means that they are established by the Board without further public consultation, subject to satisfactory information being filed by Stittco. This approach is considered to be the most reasonable and economical, as the changes are driven by commodity price changes and the process minimizes regulatory costs while providing regular updated price signals to consumers. These Interim Commodity rates for propane are reviewed and finalized annually when Stittco files its Non-Commodity application.

On October 17, 2016 Stittco applied to the Board for an increase of the propane commodity rates from \$0.7037/m³ to \$0.9731/m³. Board Order 135/16 approved the propane commodity rate increase.

3.0 STITCO OPERATIONS

Stittco Utilities Manitoba Inc. distributes propane through a pipeline distribution network to approximately 840 customers in Thompson, Flin Flon and Snow Lake, Manitoba. Bulk propane is supplied from Edmonton and is shipped to Stittco's storage facilities by rail or by truck.

Stittco's historical and projected propane sales base is described in the table below:

Propane sales- historical and projected					
		Residential	Commercial	Total	Change
2009	Customers	784	166	950	
	Propane Volumes	2,161,828	6,468,853	8,630,681	
2010	Customers	770	164	934	-1.7%
	Propane Volumes	1,735,190	5,365,294	7,100,484	-17.7%
2011	Customers	749	163	912	-2.4%
	Propane Volumes	1,864,586	5,230,726	7,095,312	-0.1%
2012	Customers	740	162	902	-1.1%
	Propane Volumes	1,663,000	5,207,000	6,870,000	-3.2%
2013	Customers	732	163	895	-0.8%
	Propane Volumes	1,865,000	5,324,100*	7,189,100*	4.6%
2014	Customers	690	153	843	-5.8%
	Propane Volumes	1,810,000	5,280,000*	7,090,000*	-1.4%
2015	Customers	690	153	843	0.0%
	Propane Volumes	1,589,000	4,943,000	6,625,000	-6.6%
2016	Customers	690	153	843	0.0%
	Propane Volumes	1,707,000	5,016,000	5,867,000	1.5%
2017	Customers	690	153	843	0.0%
	Projected Propane Volumes	1,543,350	5,003,800	6,547,300	10.4%

* increase in volume due to colder weather

As can be seen from the table, since 2009 to 2014 the number of customers, and corresponding propane volumes, has generally been declining. Since 2014 the number of Stittco residential and commercial customers has remained constant; the corresponding propane volumes have varied largely due to weather-related circumstances.

Historically, residential customers have accounted for approximately 25% of the overall propane volumes sold by Stittco, with commercial customers accounting for the remaining 75%.

The commercial customer numbers declined significantly in 2014 as a result of the conversion of several apartment buildings to electrical heat and the closing of a large commercial business. The residential decline has generally been attributed to the difference in cost between heating with propane versus heating with electricity.

4.0 APPLICATION

Non-Commodity Rates

On July 14, 2016 Stittco applied to the Board for an Order fixing non-commodity distribution rates for all gas customers served by Stittco for propane consumed on or after November 1, 2016.

The application requested the following from the Board:

- a) Approval of the non-commodity cost revenue requirement of the company;
- b) Approval of the rate base of Stittco of \$2,229,502.

In its application, Stittco noted the most recent Board Order relating to non-commodity costs was Board Order 106/15 dated October 29, 2015. This Order determined the non-commodity revenue requirement of the company and finalized non-commodity rates effective November 1, 2015.

In Board Order 141/08, the Board stated:

Going forward, subsequent to the Board finalizing the rate schedule now set on an interim basis, the Board anticipates that future rate reviews will also be handled by the Board's paper-based process. For the annual non-commodity review, the Board will expect Stittco to issue a notice to its customers concurrent with providing the Board with its application, that notice to be pre-vetted by the Board and to provide for customers with concerns writing the Board. Quarterly commodity rates changes will be reviewed by the Board and

communicated to customers by Stittco in accordance with future directions of the Board.

In accordance with Board Order 141/08, the Board decided to review the non-commodity cost application using a paper-based process.

Stittco customers were notified of the proposed non-commodity cost rate increase by including the Board's Public Notice in Stittco's August 2016 billings to customers for July propane consumption. Customers were advised that they could contact either Stittco or the Board to review Stittco's Application and to express their concerns. The Board did not receive any oral or written communication from the public regarding Stittco's Application.

On September 1, 2016, the Board submitted Information Requests to Stittco; Stittco responded on September 13, 2016.

On October 7, 2016 the Board submitted a second round of Information Requests that sought further clarification of selected Round 1 Information Requests. Stittco responded on October 13, 2016.

The table below summarizes Stittco's projected non-commodity revenue requirement for the year ending July 31, 2017 and compares it to non-commodity costs approved in Board Order 106/15 for the year ending July 31, 2016.

Table 1: Stittco's Non-Commodity Revenue Requirement

	Stittco's Application Jul-16	Approved From Board Order 106/15	Increase Decrease
Wages & Benefits	827,200.00	800,067.00	27,133.00
Materials and Supplies	57,800.00	57,800.00	0.00
Contract Services	105,500.00	107,600.00	-2,100.00
Other Operating Costs	106,000.00	113,818.00	-7,818.00
Automotive	61,200.00	69,960.00	-8,760.00
Insurance	13,000.00	41,568.00	-28,568.00
Property Taxes	115,000.00	120,000.00	-5,000.00
Administrative & General	240,100.00	250,600.00	-10,500.00
Total Direct	1,525,800.00	1,561,413.00	-35,613.00
Administration Fee	183,096.00	187,370.00	-4,274.00
Sub-Total Direct Operating Costs	1,708,896.00	1,748,783.00	-39,887.00
Other Cost of Sales	100,750.00	120,000.00	-19,250
Depreciation	112,436.00	103,364.00	9,072.00
Accretion	27,000.00	27,560.00	-560.00
Return on Rate Base	222,950.00	197,145.00	25,805.00
Income Tax Requirement	102,225.00	88,927.00	13,298.00
Other Income	-236,600.00	-274,600.00	38,000.00
Sub-Total Other Costs	328,761.00	262,396.00	66,365.00
Non-Commodity Revenue Requirement	2,037,657.00	2,011,179.00	26,478.00

The total non-commodity revenue requirement is expected to increase by \$26,478 over the currently approved costs.

Operating Costs

The largest increase in projected non-commodity costs is for wages and benefits. Wage and benefit costs have risen from \$800,067, as approved in Board Order 106/15, to \$827,200 projected to July 31, 2017. Projected wage and benefit costs to July 31, 2017 are \$649,000 in wages \$178,200 in benefits. Actual wage and benefit costs projected to July 31, 2016 are \$802,973 consisting of \$631,343 in wages and \$171,630 in benefits. This amounts to a projected increase in wages of approximately 2% above projected amounts for 2016. Overall, wages and benefits are expected to increase by 3.39% when compared with Board Order 106/15. The table below summarizes Stittco's wages and benefits.

Table 2: Stittco Wages and Benefits

	PUB Order 106/15	10 Month Actuals and 2 Months budget to July 31, 2016	2017 Projected To July 31, 2017
Wages	\$635,165	\$631,343	\$649,000
Benefits	\$164,902	\$171,630	\$178,200
Totals	\$800,067	\$802,973	\$827,200

One of the largest operating cost reductions has been insurance costs. These costs have fallen from \$41,568, as approved in Board Order 106/15, to \$13,000. This amounts to a savings of \$28,568. Stittco attributes this reduction in insurance costs to Stittco now being part of the Gibson "family". On April 1, 2014 Gibson acquired all the outstanding shares of Stittco Energy. As a large midstream energy company, Gibson has greater flexibility in negotiating corporate insurance requirements.

Administrative and general costs are also projected to decline by approximately \$10,500 over that approved in Board Order 106/15. These savings are attributable to a reduction in regulatory costs of approximately \$3,500, a reduction in the allowance for bad debt of \$5,000 and utility savings of approximately \$5,900.

Stittco's total operating costs are therefore projected to decline by approximately \$39,887 as shown in Table 1.

Rate Base and Rate of Return

Rate base is the value of property upon which the utility is allowed to earn a specified rate of return. The Board approved a 10% rate of return for Stittco's fiscal year ending July 31, 2016. The Stittco projected mid-year rate base for 2016 approved in Board Order 106/15 was \$1,971,455. Stittco's projected mid-year rate base for 2016 1,790,460. The rate base for 2016 was lower than the initial projections as upgrades to the rail unloading system were not complete before July 31, 2016. Stittco's replacement of the rail unloading towers is scheduled for completion in the fall of 2016.

The total estimated capital cost of the loading towers was forecast at \$500,000 in 2015. This cost has now increased by \$150,000 due to additional foundation enhancements at the rail unloading facility and piping upgrades and supports to connect the rail tower, storage tanks and compressor buildings. Stittco is also budgeting \$50,000 in capital improvements to the propane vaporizer and pumps.

Stittco's projected mid-year rate base is now \$2,229,502 as summarized in Table 3 below.

Table 3: Stittco's Rate Base

	PUB ORDER NO. 106/15	2016 PROJECTED	2017 PROJECTED
PLANT IN SERVICE			
Beginning Year Balance	\$4,991,963	\$4,991,963	\$5,421,200
Additions, Net	\$580,400	\$429,238	\$295,000
End of Year Balance	<u>\$5,572,363</u>	<u>\$5,421,200</u>	<u>\$5,716,200</u>
Average, Mid-year	\$5,282,163	\$5,206,582	\$5,568,700
ACCUMULATED DEPRECIATION			
Beginning Year Balance	\$3,996,607	\$3,996,607	\$4,099,060
Additions, Net	\$103,364	\$102,454	\$112,436
End of Year Balance	<u>\$4,099,971</u>	<u>\$4,099,060</u>	<u>\$4,211,496</u>
Average, Mid-year	\$4,048,289	\$4,047,833	\$4,155,278
AVERAGE MID-YEAR NET PLANT IN SERVICE	\$1,233,874	\$1,158,748	\$1,413,422
WORKING CAPITAL	<u>\$737,581</u>	<u>\$631,712</u>	<u>\$816,079</u>
MID-YEAR RATE BASE	\$1,971,455	\$1,790,460	\$2,229,502

Stittco continues to seek a 10% return on the projected rate base. This would result in a revenue requirement of \$222,950 for 2017. Stittco holds the view that given the investment risk, an appropriate rate of return would be significantly higher than the approved 10%. However, Stittco acknowledges that it operates in a very competitive market in a small service area. Stittco's primary competition is from customer's who may choose electricity as their option for space heating rather than propane.

In recent years, Stittco's actual returns have generally been less than the 10% return provided for in rates. Stittco's return on rate base for the past ten years is provided in the chart below:

Table 4: Stittco's Rate of Return – 10-year History

Rate of return- 10 year history				
Year	Mid – Year Rate Base	Actual Return (Loss)	Actual % Return	Normalized % Return*
2015	\$1,558,335	\$190,269	12.21%	11.37%
2014	\$1,747,229	\$235,826	13.50%	7.93%
2013	\$1,733,284	\$258,248	14.90%	13.78%
2012	\$1,953,864	\$67,310	3.44%	10.02%
2011	2,051,484	111,698	5.44%	6.72%
2010	1,980,700	(160,751)	(8.12)%	(0.48)%
2009	2,009,574	112,030	5.57%	4.10%
2008	2,138,167	(11,520)	(0.54)%	(1.99)%
2007	1,927,450	(88,036)	(4.57)%	(0.81)%
2006	1,937,865	(93,102)	(4.80)%	0.03%
2005	1,929,813	83,480	4.33%	4.76%

* adjusted to eliminate variances due to weather fluctuations

Stittco's projected return for the year ending July 31, 2016 is \$135,122 for a return on a mid-year rate base of 7.55%.

5.0 BOARD FINDINGS

Non-commodity Costs

The Board has reviewed Stittco's Application for non-commodity costs for the fiscal year ending July 31, 2017, as well as Stittco's responses to interrogatories posed by the Board.

The Board will approve Stittco's non-commodity revenue requirement of \$2,037,657 for the year ending July 31, 2017. The Board finds Stittco's non-commodity revenue requirement to be reasonable. The Board is encouraged by the reduction in projected operating costs and would encourage Stittco to find future labour cost savings. Stittco has stated that the integration of Stittco with Gibson's Network has created the opportunity for management Synergies and more effective business systems. The Board expects to see the outcome of these synergies through reduced labour and administration costs in the coming year. Stittco's next non-commodity cost application (expected in July of 2017) should demonstrate further reductions in operating costs from these synergies.

Return on Rate Base

The Board agrees that Stittco should receive a reasonable return on its investment. The Board will therefore approve Stittco's rate base of \$2,229,502 and a 10% return on rate base amounting to \$222,950 in non-commodity cost revenue requirement. The Board finds that the necessary capital expenditures for improvements to the rail towers to be reasonable along with the additional foundation and piping costs.

Distribution Rates

The Board notes that non-commodity cost revenue requirements have increased from \$2,011,179 in Board Order 106/15 to \$2,037,657 in this application for the year ending July 31, 2017. Despite this increase in revenue requirement, Stittco's proposed distribution rates have decreased approximately 0.68%. One of the reasons for the decrease in distribution rates is attributed to an error by Stittco in the calculation of customer revenues from the \$10 basic monthly charge. Previous non-commodity applications had estimated basic monthly charge annual revenues in the order of \$10,000. Actual annual revenue from the basic monthly charge is in the order of \$95,780. When calculating revenue requirements from distribution rates, the annual revenue requirement from the basic monthly charge needs to be subtracted from the overall non-commodity revenue requirement to arrive at the distribution rate revenue requirement used in the setting of distribution rates. The table below shows the calculation.

Table 5: Calculation of Distribution Revenue

Non-Commodity Annual Revenue Requirement from current application	\$2,037,657	\$2,037,657
Annual Revenue from Basic Monthly Charges	\$10,000 (incorrect annual revenue used in historic non-commodity applications)	\$95,780 (correct annual revenue used in current application)
Annual Revenue Requirement from Distribution Rates	\$2,027,657	\$1,941,877

As can be seen from the table above, if the historic annual revenue requirement of \$10,000 from the basic monthly charge is used, then the revenue requirement in distribution rates would be overstated by the difference between \$2,027,657 and \$1,941,877 or \$85,780 ($\$2,027,657 - \$1,941,877 = \$85,780$). This error has been found in Stittco's applications for the years ending July 31, 2014, 2015 and 2016. The current application has corrected the error for revenue requirements ending July 31, 2017.

Stittco's actual returns are highlighted in Table 3 for the last 10 years. As can be seen from the Table, Stittco's actual returns for the years ending July 31, 2014, 2015 exceeded the allowed rate of return of 10%. Stittco's 2014 and 2015 actual return on rate base was 13.50% and 12.21 %. Stittco's actual projected return on rate base for the year ending July 31, 2016 is approximately 7.55%.

Actual financial results for Stittco can vary for a number of reasons such as the number of customers, the adoption of energy efficiency measures, and the customer's personal heating expectations. One of the larger impacts to financial results however is weather. Colder weather will result in increased revenues and corresponding returns on rate base. Stittco's "normalized" returns on rate base are also provided in Table 3 which reflects returns on rate base for "normal" weather conditions.

The Board is concerned that customer distribution rates for the years ending July 31, 2014 through 2016 may have been higher than necessary due to the error in annual revenues from basic monthly charges. Under normal weather conditions, revenue from distribution rates may have been in the order of \$86,000 more per year than what they should have been during these years. Stittco reported actual returns on rate base greater than the Board's approved 10% in the years ending July 31, 2014 and 2015 (13.50% and 12.21%) and is projecting an annual return of 7.55% in 2016.

The Board will require Stittco to file a schedule of what distribution rates should have been for years ending July 31, 2014, 2015 and 2016 and corresponding amounts of customer overpayment charges. The filing should break down overpayments by both commercial and residential customer classes. The average annual residential overpayment should also be provided. Stittco is also asked to file what their return on rate base would have been for each of these years with corrected distribution rates. This information should be filed with the Board by November 14, 2016. Upon receipt of this information, the Board will determine how it wishes to proceed. The Board will also require Stittco to file its management system used in the preparation and quality control of its Non-Commodity rate application.

As the current application has corrected the error in annual revenue in basic monthly charge, and corresponding distribution system rates, the Board will approved these rates on an interim basis until such time as the Board receives the requested information from Stittco.

Commodity rates

The quarterly rate setting process for commodity costs appears to continue to serve customers well, with the periodic rate adjustment helping to mitigate rate shock due to fluctuating commodity market prices. The Board continues to recommend that customers seek ways to upgrade the heating efficiency of their premises, so as to reduce consumption, bills and carbon emissions.

Board decisions may be appealed in accordance with the provisions of Section 58 of *The Public Utilities Board Act*, or reviewed in accordance with Section 36 of the Board's Rules of Practice and Procedure. The Board's Rules may be viewed on the Board's website at www.pub.gov.mb.ca.

6.0 IT IS THEREFORE ORDERED THAT:

1. Stittco Utilities Manitoba Ltd's rates for distribution costs, as per Schedule "A", for consumption on or after November 1, 2016, **BE AND ARE HEREBY APPROVED ON AN INTERIM BASIS.**
2. Stittco Utilities Manitoba Ltd's rate base of \$2,229,502 for the year ending July 31, 2017 **BE AND IS HEREBY APPROVED ON AN INTERIM BASIS.**
3. Stittco Utilities Manitoba Ltd file a schedule of what distribution rates should have been for the years ending July 31, 2014, 2015 and 2016 when corrected for the error in basic monthly charges for these years and include corresponding amounts of customer overpayment charges for both the residential and commercial customer. Stittco is to also file what their return on rate base would have been for each of these years with corrected distribution rates. This information should be filed with the Board by November 14, 2016.
4. Stittco is to provide a description of its management system used in the design and submission of its Non-Commodity Cost Application to the Board. The management system description is to include Quality Control measures implemented by Stittco to check for accuracy of all information provided to the Board. This information should be filed by November 14, 2016.

THE PUBLIC UTILITIES BOARD

"Robert Gabor Q.C."
Chair

"Kurt Simonsen"
Acting Secretary

Certified a true copy of Order No. 136/16
issued by The Public Utilities Board

Acting Secretary

SCHEDULE " A "

GENERAL SERVICE RATE STRUCTURE

EFFECTIVE FOR CONSUMPTION ON OR AFTER NOVEMBER 1, 2016

Basic Monthly Charge	\$10.00
Volumetric Charges per m³:	
Commodity Cost Recovery	\$0.9731*
Non-Commodity Cost Recovery-Delivery Charge (monthly volumes):	
first 100 m ³	\$1.3960
next 400 m ³	\$1.2450
next 1000 m ³	\$1.1781
next 2500 m ³	\$0.9544
over 4000 m ³	\$0.7322

* Commodity Cost approved per Board Order 135/16