Direct Examination of Andrew McLaren

On behalf of the Industrial Gas Users (IGU)
August 16, 2019

Introduction

- Evidence comprises IGU Exhibits:
  - IGU-10 – Pre-filed Testimony of Andrew McLaren
  - Responses to information requests from the PUB (PUB-18-14 to PUB-18-22), Centra (Centra-25 and Centra-28) and CAC.

- This direct testimony addresses issue 17 from Order 98/19:
  - “Cost of Service Study Results – limited to options for bill mitigation based on the currently approved and utilized methodology, including the issue of the heating value margin deferral.”

Approach

- Bill mitigation options are considered in the context of the currently available and approved cost of service methodology.

- It is necessary to understand and have confidence in the overall level of revenue requirements and methods for allocating costs to customers before addressing options to mitigate bill increases to customers.

- Several options have been discussed in the current proceeding including:
  - Changes to the allocation of balances in the Heating Value Deferral Account
  - Adoption of a “zone of reasonableness” (ZOR)
  - Deferral of costs related to transmission capital additions for recovery over time.

Heating Value Deferral Account

- Purpose is to keep Centra and its customers whole with respect to non-gas revenue which would otherwise be affected by variations in the heating content of natural gas. (IGU/CENTRA I-27 a).

- Centra's revenue risk is different for different classes of customers as a result of the different rate designs for each class.

- Centra currently allocates balances in the account to customer classes based on actual volumes for each customer class (IGU/CENTRA I-27 (c)).

- The current approach does not consider the differences in rate structures and related revenue risk exposure.

Heating Value Deferral Account Options

- Christensen Associates report recommended that Centra include only customers with monthly bills that are determined according to energy sales volumes. Centra accepted this recommendation and stated the Special Contract customer should not participate in the disposal of the heating value deferral in a report dated July 19, 2012.
  - This approach would address the fact that the Special Contract class rates comprise almost entirely a customer charge.
- CAC evidence suggests potentially eliminating the Heating Value Deferral Account (page 119 of Exhibit CAC-8).
  - This approach would eliminate the problem of matching the allocation of the balances in the account to the revenue risk profile of the different customer classes.

Heating Value Deferral Account Options

- IGU-McLaren evidence suggests weighting the allocation based on non-gas volumetric revenues. Centra agreed this approach may have merit in rebuttal and provided illustrative calculations of this approach. (pages 7 and 8 of Ex Centra-33).

		Total	SGS	LGS	HVF	ML	INT
Heating Value allocated	($)	3,859,713	1,253,019	995,043	391,710	276,483	86,010
based on each class volumes	(%)		32%	26%	10%	7%	2%
Heating value allocated	($)	3,859,713	2,755,195	987,609	95,798	7,776	13,336
based on class volumetric revenue	(%)		71%	26%	2%	0%	0%
Difference		0	1,502,176	(7,434)	(295,912)	(268,707)	(72,674)

- Summary: The Board should direct Centra to change how it allocates the balances in the Heating Value Deferral Account. At a minimum the Board should direct Centra to remove the Special Contract class from the calculation. The Board may also consider allocating the balance on the basis of non-gas volumetric revenues.

Zone of Reasonableness (ZOR)

Adopting a ZOR for setting rates based on a cost of service study (COSS) may be done for several reasons.

- Acknowledge use of estimates and assumptions in cost of service study:
  - "While the results of a COSS appear to be arithmetically exact, a COSS involves considerable judgment." (pg 18, Board Order 164/16)
  - "Due to the inherent lack of precision in a Cost of Service Study, a zone of reasonableness is used to target the Revenue Cost Coverage ratios of the customer classes. The Board has approved the use of a zone of reasonableness of 95-105% in assessing the Revenue to Cost Coverage ratios of Manitoba Hydro's customer classes. Revenues that are within this range are deemed to represent full cost recovery." (pg 31, Board Order 69/19).

- Reflect level of confidence in existing COSS:
  - Following a directive to Manitoba Hydro to undertake a study to address certain COSS issues, the Board directed Manitoba Hydro in 1996 to assume a ZOR target of 95-105, narrower than the 90-110 range in prior to that time. (pgs 38 & 41, Order 51/96)

- Address goals of gradualism in ratemaking process (pg 24, Board Order 164/16)

Zone of Reasonableness (ZOR)

- Manitoba PUB has recognized a ZOR of 0.95 to 1.05 for Manitoba Hydro (pg 24 of Order 164/16). Prior to 1996, the ZOR was 90% to 110% (pg 38 of Order 51/96).

- Other natural gas utilities also adopt a ZOR for setting rates based on COS results.

- The Board has stated "…consideration of RCC ratios is a **rate design matter** that should be addressed in the rate-setting phase of a GRA." (Page 27, Order 164/16). (emphasis added).

- Conclusion: It is reasonable for the Board to adopt a ZOR for rate-setting purposes in the current proceeding. This does not require the Board to change anything about Centra's current COSS methodology.

Zone of Reasonableness (ZOR)

- Current Centra COSS is at odds with more recent principles adopted by the Board:
  - The Board found in Decision 164-16 (page 27) that:
    - "…the principle of cost causation is paramount. Further, the Board finds that ratemaking principles and goals should not be considered at the COSS stage."
    - "…ratemaking principles and goals of rate stability and gradualism, fairness and equity, efficiency, simplicity and competitiveness of rates should be considered in a GRA and not in the COSS."
  - This is in contrast to the current Centra COSS methodology which explicitly includes non-cost causal factors, particularly in the use of the peak and average methodology.

Zone of Reasonableness (ZOR)

- Differences in the COSS methods can drive large changes in RCC ratios (PUB-IGU (McLaren)-22).

Line No.		Total	SGS	LGS	HVF	COOP	ML	SC	GS	INT
1	Non-Gas Cost of Service Peak and Average (Existing Method)	148,519,256	102,632,670	32,455,799	6,824,301	8,233	2,057,841	2,246,833	157,798	769,561
2	Non-Gas Cost of Service Coincident Demand Method	148,519,256	104,058,421	33,242,324	6,274,507	8,500	1,579,764	1,499,964	186,485	303,072
3	Non-Gas Revenues at existing rates	152,524,872	109,941,344	30,132,872	6,274,676	8,024	1,484,485	1,385,423	236,483	845,414
4	RCC Ratio - Existing method	103%	107%	93%	92%	97%	72%	62%	150%	110%
5	RCC Ratio - Coincident Demand Method	103%	106%	91%	100%	94%	94%	92%	127%	279%

Note:
Excludes confidential information for Primary Gas, Firm Supplemental, Interruptible Supplemental and Fixed Price offering.
This does not affect other numbers in this table.

- Conclusion: The Board cannot have confidence that the current COSS reasonably reflects the cost of service principles adopted by the Board in Decision 164-16.

Zone of Reasonableness (ZOR)

- Board has precedent it can refer to in how to proceed when a utility's COSS is in a state of flux:
  - In Order 143/04 (page 96) the Board stated: "Because the COSS methodology is in a current state of flux, and in the Board's view incomplete, the Board can no longer rely on the current methodology in assessing the revenue to cost coverage rates for each customer class." The Board ordered equal percentage rate increases to all customers. (pg 6 of Order 143/04).

  - The Board has also previously used a wider ZOR for Manitoba Hydro (90-110).

  - <u>Conclusion:</u> Given the current inconsistencies between the COS principles adopted by the Board and Centra's existing COS methods the Board should not adjust rates to reflect RCC ratios at this time. Alternatively, the Board should expand the ZOR beyond the 95 to 105 range to acknowledge these inconsistencies.

Deferral Account for Transmission Costs

- CAC evidence describes potential deferral approach or transmission assets for large volume customers.

- If Board adopts the other IGU recommendations need for this option is reduced.