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Craig P. Donohue
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Via Courier

December 21, 2009

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

File No.: 4.2.23.2

Attention: Erica M. Hamilton
Commission Secretary

Dear Sir:

Re: Adjustments to Pacific Northern Gas Ltd. and Pacific Northern Gas (N.E.) Ltd. Capital Structure and Equity Risk Premium Application dated July 16, 2009 ("CAP/ROE Application") to Reflect the Commission's Decision on Terasen's Return on Equity and Capital Structure Application (the "Terasen Decision")

The purpose of this letter is to set out the adjustments PNG considers need to be made to its CAP/ROE Application to reflect the impact of the findings by the Commission in the Terasen Decision. At page 67 of the Terasen Decision the Commission stated:

> "**The effect of this determination will result in the ROE for TGI for 2009 being 8.47 percent for 6 months and 9.50 percent for six months or an average annual ROE of 8.98 percent**,"

The Commission also stated at page 80 of the Terasen Decision that:

> "**there is no reason on the record in this proceeding suggesting that the use of a Benchmark ROE is not in the public interest. Accordingly the Commission Panel determines that the ROE for TGI it has determined in this proceeding should continue to serve as the Benchmark ROE for FortisBC and any other utility in BC that uses the Benchmark ROE to set rates.**"

It should first be noted that the above Commission findings will not require any modifications to the evidence of Ms. McShane filed in support of her conclusion that:

> "Based on my analysis and judgment, the proposed equity ratios for PNG-West of 47.5% and for PNG (N.E.) of 42.5% are reasonable. At the proposed common equity ratios, incremental equity risk premiums of 0.75% relative to the benchmark utility ROE for both PNG-West and PNG (N.E.), both the Fort St. John/Dawson Creek and Tumbler Ridge divisions are warranted in light of their total (business plus financial) risks."
> (see page 37 of Ms. McShane's evidence)

The impacts of the Terasen Decision on the CAP/ROE Application are discussed below in respect of each of PNG's operating divisions.

PNG-West Division

For ease of reference the section on the PNG-West Division on page 6 of the CAP/ROE Application is reproduced below to put the required adjustments to this section in proper context.

> "PNG has rerun its 2009 revenue requirements model to show the impact on the approved NSP 2009 cost of service of increasing the common equity thickness from 40 to 47.5 percent in the PNG-West capital structure together with a 10 basis points increase in the equity risk premium (i.e. 65 to 75 basis points) relative to the benchmark utility ROE approved for 2009 under the Commission's automatic ROE setting mechanism. The first page under Tab 2 compares the approved NSP 2009 cost of service to the corresponding cost of service reflecting the recommended common equity thickness of 47.5 percent and equity risk premium of 75 basis points. The increase from NSP 2009 to that proposed by PNG totals $1.114 million. Regulatory Schedules 1 to 5 are provided under Tab 2 showing the details of the adjusted 2009 cost of service. PNG is seeking Commission approval of a deferred return on common equity deferral account to record the difference of $1.114 million for future recovery from customers. Similarly, if the benchmark utility ROE is adjusted in 2009, then PNG would calculate the impact of this change on the NSP 2009 cost of service and record the result in the deferred return on common equity deferral account as well."

PNG has rerun its 2009 revenue requirements model to reflect the impact of increasing the 2009 benchmark ROE from 8.47 to 8.98 percent. Enclosed are ten copies of revised schedules for insertion in Tab 2 of the CAP/ROE Application. The $1.114 million figure in the above excerpt of the narrative has been revised upward to $1.571 million. The PNG-West ROE for 2009 is 9.73 percent (i.e. 8.98% plus applied for 75 basis points equity risk premium). PNG reiterates its application for Commission approval of a deferred return on common equity deferral account to record the revised difference of $1.571 million for future recovery from customers.

PNG(N.E.)'s Fort St. John/Dawson Creek Division

At page 6 of the CAP/ROE Application, PNG(N.E.) noted the impact on the NSP 2009 cost of service of the applied for increases in common equity thickness and equity risk premium. The resulting figures were provided under Tab 3 to put the applied for changes in context but with the comment those changes would be made effective for the 2010 revenue requirements application. PNG(N.E.) did not apply for approval of a deferral account to record the $287,000 increase relative to the NSP 2009 cost of service for future recovery. PNG(N.E.) went on to state that "However, if there are any adjustments to the benchmark utility ROE in 2009, PNG(N.E.) would seek Commission approval of a deferred return on common equity deferral account to record the impact of this change on the approved NSP 2009 cost of service." PNG(N.E.) has recalculated the NSP 2009 cost of service based on the revised ROE for 2009 of 9.38 percent (i.e. 8.98% plus currently approved 40 basis points equity risk premium). The resulting increase totals $96,000 comprised of higher income taxes ($29,000) and higher return on common equity ($67,000). PNG(N.E.) is hereby seeking Commission approval to record $96,000 in a deferred 2009 return on common equity deferral account for future recovery from customers.

PNG(N.E.)'s Tumbler Ridge Division

At page 7 of the CAP/ROE Application, PNG(N.E.) made the same remarks relative to the Tumbler Ridge Division as were made with respect to the Fort St. John/Dawson Creek Division. The only difference was the reference to a $10,000 increase relative to the NSP 2009 cost of service to reflect the applied for common equity thickness and equity risk premium adjustments. PNG(N.E.) has recalculated the NSP 2009 cost of service applicable to the Tumbler Ridge division based on the revised ROE for 2009 of 9.63 percent (i.e. 8.98% plus currently approved 65 basis points equity risk premium). The resulting $4,000 increase is comprised of higher income taxes ($1,000) and higher return on common equity ($3,000). PNG(N.E.) is hereby seeking Commission approval to record $4,000 in a deferred 2009 return on common equity deferral account for future recovery from customers.

<u>Regulatory Timetable</u>

A proposed regulatory timetable was set out in the draft procedural Order under Tab 5 of the CAP/ROE Application. PNG reaffirms the proposed timetable with the necessary changes to reflect a process being conducted over the January to April 2010 period. However, PNG is not submitting a revised preliminary regulatory timetable at this time as PNG recommends the Commission schedule a procedural conference in early 2010 to address this issue. The procedural conference will allow the parties to establish a timetable to address the CAP/ROE Application having regard to potential scheduling difficulties arising from the Winter Olympics. Nothwithstanding these difficulties PNG expects the process to be expeditious given the findings already made by the Commission in the Terasen Decision and having regard to the passage of time since the filing of the CAP/ROE Application in mid 2009.

Please direct any questions regarding this letter and the enclosed to my attention.

Yours trulv.

C.P. Donohue

cc. Jim Quail – Executive Director, B.C. Public Interest Advocacy Centre
James Wightman – Consultant to BCPIAC, Econalysis Consulting Services
Carolyn M. MacEachern – Lawyer representing Peace River Regional District

Pacific Northern Gas Ltd.
(PNG-West Division)

Capital Structure / ROE Changes vs. NSP 2009
COST OF SERVICE COMPARISON
($000)

EXPENSES	CAP/ROE 2009	NSP 2009	Difference
Operating			
Labour	4,054	4,054	0
Other	3,629	3,629	0
Sub-total	7,683	7,683	0
Maintenance			
Labour	212	212	0
Other	314	314	0
Sub-total	525	525	0
Administrative and General			
Labour	2,160	2,160	0
Total Company Benefits	2,014	2,014	0
Other	2,779	2,776	3
Sub-total	6,953	6,950	3
Total (O, M, A & G) Excluding Co. Use	**15,161**	**15,158**	**3**
Transfers to Capital Operating	(519)	(519)	0
Transfers to Capital Admin. & Gen.	(825)	(825)	0
Property Taxes	3,527	3,527	0
Depreciation	6,675	6,675	0
Amortization	722	722	0
Other Income	(266)	(266)	0
Shared Services Recovery from PNG (N.E.)	(1,957)	(1,957)	0
Shared Services NSP Reduction to PNG(N.E.)	25	25	0
Methanex Termination Payment	(5,466)	(5,466)	0
NSP Settlement Allowance	(120)	(120)	0
Total Expenses Excluding Co. Use	**16,957**	**16,954**	**3**
Income Taxes	1,882 (1)	1,332 (1)	549
Return on Common Equity	6,073 (2)	4,792 (2)	1,281
Short Term Debt	166	259	(92)
Long Term Debt	4,675	4,842	(167)
Preferred Shares	351	351	0
Total Cost of Service Excluding Co. Use	**30,103**	**28,529**	**1,574**
Company Use Gas Cost	716	716	
Total Cost of Service Including Co. Use Cost	**30,819**	**29,245**	

Pacific Northern Gas Ltd.
(PNG-West Division)

UTILITY INCOME & RETURN

SCHEDULE 1
(000's)

Line No.		CAP/ROE 2009	NSP 2009
1	Energy sales (TJ)	3,128	3,128
2	Average rate per GJ	$16.18	$15.74
3			
4	Transportation service (TJ)	3,463	3,463
5	Average rate per GJ	1.65	1.59
6			
7	Total deliveries (TJ)	6,591	6,591
8			
9	Utility revenue		
10	Energy sales	$47,443	$47,443
11	Interim rates - sales	3,159	1,782
12	Transportation service	5,255	5,255
13	Interim rates - transportation	452	255
14			
15		56,309	54,735
16	Cost of sales	25,490	25,490
17			
18	Gross margin	30,819	29,245
19			
20	Operating expenses	7,880	7,880
21	Maintenance expenses	525	525
22	Admin. & general expenses	6,128	6,125
23	Property taxes	3,527	3,527
24	Depreciation	6,675	6,675
25	Amortization	722	722
26	Investment income, other revenue	-2,224	-2,224
27	Shared Services NSP Reduction to PNG(N.E.)	25	25
28	Methanex Termination Pmt. Amort. & Interest	-5,466	-5,466
29	Settlement Allowance	-120	-120
30		17,673	17,670
31			
32	Earned return before income taxes	13,146	11,575
33	Income taxes	1,882	1,332
34			
35	Earned return	$11,265	$10,243
36			
37	Utility rate base	$131,402	$131,353
38			
39	Return on rate base	8.57%	7.80%

Pacific Northern Gas Ltd.
(PNG-West Division)

UTILITY RATE BASE

SCHEDULE 2
(000'S)

Line No.		CAP/ROE 2009	NSP 2009
1	Plant in service beginning of year	$253,515	$253,515
2	Additions	$5,405	$5,405
3	Disposals (at cost)	-1,269	-1,269
4			
5	Plant in service end of year	257,651	$257,651
6	Accumulated depreciation	115,763	$115,763
7			
8	Net plant in service end of year	141,888	$141,888
9			
10	Net plant beginning of year	143,641	143,641
11			
12	Net plant in service midyear	142,764	142,764
13	Adjustment - expenditure/disposal timing	-99	-99
14	Contributions in aid of construction	-5,125	-5,125
15	Construction advances	0	0
16	Deferred income taxes	-12,212	-12,212
17	Work in progress, no AFUDC	100	100
18	Unamortized deferred charges	1,200	1,200
19	Cash working capital	2,150	2,101
20	Other working capital	2,624	2,624
21			
22	Utility rate base, midyear	$131,402	$131,353

Pacific Northern Gas Ltd.
(PNG-West Division)

INCOME TAXES

SCHEDULE 3
(000'S)

Line No.		CAP/ROE 2009	NSP 2009
1	**Calculation of Taxable Income**		
2	Earned return before income taxes	$13,146	$11,575
3	Interest	-4,841	-5,100
4	Permanent differences	81	81
5	Timing differences	886	886
6			
7	Taxable income	$9,272	$7,442
8			
9	**Calculation of Income Tax Expense**		
10	Income taxes payable	2,782	2,232
11	Income Tax Rate Deferral	0	0
12	Deferred income tax drawdown	-900	-900
13			
14	Income tax expense	$1,882	$1,332
15			
16	**Particulars of Timing Differences**		
17	A. Tax Effects Subject To Flowthrough		
18	Depreciation	6,675	6,675
19	Amortization	722	722
20	Capital cost allowance	-5,271	-5,271
21	Overheads capitalized	-1,240	-1,240
22	Other	-0	-0
23			
24	Timing differences	$886	886
25	B. Tax Effects Subject To Deferral		
26	Deferred Tax Drawdown	3,000	3,000
27			
28	Timing and Other differences	$3,886	3,886
29			
30	Tax rate	30.00%	30.00%
31	Surtax rate	0.00%	0.00%

Pacific Northern Gas Ltd.
(PNG-West Division)

COMMON EQUITY

SCHEDULE 4
(000's)

Line No.		CAP/ROE 2009	NSP 2009
1	Opening balance		
2	Share capital	$9,161	$9,161
3	Contributed surplus	$3,610	$3,610
4	Retained earnings	$71,839	$71,839
5			
6		84,611	84,611
7			
8	Net income	7,379	6,174
9	Shares issued (redeemed), contributed surplus	-2,590	-2,590
10	Preferred dividends	-338	-338
11	Common dividends	-3,371	-3,371
12			
13	Closing balance	$85,691	$84,485
14			
15			
16	Midyear common equity	85,151	84,548
17	Investment in Non Utility	0	0
18	less: acquisition premiums	-1,355	-1,410
19	less: investment in subsidiary company	-6,827	-6,826
20			
21			
22		$76,969	$76,312
23			
24	Deemed utility common equity	$62,416	$52,541
25			
26	Equity required for KSL work in progress	$140	$140
27			
28	Unused Equity	$14,413	$23,631

Pacific Northern Gas Ltd.
(PNG-West Division)

RETURN ON CAPITAL

SCHEDULE 5
(000's)

Line No.		CAP/ROE 2009	NSP 2009
1	Short Term Debt	$5,223	$7,664
2	proportion	3.97%	5.83%
3	rate of return	3.19%	3.37%
4	return component	0.13%	0.20%
5			
6	Long term debt	$58,764	$66,148
7	proportion	44.72%	50.36%
8	rate of return	7.96%	7.32%
9	return component	3.56%	3.69%
10			
11	Preferred shares	$5,000	$5,000
12	proportion	3.81%	3.81%
13	rate of return	7.01%	7.01%
14	return component	0.27%	0.27%
15			
16	Common equity	$62,416	$52,541
17	proportion	47.50%	40.00%
18	rate of return	9.73%	9.12%
19	return component	4.62%	3.65%
20			
21	Total capitalization	$131,402	$131,353
22			
23	Return on rate base	8.57%	7.80%
24			
25	Utility rate base	$131,402	$131,353