CAPP CANADA'S OIL & NATURAL GAS PRODUCERS

Submission to the Saskatchewan Rate Review Panel Re: SaskPower's Rate Application 2022 and 2023

May /2022

The Canadian Association of Petroleum Producers (CAPP) The Canadian Association of Petroleum Producers (CAPP) represents companies, large and small, that explore for, develop and produce natural gas and oil throughout Canada. CAPP's member companies produce about 80 per cent of Canada's natural gas and oil. CAPP's associate members provide a wide range of services that support the upstream oil and natural gas industry. Together CAPP's members and associate members are a solution-oriented partner to the world's needs for affordable, clean, safe and secure energy, and an important part of a national industry with revenues from oil and natural gas production of about $116 billion a year. CAPP's mission, on behalf of the Canadian upstream oil and natural gas industry, is to advocate for and enable economic competitiveness, with environmentally and socially responsible performance and is dedicated to advancing reconciliation with Indigenous peoples. CAPP is committed to ensuring that Canada is positioned to help meet global climate commitments as the supplier of choice in a world that demands a lower carbon energy future.

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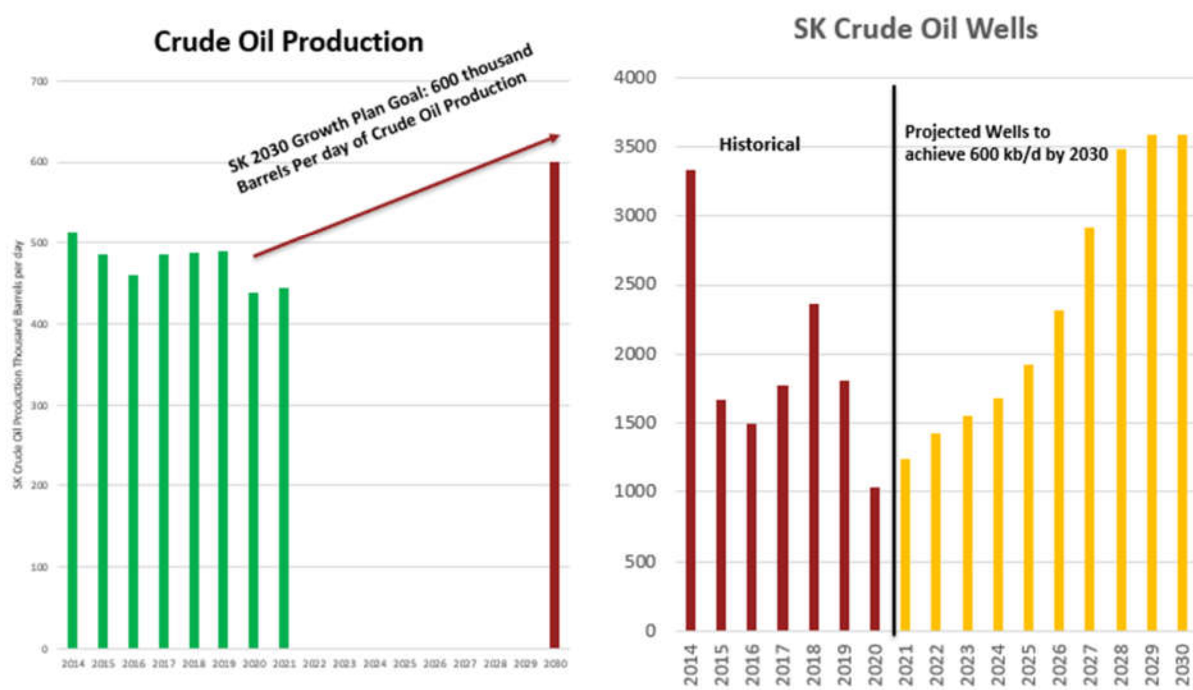
1. Introduction

The Canadian Association of Petroleum Producers (CAPP) appreciates the opportunity to file comments on SaskPower's Rate Application for 2022 and 2023. Electricity costs comprise a large portion of oil and natural gas producers' operating costs so that changes in these costs can have significant impacts on the economics of operations in the province. Consequently, the province's oil and natural gas producers retain a keen interest in SaskPower's rate applications to evaluate whether rates are just and reasonable and to ensure that any rate increases are fully justified and kept to a minimum.

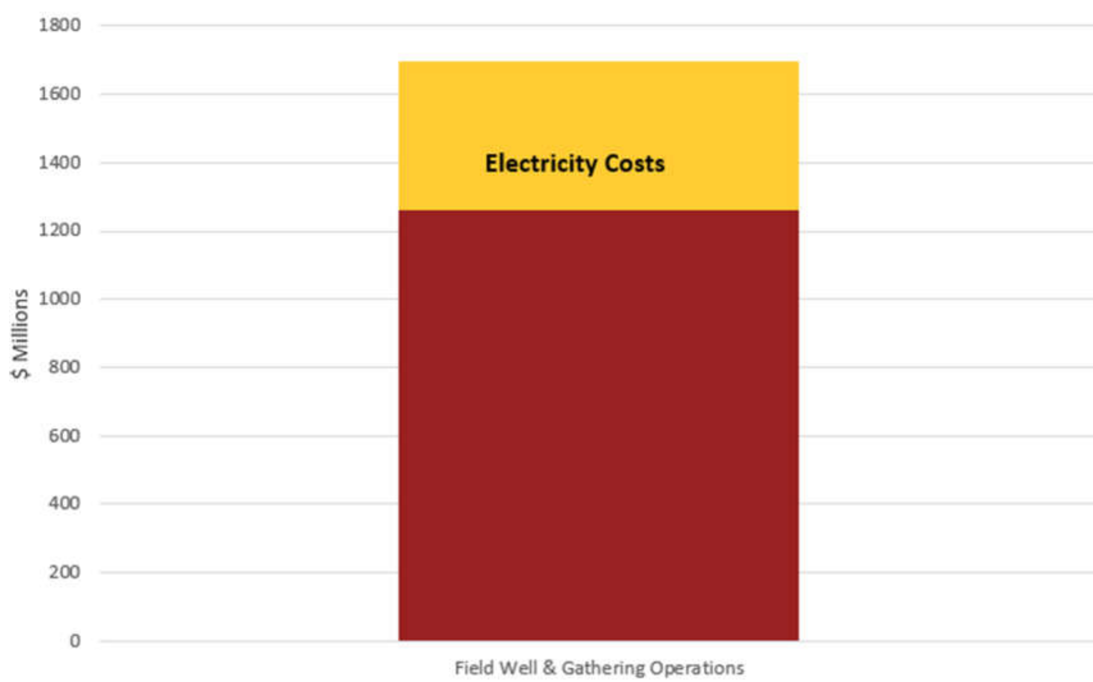
The oil and natural gas industry is a very important sector for the Saskatchewan economy. It not only contributes a significant portion of the provincial GDP but provides substantial royalty payments that support government expenditures in areas such as healthcare and education, as well as offering the people of Saskatchewan many well-paying jobs. The sector's importance is recognized by the Government of Saskatchewan (GoS), and CAPP appreciates the government's commitment to ensure a competitive jurisdiction to attract the investment needed to support a viable and healthy provincial economy. Saskatchewan continues to be a leader in regulatory excellence and a leader in supporting the advancement of innovation and technology, making Saskatchewan a competitive jurisdiction to invest.

Fig 1. Competitiveness is Key to Encourage Investment to meet Saskatchewan Growth Plan Objectives



One of the objectives of the GOS Growth Plan, is to increase crude oil production to 600 kbd by 2030. This is an important objective that would endow tremendous economic benefits to the province but is achievable only with significant additional investment in terms of the number of oil wells being drilled. **As Saskatchewan competes for investment with other oil and gas producing jurisdictions, attracting the necessary level of investment to meet these goals requires a competitive fiscal and operating environment. Electricity costs are a key component of operating costs.**

Fig 2. Oil Industry Operating Costs in Saskatchewan in 2020



(Source: CAPP statistical handbook, SaskPower)

As can be seen in Figure 2, in 2020 field well and gathering operating expenditures in Saskatchewan were $1,696 million. In this same year, SaskPower realized $435 million in revenues from its Oilfield customer class. **This indicates that electricity costs were slightly more than 25 per cent of all oil and natural gas producer operating expenses in their field and gathering operations.** As electricity costs comprise such a large portion of operating expenditures, they will also have significant impacts on competitiveness relative to other oil and natural gas producing jurisdictions.

It is with these provincial growth objectives in mind and the consequent need to successfully compete for capital that CAPP makes its following comments.

2. Establish Rates that are Fair and Equitable Across All Customer Classes

Widely accepted principles in the public utility ratemaking process are those first laid out by Professor James Bonbright in his seminal work, Principles of Public Utility Rates that was published in 1961. These principles have been distilled into the following five key criteria.[1]

1. **Economic Efficiency** – where ratemaking discourages wasteful use of service and promote innovation while responding economically to changing demand and supply patterns
2. **Equity** – where ratemaking apportions costs fairly among the customer classes and avoid undue discrimination
3. **Revenue Stability** – where ratemaking provides revenue stability and predictability and yield revenue requirements under the fair-return standard
4. **Bill Stability** – where ratemaking provides stability and predictability of the rates with a minimum of changes adverse to utility customers
5. **Customer Satisfaction** – where ratemaking provides inter-alia the practical attributes of simplicity, certainty, convenience of payment

It is with respect to the equity ratemaking principle, described above, that CAPP has concerns with SaskPower's application i.e., whether the ratemaking method employed apportions costs fairly among the customer classes and avoids undue discrimination. Rate equity is achieved where each class pays the costs that its customers incur and there is no *undue* cross-subsidization of one customer class by another. As a result, customers who incur high costs for the system will pay proportionally higher amounts than low-cost customers and vice versa.

A widely accepted way to achieve equity between customers, with different load profiles and consumption values, is through cost-reflective rates. This is ideally achieved where the revenues generated by the rates for a customer class are equal to the cost of service (or revenue requirement) that has been allocated to that class. In this case, the Revenue-to-Revenue Requirement Ratio (R/RR) equals one. A R/RR ratio greater than one indicates that a customer class is paying more than its allocated costs while a R/RR ratio less than one indicates a customer class paying less than its allocated costs.

[1] Bonbright, James C. "Principles of Public Utility Rates" Columbia University Press, 1961

Since not many costs can be directly assigned and therefore must be allocated among customers, regulators in many jurisdictions have employed various ranges of acceptability of R/RR ratios due to the imperfections associated with the cost allocation process. However, the wider the variability in R/RR ratios across customer classes the greater the likelihood that the ratemaking principle of equity is not being achieved.

Table 1. SaskPower Revenue Requirement Ratio

Customer Classes	2023 Revenue to Revenue Requirement Ratio	2024 Revenue to Revenue Requirement Ratio
Residential	0.97	0.96
Farms	0.96	0.97
Commercial	1.03	1.02
Power – Published Rates	1.01	1.02
Power – Contract Rates	0.98	0.98
Oilfields	1.04	1.03
Streetlights	0.93	0.97
Reseller	0.99	1.00
Total (System)	1.00	1.00

As can be seen from the above table, the R/RR range across SaskPower's customer classes for 2023 is from 0.93 – 1.04, while the range in 2024 is from 0.96 – 1.03.

To achieve greater equity in the case of SaskPower, CAPP requests that rates be immediately established utilizing a R/RR range of 0.98 – 1.02. SaskPower has indicated that achieving this range is a long-term goal, however, CAPP is concerned that with no clear time frame to achieving this target range, some customer classes will be unfairly cross-subsidizing other customer classes for a protracted period. This is a particularly disconcerting prospect for the Oilfield class that sits at the top of SaskPower's R/RR ratio range in both 2023 and 2024. As explained earlier in this submission, power costs comprise a substantial portion of overall operating costs for oil and gas producers in Saskatchewan, and the continued inequity in SaskPower's ratemaking process will compromise the province's ability to attract sufficient investment capital in the oil and gas sector to meet is growth plan targets.

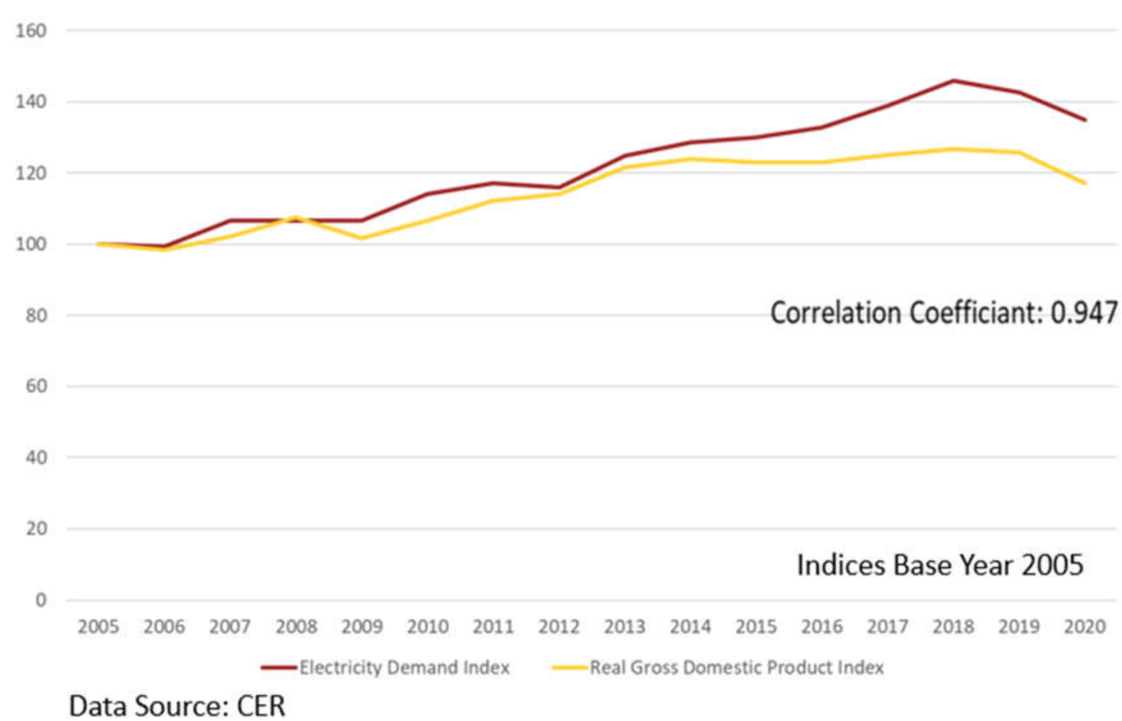
3. SaskPower's Applied-for Rates are Underpinned by an Overly Conservative Outlook for Load Growth

Another area of concern to CAPP are the very conservative assumptions with respect to load-growth upon which SaskPower's applied-for rates are based. While SaskPower assumes annual growth in 2021-22 of 5.5% as the province emerges from the impacts of the Covid pandemic, in the ensuing years annual load is forecast to be essentially flat with growth of only 0.1% in 2022-23 and a decline in load of 0.2% in 2023-24.

These load-growth assumptions appear overly conservative given the anticipated increase in economic activity. For example, TD Bank's Provincial Economic Forecast, that was released on March 18th, 2022, is projecting GDP growth of 3.4% for Saskatchewan in 2023. Moreover, in its provincial budget papers released on March 23rd, 2022, the GoS is projecting real GDP growth of 3.7% in 2022, and 2.5% growth in 2023 and 2.2% growth in 2024.

Like many economies throughout the developed world, the Saskatchewan economy exhibits a high degree of correlation between real GDP and electricity demand which is shown in Figure 3.

Fig 3. Correlation between GDP Growth and Electricity Demand in Saskatchewan



The conservative nature of this forecast is also highlighted by the fact that in its Mid-Application update, SaskPower has increased its forecasted revenue in 2023-24 by $71 million (excluding Federal Carbon Tax). The increase in forecasted revenue in 2023-24, is due to a 708 GWh increase in forecasted demand driven by increases in the Power, Residential, Oilfield and Commercial customer classes.

SaskPower has identified customer self-generation as one reason for its very conservative load growth outlook, however, CAPP notes that to date customer self-generation appears to be extremely small relative to the overall scale of SaskPower's operations.

For example, in its most recent annual report, SaskPower describes its Power Generation Partner Program (PGPP) as supporting the development of new small renewable and carbon-neutral energy projects, with customers participating in a competitive bidding process. To date, four projects from the PGPP have been interconnected, resulting in 1.4 MW of additional capacity. In its third and final year another eleven projects have been initially selected that could add an additional 11 MW of capacity.

SaskPower's Net Metering Program also provides participants with the opportunity to generate up to 100 kilowatts of power to offset their own power use. Customers can use qualified energy sources such as solar, low-impact hydro, biomass, biogas, flare gas or waste heat recovery with the ability to sell any excess power back to the grid. SaskPower estimates that this program has provided over 35 MW of additional capacity.

These programs appear not only small compared to the 4987 MW of generation capacity currently available to SaskPower (2020-21 Annual Report page 12), but as this number is projected to grow by 867 MW to reach 5854 MW by 2025-26 (2020-21 Annual Report page 14), this indicates that on-system generation will continue to be the over-whelming dominant source for meeting electricity demand in the province. CAPP would also observe that a lower rate increase would result in more competitive options for customers, when compared with self-generation, and result in less demand destruction than assumed, and therefore more revenue growth.

To the extent that actual load growth in 2022-23 and 2023-24 proves to be higher than SaskPower forecasts then the applied-for rates will produce a higher level of revenues than currently projected. Consequently, if SaskPower had utilized a less conservative load-growth outlook in its application, it would have shown an ability to recover its revenue requirement with increases in rates less than the 4% being applied-for in September 2022 and again in April 2023.

Past increases in SaskPower load-growth have resulted in very similar increases in revenues. For example, page 5 of SaskPower's third quarter financial report for the 9-month period ending December 31, 2021, stated that electricity sales volumes rose 740 GWh or 4.5% over the same 9-month period in 2020. It also stated that electricity sales revenues rose by 3.8% in this same timeframe because of increased electricity demand.

As indicated above, SaskPower is assuming flat electricity demand post 2021-22 in its application. However, using a 2% load-growth rate, that is consistent with several third-party forecasts of provincial GDP growth of 2% or higher, a similar level of revenues can be derived with only a 2% increase in rates.

4. Recommendations

Based on the submissions outlined above CAPP requests that the SRRP:

1. Immediately establish a R/RR range of 0.98 – 1.02 for SaskPower to set rates to achieve greater equity among the various customer classes; and
2. Award less than the applied-for 4% overall rate increase for September 2022 and again in April 2023 in recognition of the overly conservative load forecast that SaskPower utilized in its application. A 2% overall rate increase would be more consistent with third-party forecasts of economic growth.

CAPP and our members appreciate the opportunity to participate in the SRRP's review of SaskPower's rate application. Thank you for your review and consideration of the recommendations presented herein.