PUB Order No. 7 (1996-97)
re: NP 1996 Hearing

fiscal year. It will be very difficult to conduct the study prior to the close of 1997, as not enough evidence will have been produced until that date. This study shall recommend whether an adjustment of rates to reflect indirect benefits is warranted and shall confirm the actual direct tax benefits, including the direct savings to Hydro.

The Board orders that the rates be adjusted to reflect direct savings immediately upon the implementation of the VAT. The direct savings will be calculated in reference to Schedule 5 of the Doane Raymond Report.

Forecast Capital Expenditures and Related Depreciation Provision

During the hearing, issues related to the forecast of capital expenditures for the years 1996 and 1997 were discussed. Vice-President Pinhorn's prefiled evidence notes that the total capital expenditure of $30.6 million for 1996 is $308,000 below the 1996 budget submitted to the Board on December 8, 1995 and approved under Order No. P.U. 5 (1995-96). This difference is primarily due to a reduction in the distribution related expenditures. The $31.7 million capital forecast of 1997 reflects an expenditure level similar to 1996 and reflects the information currently available on 1997 requirements.

The intervenors at the hearing took issue with the pattern established in over budgeting capital expenditures over the period 1991 through to 1995. The following table indicates the dollar and percentage variances for each year.

SCHEDULE OF CAPITAL EXPENDITURE VARIANCES		
YEAR	$ UNDER VARIANCE	% UNDER VARIANCE
1991	$6,580,000	13.19%
1992	$4,659,000	9.76%
1993	$1,318,000	3.75%
1994	$4,951,000	12.46%
1995	$7,241,000	19.04%

In the 1991 General Rate Hearing, the Applicant provided evidence indicating that its financial model for rate making purposes included a reduction in its capital expenditure forecast of approximately 4% for the 1991 test year and approximately 8% in the 1992 test year. This was to reflect the fact that further reviews of each capital project are carried out prior to its actual undertaking, resulting in some project deferrals.

The Consumer Advocate provided argument that the traditional capital over-budgeting rate amounted to 12%. The Consumer Advocate also proposed a further 8% reduction in possible capital over-budgeting. The impact on the 1996 and 1997 forecast figures was calculated as a $215,000 reduction in depreciation expense for 1996 and a $437,000 cumulative reduction in depreciation expense for 1997 costs. The Consumer Advocate offered the rationale that the 1995 budget was underspent as a result of a very slow growth period in the Applicant's jurisdiction. The same would be expected during the periods of 1996 and 1997. The Applicant did not agree that a 20% reduction in capital expenditure is reasonable.

The Board notes that the 1996 capital expenditure forecast has been adjusted to reflect what is known to be a reduced distribution expenditure for 1996. However, there is no indication in the evidence that the 1997 capital expenditure forecasts have been adjusted in any sense to reflect what is often a normal deferral process during a particular year. This omission is of concern to the Board. This was considered a necessary part of the 1991 financial model used by the Applicant. The Board views the capital expenditure amount for 1995 of $30.8 million as reflective of a very low level capital budget. The years 1996 and 1997 continue to be very low dollar value capital budgets. Therefore, it does not seem reasonable to apply a reduction for possible deferrals during the year in the order of 20% without a risk of impairment in quality service and reliability. However, the Board believes that a 4% reduction in the value of the capital expenditure budget for the year 1997 would be reasonable to reflect what has been the regular deferral process. This would result in a reduction to the depreciation expense of 1997 of approximately $40,000.

Board Determination

The Board orders that for rate setting purposes the 1997 capital expenditure budget be reduced by 4% and that the 1997 depreciation expense be reduced by $40,000.

Inter-corporate Transactions and Charges

The Applicant is one of the wholly owned subsidiaries of Fortis Inc. and is the largest subsidiary of the group. As a result, it is incumbent upon the Applicant to document fully all transactions with its parent company as well as with any of the subsidiary group. Due to the absence of arms length negotiation in any inter-corporate transaction, measures must be put in place to guide