

PART FIVE. SCHEDULES AND APPENDICES

Board of Commissioners of Public Utilities Order No. P. U. 8(2007) List of Schedules and Appendices		
Schedule	Description	Dated
A	Newfoundland and Labrador Hydro <i>Schedule of Rates, Tolls and Charges – Utility and Industrial Customers</i>	April 12, 2007
B	Newfoundland and Labrador Hydro <i>Excerpt from Rate Stabilization Plan - Section F: Hydraulic Variation Special Adjustment December 31, 2006</i>	April 12, 2007
Appendix		
A	Regulatory Framework <i>Statutory Powers and Responsibilities</i>	April 12, 2007

NEWFOUNDLAND AND LABRADOR HYRO

UTILITY

Availability:

This rate is applicable to service to Newfoundland Power (NP).

Definitions:

"Billing Demand"

In the Months of January through March, billing demand shall be the greater of:

- (a) the highest Native Load less the Generation Credit, beginning in the previous December and ending in the current Month; and
- (b) the Minimum Billing Demand.

In the Months of April through December, billing demand shall be the greater of:

- (a) the Weather-Adjusted Native Load less the Generation Credit, plus the Weather Adjustment True-up; and
- (b) the Minimum Billing Demand.

"Generation Credit" refers to NP's net generation capacity less allowance for system reserve, as follows:

	kW
Hydraulic Generation Credit	80,104
Thermal Generation Credit	<u>37,826</u>
Total Generation Credit	117,930

In order to continue to avail of the Generation Credit, NP must demonstrate the capability to operate its generation to the level of the Generation Credit. This will be verified in a test by operating the generation at a minimum of this level for a period of one hour as measured by the generation demand metering used to determine the Native Load. The test will be carried out at a mutually agreed time between December 1 and March 31 each year. If the level is not sustained, Newfoundland Power will be provided an opportunity to repeat the test at another mutually agreed time during the same December 1 to March 31 period. If the level is not sustained in the second test, the Generation Credit will be reduced in calculating the associated billing demands for January to December to the highest level that could be sustained.

NEWFOUNDLAND AND LABRADOR HYRO

UTILITY (continued)

“Maximum Native Load” means the maximum Native Load of NP in the four-Month period beginning in December of the preceding year and ending in March of the current year.

“Minimum Billing Demand” means ninety-nine percent (99%) of:

NP’s test year Native Load less the Generation Credit.

“Month” means for billing purposes, the period commencing at 12:01 hours on the last day of the previous month and ending at 12:00 hours on the last day of the month for which the bill applies.

“Native Load” is the sum of:

- (a) the amount of electrical power, delivered at any time and measured in kilowatts, supplied by Hydro to NP, averaged over each consecutive period of fifteen minutes duration, commencing on the hour and ending each fifteen minute period thereafter; and
- (b) the total generation by NP averaged over the same fifteen-minute periods.

“Weather-Adjusted Native Load” means the Maximum Native Load adjusted to normal weather conditions, calculated as:

Maximum Native Load
plus (Weather Adjustment, rounded to 3 decimal places, x 1000)

Weather Adjustment is further described and defined in the Weather Adjustment section.

“Weather Adjustment True-up” means one-ninth of the difference between:

- (a) the greater of:
 - the Weather Adjusted Native Load less the Generation Credit, times three;
 - and
 - the Minimum Billing Demand, times three; and
- (b) the sum of the actual billed demands in the Months of January, February and March of the current year.

NEWFOUNDLAND AND LABRADOR HYRO

UTILITY (continued)

Monthly Rates:

Billing Demand Charge:

Billing Demand, as set out in the Definitions section, shall be charged at the following rate:

\$4.00 per kW of billing demand

Energy Charge:

First 250,000,000 kilowatt-hours* @ 3.246 ¢ per kWh
All excess kilowatt-hours* @ 8.805 ¢ per kWh

Firming-up Charge:

Secondary energy supplied by
Corner Brook Pulp and Paper Limited* @ 0.841 ¢ per kWh

RSP Adjustment:

All kilowatt-hours @ 0.425 ¢ per kWh

***Subject to RSP Adjustment:**

RSP Adjustment refers to all applicable adjustments arising from the operation of Hydro's Rate Stabilization Plan, which levelizes variations in hydraulic production, fuel cost, load and rural rates.

Adjustment for Losses:

If the metering point is on the load side of the transformer, either owned by the customer or specifically assigned to the customer, an adjustment for losses as determined in consultation with the customer prior to January 31 of each year, shall be applied to metered demand and energy.

Adjustment for Station Services and Step-Up Transformer Losses:

If the metering point is not on the generator output terminals of NP's generators, an adjustment for Newfoundland Power's power consumption between the generator output terminals and the metering point as determined in consultation with the customer prior to the implementation of the metering, shall be applied to the metered demand.

NEWFOUNDLAND AND LABRADOR HYRO

UTILITY (continued)

Weather Adjustment: This section outlines procedures and calculations related to the weather adjustment applied to NP's Maximum Native Load.

- (a) Weather adjustment shall be undertaken for NP's actual Maximum Native Load.
- (b) Weather adjustment shall be derived from Hydro's general NP native peak demand forecasting model.
- (c) By September 30th of each year, Hydro shall provide NP with updated weather adjustment coefficient incorporating the latest year of actuals.
- (d) The underlying temperature and wind speed data utilized to derive weather adjustment shall be sourced to Environment Canada's weather station data for the St. John's, Gander, and Stephenville airports. NP's regional customer counts shall be used to weight regional weather data. Hydro shall consult with NP to resolve any circumstances arising the availability of, or revisions to, Environment Canada's weather data and/or wind chill formulation.
- (e) The primary definition for the temperature weather variable is the average temperature for the peak demand hour and the preceding 19 hours. The primary definition for the wind weather data is the average wind speed for the peak demand hour and the preceding seven hours. Hydro will consult with NP should data anomalies indicate a departure from the primary definition on underlying weather data.
- (f) Subject to the availability of Environment Canada weather data, Hydro shall prepare a preliminary estimate of the Weather-Adjusted Native Load by March 15th of each year, and a final calculation of Weather-Adjusted Native Load by April 5th of each year.

General:

This rate schedule does not include the Harmonized Sales Tax (HST) which applies to electricity bills.

With respect to all matters where the customer and Hydro consult on resolution but are unable to reach mutual agreement, the billing will be based on Hydro's best estimate.

NEWFOUNDLAND AND LABRADOR HYRO

INDUSTRIAL - FIRM

Availability:

Any person purchasing power, other than a retailer, supplied from the Interconnected Island bulk transmission grid at voltages of 66 kV or greater on the primary side of any transformation equipment directly supplying the person and who has entered into a contract with Hydro for the purchase of firm power and energy.

Rate:

Demand Charge:

The rate for Firm Power, as defined and set out in the Industrial Service Agreements, shall be \$6.68 per month per kilowatt of billing demand.

Firm Energy Charge:

Base Rate*@ 3.676 ¢ per kWh

RSP Adjustment

Historic Plan@ 1.215 ¢ per kWh**

Current Plan@ (2.000) ¢ per kWh

Fuel Rider@ 0.000 ¢ per kWh

Total RSP Adjustment.....@ (0.785) ¢ per kWh

Energy Rate.....@ 2.891 ¢ per kWh

** Aur Resources Inc. Energy rate excluding Historic Plan@ 1.676 ¢ per kWh

***Subject to RSP Adjustment:**

RSP Adjustment refers to all applicable adjustments arising from the operation of Hydro's Rate Stabilization Plan, which levelizes variations in hydraulic production, fuel cost, load and rural rates.

** Aur Resources Inc. is not subject to Historic Plan component of the RSP Adjustment, in accordance with Order No. P.U. 1 (2007).

Specifically Assigned Charges:

The table below contains the additional specifically assigned charges for customer plant in service that is specifically assigned to the Customer.

	Annual Amount
Abitibi-Consolidated (Grand Falls)	\$ 1,244
Abitibi-Consolidated (Stephenville)	\$ 104,647
Corner Brook Pulp and Paper Limited	\$ 347,167
North Atlantic Refining Limited	\$ 150,976
Aur Resources Inc.	\$ 186,169

NEWFOUNDLAND AND LABRADOR HYRO

INDUSTRIAL - FIRM

Adjustment for Losses:

If the metering point is on the load side of the transformer, either owned by the customer or specifically assigned to the customer, an adjustment for losses as determined in consultation with the customer prior to January 32 of each year, shall be applied.

General:

Details regarding the conditions of Service are outlined in the Industrial Service Agreements. **This rate schedule does not include the Harmonized Sales Tax (HST) which applies to electricity bills.**

NEWFOUNDLAND AND LABRADOR HYDRO
INDUSTRIAL – NON-FIRM

Availability:

Any person purchasing power, other than a retailer, supplied from the Interconnected Island bulk transmission grid at voltages of 66 kV or greater on the primary side of any transformation equipment directly supplying the person and who has entered into a contract with Hydro for the purchase of firm power and energy.

Rate:

Non-Firm Energy Charge (¢ per kWh):

Non-Firm Energy is deemed to be supplied from thermal sources. The following formula shall apply to calculate the Non-Firm Energy rate:

$$\{(A \div B) \times (1 + C) \times (1 \div (1 - D))\} \times 100$$

- A = the monthly average cost of fuel per barrel for the energy source in the current month or, in the month the source was last used
- B = the conversion factor for the source used (kWh/bbl)
- C = the administrative and variable operating and maintenance charge (10%)
- D = the average system losses on the Island Interconnected grid for the last five years ending in 2005 (2.68%).

The energy sources and associated conversion factors are:

1. Holyrood, using No. 6 fuel with a conversion factor of 630 kWh/bbl
2. Gas turbines using No. 2 fuel with a conversion factor of 475 kWh/bbl
3. Diesels using No. 2 fuel with a conversion factor of 556 kWh/bbl.

Adjustment for Losses:

If the metering point is on the load side of the transformer, either owned by the customer or specifically assigned to the customer, an adjustment for losses as determined in consultation with the customer prior to January 31 of each year, shall be applied.

General:

Details regarding the conditions of Service are outlined in the Industrial Service Agreements. **This rate schedule does not include the Harmonized Sales Tax (HST) which applies to electricity bills.**

NEWFOUNDLAND AND LABRADOR HYDRO
INDUSTRIAL - WHEELING

Availability:

Any person purchasing power, other than a retailer, supplied from the Interconnected Island bulk transmission grid at voltages of 66 kV or greater on the primary side of any transformation equipment directly supplying the person and who has entered into a contract with Hydro for the purchase of firm power and energy and whose Industrial Service Agreement so provides.

Rate:

Energy Charge:

All kWh (Net of losses)* @ 0.384 ¢ per kWh

* For the purpose of this Rate, losses shall be 2.68%, the average system losses on the Island Interconnected Grid for the last five years ending in 2005.

General:

Details regarding the conditions of Service are outlined in the Industrial Service Agreements.
This rate schedule does not include the Harmonized Sales Tax (HST) which applies to electricity bills.

NEWFOUNDLAND AND LABRADOR HYDRO
EXCERPT FROM
RATE STABILIZATION PLAN

Section F: Hydraulic Variation Special Adjustment December 31, 2006

1. Hydraulic Variation Customer Assignment

Customer assignment of the December 31, 2006 hydraulic variation account balance will be performed as follows:

$$E \times 100\%$$

Where:

E = Hydraulic Variation Account Balance as of December 31, 2006, including financing charges

The total amount of the Hydraulic Customer Assignment shall be removed from the Hydraulic Variation Account.

2. Customer Allocation

The December 31, 2006 customer assignment will be allocated among the Island Interconnected customer groups of (1) Newfoundland Power; (2) Island Industrial Firm; and (3) Rural Island Interconnected. The allocation will be based on percentages derived from 12 months-to-date kWh for: Utility Firm and Firmed-Up Secondary invoiced energy, Industrial Firm invoiced energy, and Rural Island Interconnected bulk transmission energy.

The portion of the hydraulic customer assignment which is initially allocated to Rural Island Interconnected will be re-allocated between Newfoundland Power and regulated Labrador Interconnected customers in the same proportion which the Rural Deficit was allocated in the approved Test Year Cost of Service Study.

The Labrador Interconnected Hydraulic customer allocation shall be written off to Hydro's net income (loss).

3. Adjustment Rates

The Newfoundland Power customer allocation shall be included with the Newfoundland Power Historic Plan RSP balance as of December 31, 2006. To implement the affect of the adjustment over the remaining recovery period in the Historic Plan, the adjustment rate is calculated as follows:

January 1, 2007 RSP Adjustment Rate

Newfoundland Power's adjustment rate for January 1, 2007 will be based on the forecast Hydraulic Variation credit balance of \$20,707,844, with Newfoundland Power's share equal to \$17,759,489, calculated using forecast sales to December 31, 2006.

The January 1, 2007 RSP rate Adjustment is calculated as follows:

NP December 2006 Hydraulic Variation Allocation	\$(17,759,489)
Divided by:	

NEWFOUNDLAND AND LABRADOR HYDRO
EXCERPT FROM
RATE STABILIZATION PLAN

Remaining Historic Plan Recovery Months	<u>18</u>
Equals:	
Forecast Monthly Recovery	\$(986,638)
Multiplied by 12 equals	
Annual Adjustment	\$(11,839,659)
Divided by	
12 months to date (Jan - Dec) forecast NP Sales (kWh)	<u>4,680,392,181</u>
Equals	
Reduction in Historic Plan Adjustment Rate (mills per kWh), effective January 1, 2007	<u>(2.53)</u>

July 1, 2007 RSP Adjustment Rate

The July 1, Historic Plan will be calculated in accordance with Section E, with the January 1, 2007 RSP adjustment rate calculated above included for the purpose of calculating the projected recovery (Component C) to June 2007 and the projected financing charges (Component D).

The Island Industrial customer allocation shall be allocated between the Industrial Customer current and Historic plans as follows:

Current Plan

The current plan assignment will be equal to the assignment calculated in accordance with Section A.3.

Historic Plan

The difference between the total amount assigned to the Industrial Customers in this section and the amount assigned to the Current Plan above will be included in the Historic Plan. The December 31, 2006 Historic Plan balance used for rate setting in Section E will be adjusted to remove the 2006 Hydraulic Variation amount, so that the impact of the Hydraulic Variation adjustment will not affect Industrial Customer rates until January 1, 2008.

REGULATORY FRAMEWORK

STATUTORY POWERS AND RESPONSIBILITIES

The statutory powers and responsibilities described below are consistent with those set out in Order No. P. U. 7(2002-2003) and are intended to communicate to the utilities and other stakeholders the fundamental regulatory framework used by the Board in issuing its decisions, findings and subsequent Orders.

The Board is an independent, quasi-judicial body established under Provincial legislation to regulate public utilities in the Province. Regulation is designed to ensure consumers receive safe and reliable electricity at rates that are reasonable while allowing the utility to earn a fair return on its investment in supplying the electrical service. Regulation strives to strike an equitable balance between the interests of consumers and the utility.

The regulatory framework of the Board consists of five cornerstones, as follows:

- i. BOARD AUTHORITY sets out the legislative and legal powers and responsibilities of the Board.
- ii. BOARD HEARING PROCEDURES govern the presentation of the evidentiary record on matters before the Board.
- iii. REGULATORY PRINCIPLES which are commonly accepted in guiding sound public utility regulation.
- iv. THE RATE SETTING PROCESS is founded in accounting, engineering and economic methodologies which are applied in combination with i), ii) and iii) and weighed by the Board in making decisions affecting rates.
- v. REPORTING/COMPLIANCE provides appropriate regulatory monitoring of the utility's ongoing activities and compliance with Board Orders.

1. Board Authority

Mandate

The Board's authority is derived from its statutory powers and responsibilities as set out in the *Public Utilities Act* (the "Act") and the *Electrical Power Control Act, 1994* (the "EPCA").

The *Act* sets out the structure of the Board and defines its powers. The Board has responsibility for the general supervision of public utilities in the Province, which requires the Board to approve rates, capital expenditures and other aspects of the business of public utilities.

In addition to the provisions of the *Act*, the Board is also mandated through the *EPCA*, particularly Section 3, which states the power policy of the Province as follows:

“3. *It is declared to be the policy of the province that*

(a) the rates to be charged, either generally or under specific contracts, for the supply of power within the province

- (i) should be reasonable and not unjustly discriminatory;*
- (ii) should be established, wherever practicable, based on forecast costs for that supply of power for 1 or more years;*
- (iii) should provide sufficient revenue to the producer or retailer of the power to enable it to earn a just and reasonable return as construed under the Public Utilities Act so that it is able to achieve and maintain a sound credit rating in the financial markets of the world; and*
- (iv) should be such that after December 31, 1999 industrial customers shall not be required to subsidize the cost of power provided to rural customers in the province, and those subsidies being paid by industrial customers on the date this Act comes into force shall be gradually reduced during the period prior to December 31, 1999;*

(b) all sources and facilities for the production, transmission and distribution of power in the province should be managed and operated in a manner

- (i) that would result in the most efficient production, transmission and distribution of power;*
- (ii) that would result in consumers in the province having equitable access to an adequate supply of power;*
- (iii) that would result in power being delivered to consumers in the province at the lowest possible cost consistent with reliable service...”*

Section 4 of the *EPCA* states:

“4. *In carrying out its duties and exercising its powers under this Act or under the Public Utilities Act, the public utilities board shall implement the power policy declared in section 3, and in doing so shall apply tests which are consistent with generally accepted sound public utility practice.*”

In summary, the *EPCA* mandates the Board to make rate decisions that are reasonable and not unjustly discriminatory. Rates are to be based on forecast costs for the supply of power for one (1) or more years. This timeframe in practice is generally referred to as the “*test year(s)*”. The legislation also ensures that the utilities are permitted to earn a just and reasonable financial return while maintaining a sound credit rating in the financial markets of the world. The legislation calls for the most efficient production, transmission and distribution of power that will afford consumers the lowest possible cost electricity consistent with equitable, safe and reliable service.

Form of Regulation

With regard to the form of regulation, Section 80(1) of the *Act* states:

“80. (1) A public utility is entitled to earn annually a just and reasonable return as determined by the Board on the rate base, as fixed and determined by the Board for each type or kind of service supplied by the public utility...”

This is commonly referred to as return on rate base regulation. Rate base consists largely of investment by the utility in plant and equipment and historically has constituted the statutory form of regulation used in the Province. Return on rate base regulation is more fully described in relation to the Rate Setting Process. Alternative forms of regulation in place elsewhere include Return on Equity (ROE) and/or an emerging trend toward Performance Based Regulation (PBR).

Statutory Limitations

The legislative authority of the Board is, nonetheless, subject to two limitations (Sections 5.1 and 5.2) in the *EPCA* as follows:

“5.1 Notwithstanding section 3 and section 4 of the Act and the provisions of the Public Utilities Act, the Lieutenant-Governor in Council may direct the public utilities board with respect to the policies and procedures to be implemented by the board with respect to the determination of rate structures of public utilities under the Public Utilities Act and, without limiting the generality of the foregoing, including direction on the setting and subsidization of rural rates, the fixing of a debt-equity ratio for Hydro and the phase in, over a period of years from the date of coming into force of this section, of a rate of return determination for Hydro and the board shall implement those policies and procedures.

5.2 The Lieutenant-Governor in Council may exempt a public utility from the application of all or a portion of this Act where the public utility is engaged in activities that in the opinion of the Lieutenant-Governor in Council as a matter of public convenience or general policy are in the best interest of the province, to the extent of its engagement in those activities.”

Appeal Process

Section 99 (1) of the *Act* states the statutory authority embodied in an Order of the Board as follows:

“An appeal lies to the Court of Appeal from an order of the board upon a question as to its jurisdiction or upon a question of law, but the appeal can be taken only by leave of a judge of the court, given upon an application presented within 15 days after the making of the decision and upon the terms that the judge may determine.”

An Order of the Board has the force of law and is binding on the parties and can only be appealed to the Court of Appeal on an issue of law or jurisdiction of the Board.

Stated Case

The most comprehensive judicial consideration of the authority of the Board comes from the comments of Mr. Justice Green in Newfoundland (Board of Commissioners of Public Utilities)(Re)(1998), 64 NFLD. & PEI R.60 (NFLD.C.A.) In 1998 the Board stated a case for the consideration of the Court of Appeal pursuant to Section 101 of the *Act*. Mr. Justice Green set out some general principles that apply to all decisions of the Board, which may be summarized as:

1. The *Act* should be given a liberal interpretation respecting the purpose of the legislation and the power policy of the province;
2. The Board has discretion in how it approaches its mandate;
3. The Board has all appropriate and necessary powers;
4. The Board must balance the interests of public utilities and electrical consumers;
5. The Board sets rates prospectively, after a full consideration of all available evidence; and
6. The Board has discretion to choose the approach to setting rates as long as it observes the legislation and sound utility practices.

The Court was clear in setting out that the Board must balance two sets of interests - the utility's right to a fair return and the consumer's right to reasonable access to power. Mr. Justice Green notes that the Board must be careful to balance both interests, when he says, at para. 144:

"It must always be remembered that, as has been emphasized throughout this opinion, the Board is charged with balancing the competing interests of the utility and the consumers of the service it provides. Neither set of interests can be emphasized in complete disregard of the interests of the other. Thus, in choosing to exercise a particular power within the Board's jurisdiction, the Board must always be mindful of whether, in so acting, it will be furthering the objectives and policies of the legislation and doing so in a manner that amounts to a reasonable balance between the competing interests involved."

In conclusion, the Court found that the Board can be regulative and corrective but not managerial in its prospective regulation of a utility. The Board notes that the Court of Appeal suggested that the Board should observe a presumption of managerial good faith.

2. Board Procedures

The Board's procedures are governed by the relevant legislation and, as a quasi-judicial body, the principles of natural justice and procedural fairness apply. The *Act* and *Regulation 39/96* both set out procedures for the Board. In addition to prescribed regulations, Section 26 of the *Act* enables the Board to establish its own procedures. This permits the Board to exercise discretion to allow for a more informal and flexible treatment of issues.

The procedures of the Board address items such as the form of the application, public notice, submission by intervenors, information requests, document exchange along with rules and protocol surrounding public hearings. While the procedures in a hearing before the Board are less formal than a court, the principles of natural justice are still observed. Sufficient notice is given to all interested persons who are provided with the opportunity to participate. Witnesses are sworn, and their testimony is heard by way of both direct and cross-examination. Evidence is entered and documented and the Board maintains a full and complete record.

Hearing documentation is generally filed in electronic format with a paper copy maintained as the official Board record. The Board provides public access to all information through the Board's web site (www.pub.nl.ca). The web site is updated daily with transcripts and additional evidence filed during each day's proceedings posted in advance of the commencement of the hearing the following day. During the hearing the evidence can also be viewed simultaneously by the Board, parties and witnesses on monitors located in the Hearings Room.

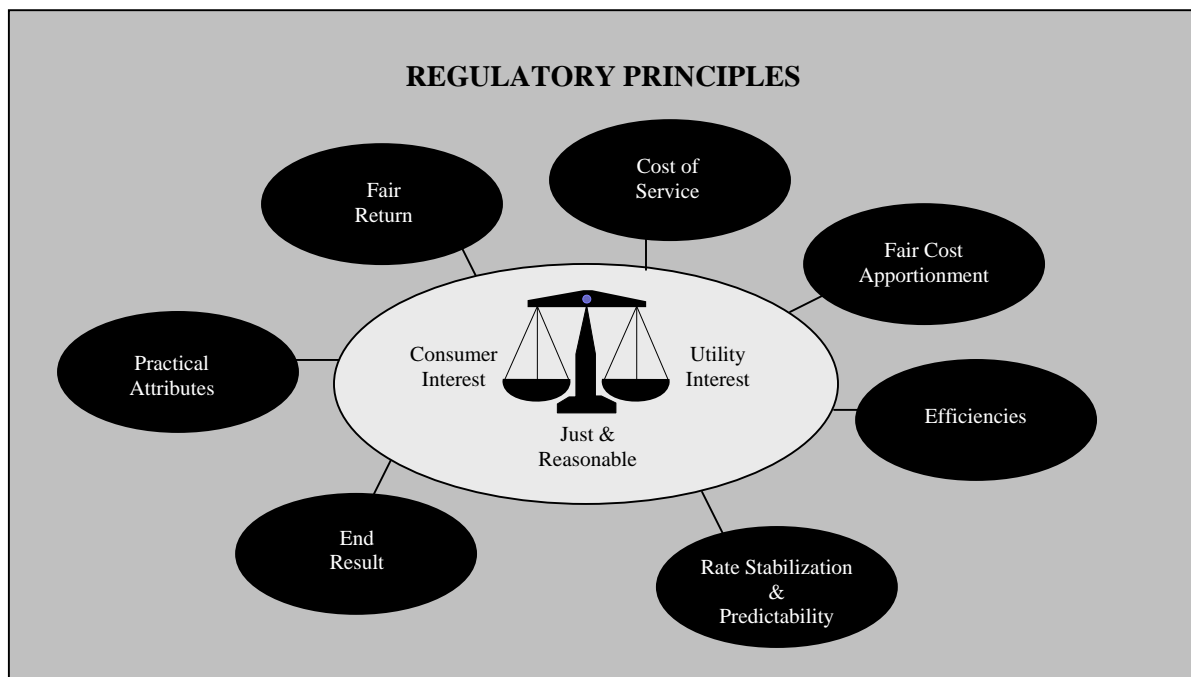
Through these procedures the Board ensures that the process is accessible and transparent for stakeholders, including the public. The Board may also travel throughout the province to hear from interested persons or organizations. Full and informed public debate and discussion on the issues is encouraged through the participation of the parties, the general public and, for major hearings, a government appointed consumer advocate.

After full consideration of all of the evidence the Board will issue a reasoned decision, usually in writing. A Decision and Order of the Board will be issued and, as noted previously, can only be appealed to the Court of Appeal.

3. Regulatory Principles

Sound regulatory practices encompass fundamental principles which are used by regulators as a guide or roadmap to rational decision-making. As stated in the Bonbright J. C., Daniels A.L., Kamerschen D.R., Principles of Public Utility Rates (Arlington: Public Utilities Reports, Inc., 1988): “We are simply trying to identify the desirable characteristics of utility performance that regulators should seek to compel through edict.” These are commonly referred to as Bonbright’s principles.

Section 4 of the *EPCA* directs the Board to apply tests that are consistent with generally accepted sound public utility practice. The Board sets out the following principles for purposes of its regulatory framework:



1. Fair Return

Regulated utilities are given the opportunity to earn a fair rate of return. To be considered fair, the return must be:

- commensurate with return on investments of similar risk;
- sufficient to assure financial integrity; and
- sufficient to attract necessary capital.

The fair return principle is consistent with both Section 80(1) of the *Act* and Section 3(a)(iii) of the *EPCA*.

2. Cost of Service

Under this principle a utility is permitted to set rates that allow the recovery of costs for regulated operations, including a fair return on its investment devoted to regulated operations - no more, no less. Costs should be:

- prudent;
- used and useful in providing the service;
- assigned based on cause (causality);
- incurred and recovered (matching costs and benefits) during the same period; and
- reflective of private/social costs and benefits occasioned by the service.

3. Fair Cost Apportionment

Fairness of specific rates in the apportionment of total costs of service among the different ratepayers should be such so as to avoid arbitrariness, capriciousness, inequities or discrimination. Under this principle, customers in similar situations should be treated equally (horizontal equity), while those in different situations should be treated differently (vertical equity). This principle would not deny cross-subsidization of rates among customers of equal circumstances but such subsidization should not cause undue discrimination. The principle of horizontal equity (i.e. equals treated equally) is set forth in Section 73(1) of the *Act* which requires that “*all tolls, rates and charges shall always, under substantially similar circumstances and conditions in respect of service of the same description, be charged equally to all persons and at the same rate, ...*”. Furthermore, the aspect of undue discrimination also has statutory reinforcement in Section 3(a)(i) of the *EPCA* which declares it to be “*...the policy of the province that the rates to be chargedshould be reasonable and not unjustly discriminatory.*”

4. Efficiencies

Rate classes and rate blocks should discourage wasteful use of service while promoting all types and amounts of use that are economically justified. Greater efficiency should also be encouraged in promoting innovation and responding economically to changing demand and supply patterns.

5. Rate Stability and Predictability

Rates and revenues should be stable and predictable from year to year with a minimum of unexpected changes seriously adverse to either ratepayers or utility companies. This principle may justify smoothing out increases to avoid sharp rate climbs or temporary fluctuations. The emphasis using this standard relates to the timing of rate implementation.

6. End Result

In compliance with the legislation, the end result must be fair, just and reasonable from the perspective of both the consumer and utility.

7. Practical Attributes

Rates should be simple, understandable and publicly acceptable with a minimum of controversy upon implementation.

While setting out these principles may be useful to ensure full consideration of all the issues, the Board notes that at times they may contain ambiguities, conflict with legislation, be inconsistent and/or hold different priorities. The real challenge for the Board, in keeping with its legislative mandate, is to balance oftentimes competing objectives within the regulatory environment to ensure a set of sound and reasoned decisions serving the interests of both consumer and utility alike.

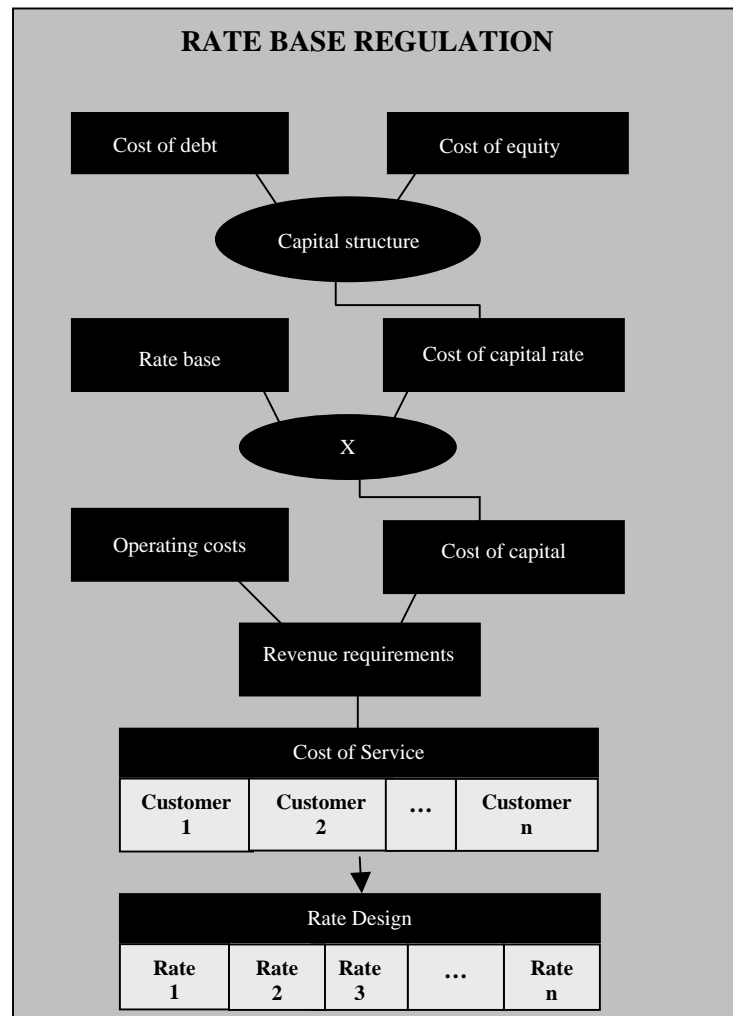
During rate proceedings the Board is often petitioned by intervenors and presenters to consider the customers' ability to pay when setting rates for various classes of customers and service. While cross subsidization of a group of customers contributing toward the cost of service assigned to another group of customers is a common regulatory practice, the ability of an individual customer to pay for the electrical service consumed is not considered by the Board in setting rates. Without compelling change in either legislation, public policy or structure of regulation, the Board will continue to pursue generally accepted regulatory principals as outlined above which does not incorporate ability to pay among its criteria for rate setting.

4. The Rate Setting Process

The rate setting process is founded in accounting, engineering and economic methodologies and is the proverbial glue that binds the regulatory framework. The Board's authority, the evidence and regulatory principles are combined by the Board through this process to make decisions affecting rates. The rate setting process is described below under the heading "*Rate Base Regulation*".

Rate Base Regulation

As noted previously, pursuant to Section 80 of the *Act*, the regulatory framework of the Board is founded in rate base regulation. The elements of rate base regulation are illustrated as follows:



(As modified from “*Basics of Canadian Rate Regulation*”, pg. 13,
by J. T. Browne and Charles Perron, Deloitte & Touche, 1997.)

The focus of return on rate base regulation is on earnings, in particular the allowed return per dollar of investment (rate base). Rates are set to give the regulated utility the opportunity to recover its revenue requirement consisting of its estimated operating costs and a fair return on its rate base. These costs are generally estimated for a test year(s) for which the rates are set.

Rate Base

Rate base is the amount of investment on which a regulated utility is allowed to earn a fair return. Rate base comprises primarily depreciated investment in plant and equipment plus working capital as well as certain deferred assets/costs attributable to future operations. Regulators tend to focus on whether additions to the rate base, looking at the asset, are needed and if the cost is reasonable.

Capital Structure

Capital structure is the relative amounts of equity and debt, commonly referred to as the debt to equity ratio, which comprises a company's total invested capital. The total invested capital represents the funds invested in the public utility by shareholders (equity) and by bondholders and other long-term debt holders (debt). The just and reasonable rate of return allowed on rate base is equivalent to the cost of capital representing the sum of the weighted costs of both debt and equity in the capital structure.

Revenue Requirement

Revenue requirement is the amount of revenue required by a utility to cover the sum of operating costs including debt service, depreciation, taxes and allowed return on rate base (\$ rate base x cost of capital). The revenue requirement is the total amount of money a utility is eligible to collect from customers through rates:

$$\text{Revenue Requirement} = \text{Operating Costs} + (\text{Rate Base} \times \text{Rate of Return})$$

From a regulatory perspective, efficient operations, fully justified capital expenditures and a low cost capital structure all combine to minimize revenue requirement, and hence provide least cost electricity to ratepayers.

Cost of Service

Cost of service constitutes the basis on which the utility's revenue requirement is allocated to each class of customer served. The utility normally submits a study of the costs incurred in purchasing, producing, transmitting and distributing electricity to its customers, by customer class.

Rate Design

Once the cost of service or revenue requirement is allocated by customer class, specific rates are determined to recover the required costs/revenues from each customer within the class.

5. Reporting/Compliance

Reporting/Compliance is the mechanism used to monitor the ongoing activities of the utility from a regulatory perspective and is an important part of the regulatory framework. Section 16 of the *Act* states:

“The board shall have the general supervision of all public utilities, and may make all necessary examinations and inquiries and keep itself informed as to the compliance by public utilities with the law and shall have the right to obtain from a public utility all information necessary to enable the board to fulfil its duties.”

Consistent with the Court of Appeal’s findings, the role of the Board is not to exercise managerial influence but to ensure appropriate reporting/compliance mechanisms are in place such that regulatory objectives are met. The objective of the Board is to focus on regulatory accountability of the utility rather than engage in detailed reviews and costly controls. In keeping with this approach, some examples of the Board’s reporting/compliance requirements requested of the utilities include:

- Compliance with Board Orders;
- Annual financial review;
- Quarterly reports;
- Incident/Outage reports;
- Technical reports;
- Productivity, cost benefit and efficiency studies;
- CIAC audits; and
- Monitoring complaints.

6. Summary

A consistent and equitable regulatory framework is in the interests of both the regulated utilities and consumers. The framework as described above has been in place in one form or another since the Board was established in 1949. This framework has evolved to date through a series of legislative amendments and case law and will continue to form the basis of the Board’s exercise of its regulatory authority under existing legislation, both in this Decision and Order and on a go forward basis.