

PART THREE. SUMMARY OF BOARD DECISIONS

I. SUBMISSION OF CONSUMER ADVOCATE ON EXCESS EARNINGS

1. The Board finds that it has no jurisdiction under the *Public Utilities Act* to require payment by NP into a reserve account or otherwise deprive NP of any amount which is within the allowed return on rate base as fixed and determined by the Board pursuant to Section 80(1) of the *Act*.

II. FORECASTING ISSUES

2. The Board will accept NP's customer and energy sales forecasts for the test year period 2003-2004.

III. RISK ASSESSMENT

3. The Board does not anticipate a change in the business risk of NP in the foreseeable future and concurs with the assessment of NP and the cost of capital experts that NP is of average business risk compared to other utilities.
4. The Board finds that capital market conditions, in particular affecting the equity market, have changed substantially since 1998. This volatility has contributed to an overall reduction in investor expectations in the equity market from historic levels. In addition, volatility has contributed to greater spreads being demanded by corporate bondholders and equity investors to account for added risk as compared to long-term government securities. The Board finds these trends will similarly influence NP but present no greater financial risk to NP than will be experienced by other comparable Canadian utilities.
5. The Board finds that based on its financial performance NP continues to sustain a sound credit rating which is providing appropriate and cost efficient access to the financial markets.
6. The Board concludes that in the interest of both the utility and its customers. NP should continue to be treated as a stand-alone utility. Therefore, the Board will require NP to take all appropriate steps necessary to preserve the financial integrity and independence of the utility. As a first step, NP will be required to file a report by June 30, 2004 addressing how it can ensure stand-alone status in respect of its corporate credit linkage by S & P to Fortis. This report should: 1) document discussions with the credit rating agencies and Fortis on this issue; 2) explain how other regulated Canadian utilities are facing similar challenges; 3) provide a list of possible mitigating actions; and 4) provide a plan of implementation of recommended actions.

7. Despite the change in circumstances since 1998, the Board finds that the overall investment risk of NP is average when compared to other Canadian utilities. This finding will be the basis on which the Board will consider a commensurate capital structure and ROE for the utility.

IV. FINANCIAL TARGETS AND OBJECTIVES

8. Having reviewed the evidence the Board is of the opinion that it is reasonable and prudent to maintain the capital structure deemed appropriate in Order No. P.U. 16(1998-99). The proportion of regulated common equity in the capital structure should not exceed 45%. Any regulated common equity in excess of 45% will only be entitled to a rate of return equal to the rate of return on preferred equity. For the purpose of determining the weighted average cost of capital, the Board accepts NP's proposed forecast average capital structure for the 2003 and 2004 test years.
9. The Board will continue to rely principally on the equity risk premium test and will determine a return on regulated common equity primarily with a view to establishing a risk-free rate based on long-term Government of Canada bond yields plus an appropriate risk premium.
10. The Board will utilize 5.60% as the forecast of the risk-free rate to be applied in the equity risk premium test for the test years 2003 and 2004.
11. The Board will make no adjustment to the equity risk premium test for financing costs.
12. The Board will incorporate a risk premium of 4.15% in the equity risk premium test in calculating the cost of common equity.
13. The Board will utilize a return on regulated common equity of 9.75% for the purposes of determining the WACC for both 2003 and 2004.
14. The Board finds an interest coverage in the order of 2.4x is acceptable given NP's level of risk and the Board's findings in this Decision with respect to NP's capital structure and return on regulated equity.

V. INTER-CORPORATE RELATIONSHIPS AND CHARGES

15. NP will be required to observe the following principles in all inter-corporate transactions:
 - (i) All inter-corporate transactions between a utility and its affiliates shall be fully transparent and are subject to scrutiny by the Board.
 - (ii) A utility shall have the right to manage its affairs but it must demonstrate to the satisfaction of the Board that all affiliate transactions are prudent.
 - (iii) A utility shall ensure that inter-corporate transactions will not disadvantage the interests of ratepayers and furthermore that ratepayers and the utility will derive some demonstrable benefit from such transactions.

- (iv) The onus is on the utility to show that it is in compliance with the guidelines and principles with respect to inter-corporate transactions.
16. These principles may be amended by the Board from time to time. Given the implications of these principles on both NP and its affiliates, NP will be required to undertake a review and update of its operating practices and procedures relating to any and all inter-corporate transactions to ensure that the principles as set out above are reflected. The results of such a review shall be reported to the Board no later than March 31, 2004.
17. NP will be directed to prepare a report which should compare and quantify the benefits to NP and ratepayers of its administration of and participation in a centralized insurance program for the Fortis Group of Companies, rather than be insured on a stand-alone basis. This report should be filed with the Board no later than March 31, 2004.
18. NP will be required to modify its quarterly reports on inter-corporate charges to show separately associated labour and other staff and expense charges billed in relation to NP's insurance administration on behalf of Fortis and related companies.
19. As part of the review of operating practices and procedures relating to inter-corporate transactions NP will be required to investigate the utilization of market rates for executive and management time charges. In lieu of market rates, NP shall propose an appropriate markup on its cost-based rates as a proxy for market in the event that utilization of market rates is not practical.
20. NP will be required to apply billing and collection practices with respect to inter-corporate transactions which are consistent with those applied to unrelated parties. Billings to Fortis and related companies should also be undertaken within 30 days of the service and/or expenses being charged for recovery.

VI. AUTOMATIC ADJUSTMENT FORMULA

21. The Board will continue to use the existing methodology in the Automatic Adjustment Formula for calculating the risk-free rate. However, the risk-free rate will now be calculated based on the actual yields of the three most recent series of long-term Government of Canada bonds during the 10 trading days being monitored as reported in The Globe and Mail under the heading "*Ask Yields*". The observed average of the daily ask yields for the last five trading days of October and the first five trading days of November for these three most recent issues will be used to forecast the risk-free rate for the upcoming year, in each year of operation of the Formula.
22. The Board has determined that a total risk premium of 415 basis points, or 4.15%, is reasonable. This is the value that will be used and adjusted on the same basis as was ordered in Order No. P.U. 36(1998-99) in the application of the Formula.

23. NP will be required to modify the schedule filed as part of its annual return that calculates the embedded cost of debt to identify specifically the causes of variations in the actual embedded cost of debt from the cost forecast for the test year period.
24. The Board will establish a mechanism tied to the observed rate of return on regulated common equity which may trigger an early review of the Formula and cost of capital. Where the actual rate of return on regulated equity in any intervening year exceeds the cost of equity determined by the Formula by more than 50 basis points, then NP will be required to file a report with the Board in its annual return setting out the circumstances and facts contributing to the difference.
25. The Board will approve the use of the Formula, as modified by this Decision, for a further three-year period. Customer rates will be set for 2003 and 2004 by this Decision and Order. The Formula will be used to set the rate of return on rate base, and hence customer rates, for 2005, 2006 and 2007.
26. The Board finds that the Asset Rate Base method should replace the Invested Capital approach currently used to calculate NP's rate base. The move to the Asset Rate Base method will begin in 2003 by incorporating deferred charges in rate base. The Board will direct NP to implement the following guidelines in switching to the Asset Rate Base method:
 - (i) Average deferred charges based on BVP-11 to be added to the average rate base for the 2003 and 2004 test years and all subsequent fiscal years.
 - (ii) Evidence relating to changes in deferred charges, in particular deferred pension costs, to be filed annually at the capital budget hearing.
 - (iii) NP will provide a reconciliation of average Rate Base to average Invested Capital annually at the capital budget hearing.
 - (iv) NP will review no later than its next general rate application, the appropriateness and approach to including the remaining reconciling items in the Rate Base. This review will address the issue of discontinuing the use of regulated common equity in favour of book equity.

VII. RATE BASE

27. NP will be required to file a revised calculation of rate base and return on rate base for test years 2003 and 2004 which reflects the decisions taken by the Board.
28. The Board will approve a range of 36 basis points for the rate of return on rate base for test years 2003 and 2004 and for use with the Formula, unless otherwise ordered by the Board.

VIII. ACCOUNTING TREATMENT AND POLICIES

29. The Board will accept NP's proposal to amortize the recovery of the \$5,600,000 balance in the Hydro Production Equalization Reserve over a period of five years, beginning in 2003. NP will be required to review the balance in the Hydro Production Equalization Reserve as of December 31, 2005 and to apply to the Board for an Order as to the disposition of outstanding balances, positive or negative, as part of its next general rate application.
30. The Board will approve NP's proposal to adopt the market-related method of determining pension expense on a prospective basis, effective January 1, 2003.
31. The Board will approve the 2002 Depreciation Study as filed. The depreciation rates as recommended in the Depreciation Study will be approved for calculating depreciation expense for the test year period 2003 and 2004.
32. The Board will approve NP's proposal to amortize the depreciation reserve variance over the three-year period 2003-2005.
33. The Board will approve NP's proposal to continue with the cash basis for recognizing expenses for other employee future benefits. With its next general rate application, NP will be required to submit a report which addresses the use of the accrual method as an alternative to the existing accounting treatment for other employee future benefits.
34. The Board will approve NP's proposal to amortize over a three-year period, beginning in 2003, the estimated regulatory costs of \$1,200,000.
35. The Board finds that the 2001 excess earnings of \$944,000 should be rebated to customers. NP will be required to submit a proposal for this rebate as part of its filing of revised rates.
36. The Board will accept NP's proposal for adjusting 2003-2004 revenue requirement to recover the outstanding amount of the 1992-1993 excess earnings as required by Order No. P.U. 36(1998-99), subject to any adjustments arising from this Decision.
37. The Board will approve NP's request to defer dealing with the outstanding issues relating to the Revenue Recognition Study pending resolution of the dispute with Canada Customs and Revenue Agency (CCRA).
38. Since the Board has agreed to the deferral of the issues relating to the Revenue Recognition Study until the dispute between NP and CCRA is resolved, the Board will also approve NP's request to defer dealing with the disposition of the unbilled revenue increase reserve account. This issue will be dealt with as part of the Order arising from consideration of the Revenue Recognition Study to be filed by NP, as was intended in Order No. P.U. 36(1998-99).

39. The Board accepts NP's treatment of expenses associated with the 2000 and 2001 early retirement programs.

IX. REVENUE REQUIREMENT

40. The Board will use fiscal years 2003 and 2004 as the test years for determining revenue requirement, as proposed by NP.
41. The Board accepts the purchased power expense for the test year period 2003-2004, as proposed by NP, subject to any adjustments arising from this Decision.
42. The Board accepts the proposed operating expense forecast for the test year period 2003-2004, with the exception of executive compensation which is dealt with separately below.
43. The Board will no longer require NP to file an annual Advertising and Marketing Report.
44. The Board will direct that any STI payouts in excess of 100% of target payouts will be the responsibility of the shareholder, Fortis, and will be charged to non-regulated operations.
45. The Board accepts the level of executive compensation as part of NP's revenue requirement for the test year period 2003-2004.
46. The Board accepts the depreciation expense for the test year period 2003-2004, as proposed by NP.
47. The Board accepts the forecast income tax expense for the test year period 2003-2004, as proposed by NP, subject to any adjustments arising from this Decision.
48. The Board accepts the deduction from revenue requirement of other revenue for the test year period 2003-2004, as proposed by NP.
49. Since the Board will require that the 2001 Excess Revenue be rebated to customers, NP's revenue requirement will not be reduced by this amount, as proposed by NP.
50. The Board accepts the deductions from revenue requirement of non-regulated expenses for the test year period 2003-2004, as proposed by NP.
51. NP will be required to calculate and file a revised revenue requirement for 2003 and 2004 based on its proposals in this Application, and incorporating the changes set out in this Decision relating to allowed rate of return on rate base and the adjustment for 2001 Excess Revenue.
52. The Board will accept, subject to review of reasonableness and prudence, certain other secondary or incidental changes in revenue requirement which arise as a result of this Decision.

X. COST OF SERVICE

53. The Board has reviewed the Mediation Report and the evidence filed relating to Cost of Service issues. The Board accepts the recommendations of the parties as set out in the Mediation Report and will approve the recommendations as presented.
54. The Board will approve additional 2003 capital expenditures of \$425,000 for a load research program, as proposed by NP.

XI. RATES, RULES AND REGULATIONS

55. The Board has reviewed the Mediation Report and the evidence filed relating to Rate Design Issues. With the exception of the issue relating to meter meading, which was not agreed to by the parties, the Board accepts the recommendations of the parties as set out in the Mediation Report and will approve the recommendations as presented.
56. Since the conclusion of the hearing of this Application, NLH has filed its general rate application for 2004. The Board will direct that scheduling of the consultation recommended in the Mediation Report on NLH's wholesale power rate design be considered at the pre-hearing conference for NLH's general rate application.
57. The Board will direct NP to propose to the Board for approval a "*peer group*" of utilities and performance measures upon which to evaluate NP's performance in accordance with the terms of the Mediation Report.
58. The Board will not direct any changes to the wording of Rules & Regulations 8-Meter Reading at this time. The Board will undertake a review of NP's meter reading program with a focus on the estimating methodology and process. This review will also include an assessment of existing regulatory and utility practice in other Canadian jurisdictions.
59. The Board will not make any adjustments to the application of demand charges within the General Service Rates.
60. The Board will not order the Domestic Rate be made available to house meters of apartment buildings.
61. The Board is not persuaded that changes to the Customer Deposit Policy or to the Rules and Regulations respecting security deposits would be fair to other customers. The Board will not order a change in the present policy covering the rate of interest paid to customers on cash security deposits.
62. The requirement for inspection of service prior to reconnection is primarily a safety issue and the Board will not intervene.

63. In order to finalize rates to be implemented as a result of this Application, NP will be directed to re-file, along with its revised revenue requirement and revised calculations of rate base and return on rate base, its Schedule of Rates, Tolls and Charges to be effective for billings on or after August 1, 2003 incorporating the decisions of the Board. The rates shall be calculated on the same basis as in the Application and shall be designed to remain in effect through 2004.
64. NP will also be directed to file a proposal as to the finalization of interim rates as set by Order No. 35(2002-2003) and the disposition of any variance between revenue generated based on these interim rates and the revised 2003 test year revenue requirement. The proposal should include a plan for the rebate of this amount to customers.
65. The Board will review NP's revised filing to ensure its decisions are appropriately incorporated and then issue a final Order, approving or modifying, as it deems appropriate, NP's rate base, NP's return on rate base and the revised rates for NP's customers as of August 1, 2003.

PART FOUR. BOARD ORDER**IT IS THEREFORE ORDERED THAT:****CAPITAL STRUCTURE**

1. The proportion of regulated common equity in the capital structure shall not exceed 45%. Regulated common equity in excess of 45% of the total invested capital shall not attract a rate of return higher than the rate of return on preferred equity of 6.31%.
2. For purposes of determining the weighted average cost of capital, the Board accepts the forecast average capital structure for the 2003 and 2004 test years as proposed by NP. The forecast average capital structure for 2003 shall be deemed to be debt of 54.28%, preferred equity of 1.45%, and common equity of 44.27%; and, for 2004, debt of 54.06%, preferred equity of 1.39%, and common equity of 44.55%.

RATE BASE/RETURN ON RATE BASE

3. NP shall move toward the adoption of the Asset Rate Base method for determining rate base and beginning in 2003 shall incorporate the average deferred charges, as set out in its Application, to the average rate base.
4. NP shall calculate and file a revised average rate base and return on rate base for 2003 and 2004, based on its proposals in this Application, incorporating the changes set out in this Decision and Order, which include:
 - i. A return on regulated common equity of 9.75% is to be used for calculating the weighted average cost of capital for the 2003 and 2004 test years; and
 - ii. The move to the Asset Rate Base method of determining rate base.
5. NP shall file annually with its capital budget application, unless otherwise ordered by the Board:
 - i. Evidence relating to changes in deferred charges, including pension costs; and
 - ii. A reconciliation of average rate base to average invested capital.
6. NP shall file no later than its next general rate application a report on including in rate base the remaining reconciling items between rate base and invested capital as described in this Decision and Order.
7. The allowed range of rate of return on rate base shall be 36 basis points for 2003 and 2004 and for use in the Automatic Adjustment Formula, unless otherwise ordered by the Board.

AUTOMATIC ADJUSTMENT FORMULA

8. Unless the Board otherwise orders upon application by NP or by the Board of its own motion, the rate of return on rate base for the years 2005, 2006 and 2007 shall be set using the Automatic Adjustment Formula that was established by the Board in Order No. P. U. 36 (1998-99), incorporating the changes set out in this Decision and Order, including:
 - i. The move to the Asset Rate Base method; and
 - ii. The use of the three most recent, rather than the two previously specified, series of long-term Government of Canada bonds in determining the risk-free rate.
9. NP shall apply no later than November 30th in each of 2004, 2005 and 2006 for the application of the Automatic Adjustment Formula to the rate of return on rate base and for a revised Schedule of Rates, Tolls and Charges effective January 1 in each year following.
10. NP shall prepare and file with the Board:
 - i. With its annual return until otherwise directed by the Board, a modified schedule calculating the embedded cost of debt for the reporting year to identify specifically the causes of variations in the actual embedded cost of debt from the cost forecast for the test period; and
 - ii. With its annual return where in a year the actual rate of return on regulated equity is greater than 50 basis points above the cost of equity as determined by the Formula, a report explaining the circumstances and facts contributing to the difference.

INTER-CORPORATE RELATIONSHIPS AND CHARGES

11. NP shall review and update its operating practices and procedures to reflect the principles governing all inter-corporate transactions as set out in this Decision and Order, and which may be amended by the Board from time to time.
12. NP shall file with the Board:
 - i. By June 30, 2004 a report addressing its stand-alone status in respect of the corporate credit linkage of NP to Fortis, as detailed by the Board in this Decision and Order.
 - ii. By March 31, 2004 a report as to its operating practices and procedures relating to any and all inter-corporate transactions, including:
 - a) An investigation of the utilization of market rates or a suitable proxy markup for executive and management time charges;

- b) **Quantification of the benefits to NP and its customers of its administration of and participation in a centralized insurance program for the Fortis Group of Companies and comparing these benefits to being insured on a stand-alone basis;**
 - c) **A comparison of NP's billing and collection practices with respect to affiliate companies and unrelated parties.**
- iii. **Modified quarterly reports which show separately the associated labour and other staff and expense charges billed in relation to NP's insurance administration on behalf of Fortis and related companies.**

ACCOUNTING TREATMENT AND POLICIES

- 13. **NP's proposal to amortize the recovery of the \$5,600,000 balance in the Hydro Production Equalization Reserve over a period of five years, beginning in 2003, is approved.**
- 14. **NP's proposal to adopt the market-related method of determining pension expense on a prospective basis, effective January 1, 2003, is approved.**
- 15. **The 2002 Depreciation Study and depreciation rates included therein are approved.**
- 16. **NP's proposal to amortize the depreciation reserve variance over the three-year period 2003-2005 is approved.**
- 17. **NP's proposal to continue using the cash basis for recognizing expenses for other employee future benefits is approved.**
- 18. **NP's proposal to amortize over a three-year period, beginning in 2003, regulatory costs of \$1,200,000 is approved.**
- 19. **NP's request to defer dealing with the outstanding issues relating to the Revenue Recognition Study and the unbilled revenue increase reserve account is approved.**
- 20. **NP shall file with the Board:**
 - i. **A new depreciation study as of December 31, 2006;**
 - ii. **No later than with its next general rate application a report which addresses the use of the accrual method for other employee future benefits; and**
 - iii. **As part of its next general rate application a proposal as to the disposition of the balance in the Hydro Production Equalization Reserve as of December 31, 2005.**

REVENUE REQUIREMENT

21. NP shall calculate and file a revised total revenue requirement for the 2003 and 2004 test years based on its proposals in this Application, incorporating the changes set out in this Decision and Order.
22. NP shall rebate to customers the 2001 excess earnings of \$944,000 and shall file for the approval of the Board a proposal for this rebate.
23. NP's proposal for adjusting 2003-2004 revenue requirement to recover the outstanding amount of the 1992-1993 excess earnings as required by Order No. P.U. 36(1998-99) is approved, subject to any adjustments arising from this Decision and Order.
24. Regulated expenses for 2003 and subsequent years shall exclude short-term incentive program payouts in excess of 100% of target.
25. NP is no longer required to file the Advertising and Marketing reports required by Order No P. U. 7(1996-97).

COST OF SERVICE

26. NP shall revise its cost of service methodology, using the COS methodology as proposed by NP, incorporating the changes set out in this Order which include the recommendations of the Mediation Report, as set out in Schedule 1 of this Decision and Order.

RATES, RULES AND REGULATIONS

27. NP shall revise and file for the approval of the Board a revised Schedule of Rates, Tolls and Charges which shall be effective for monthly bills issued August 1, 2003 through to December 31, 2004, based on the proposals of NP in its Application, incorporating the changes set out in this Decision and Order, which include the recommendations of the Mediation Report as set out in Schedule 2 of this Decision and Order.
28. NP shall file a proposal as to the finalization of interim rates as set by Order No. P.U. 35(2002-2003) and the disposition of any variance between revenue generated based on those interim rates and the revised 2003 test year revenue requirement.
29. NP shall revise and file for the approval of the Board revised Rules and Regulations, based on the proposals of NP in this Application, incorporating the changes set out in this Decision and Order, which include the Recommendations of the Mediation Report as set out in Schedule 2.

30. NP shall revise and file for the approval of the Board the definition of “*excess earnings*” in the company’s system of accounts to reflect earnings above the maximum of the allowed range of rate of return on rate base.
31. NP shall file with the Board by March 31, 2004 a report suggesting a “*peer group*” of utilities and performance measures upon which to evaluate NP’s performance, in accordance with the terms of the Mediation Report.

CAPITAL ITEM

32. The additional 2003 capital expenditure of \$425,000 for a load research program as proposed by NP is approved.

HEARING COSTS

33. NP shall pay the expenses of the Board arising from this Application, including the expenses of the Consumer Advocate incurred by the Board, pursuant to Section 117 of the *Act*.

Dated at St. John's, Newfoundland and Labrador this 20th day of June 2003.

Robert Noseworthy,
Chair & Chief Executive Officer.

Darlene Whalen, P.Eng.,
Vice-Chairperson.

John William Finn, Q.C.,
Commissioner.

G. Cheryl Blundon,
Director of Corporate Services
and Board Secretary.