

P.U. 7 (1996-97)

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**IN THE MATTER OF THE PUBLIC UTILITIES
ACT, R.S.N. 1990, CHAPTER P-47, (“THE ACT”)**

AND

**IN THE MATTER OF AN APPLICATION OF
NEWFOUNDLAND LIGHT & POWER CO.
LIMITED FOR AN ORDER:**

- (i) fixing and determining rate base;**
- (ii) determining a just and reasonable return;**
- (iii) determining rates of depreciation;**
- (iv) approving a revised schedule of rates, tolls and charges; and**
- (v) approving revisions to the rules and regulations.**

I INTRODUCTION

THE APPLICATION

On February 19, 1996, the Board of Commissioners of Public Utilities (“the Board”) received an application from Newfoundland Light & Power Co. Limited (“the Applicant”), which was amended on April 29, 1996, requesting an Order of the Board:

- (a) fixing and determining the average rate base of the Applicant for the year ended December 31, 1991 at \$435,007,000; for the year ended December 31, 1992 at \$450,418,000; for the year ended December 31, 1993 at \$459,561,000; for the year ended December 31, 1994 at \$465,333,000; and for the year ended December 31, 1995 at \$469,676,000;

- (b) fixing and determining the estimated average rate base for the Applicant for the year ending at December 31, 1996 at \$472,631,000 and for the year ending December 31, 1997 at \$476,103,000;
- (c) determining a just and reasonable rate of return on average rate base in the range of 11.15% to 11.41% based on a range of rate of return on average common equity of 11.75% to 12.25%;
- (d) approving revised rates of depreciation for the property of the Applicant for the year 1996 and for subsequent years;
- (e) approving a revised Schedule of Rates, Tolls and Charges to be effective for service provided on and after November 1, 1996;
- (f) approving the revisions to the Applicant's Rules and Regulations to be effective November 1, 1996; and
- (g) granting such alternate, additional or further relief as the Board, after hearing the application, shall consider fit and proper in all of the circumstances.

At the time of initial submission, the Applicant filed the evidence and exhibits it intended to enter through its witnesses at the public hearing. The amended application, received on April 29, 1996, appropriately amended the evidence and exhibits. Schedule A (Proposed Rates) to the application was further amended and filed on July 31, 1996.

Notice of the application was given in local newspapers circulated throughout the Province. In the same advertisement, the Board also gave notice that it would conduct Phase I of the Hearing in the Hearings Room of the Board in St. John's on March 11, 1996.

The Phase I Hearing

The purpose of a Phase I Hearing (or Pre-Hearing) is to bring together all parties who may wish to participate in the proceedings, to explain the Board's procedures, to have all identified parties attempt to agree on a commencement date for the Phase II Hearing, and, if possible, identify and schedule proposed witnesses. Phase I Hearings were also held on March 20 and May 7, 1996.

It was agreed that the Phase II Hearing would begin on July 15, 1996 at 9:00 A.M. Notice of the Phase II Hearing of the amended application was subsequently advertised in local newspapers circulated throughout the Province.

At the Phase I Hearing on May 7, 1996, the Consumer Advocate made a request that:

- (1) the Board provide a date so that the rates set by the Board in its Order No. P.U. 6 (1991) be declared interim rates, and that if, after deliberations at the conclusion of the hearing, the Board determined that the rates of return on rate base (and common equity) to be approved were less than those which the Applicant was now enjoying, the excess funds earned from the date of such an Order to the date of the Board's final Order would be declared surplus earnings and the excess funds be returned to the consumers;
- (2) the Board issue an Interim Order for a temporary rescission of its Order No .P.U. 1 (1996-97) approving the application of the Applicant to issue \$40,000,000 of First Mortgage Sinking Fund Bonds, because of lack of appropriate notice to the public.

- (3) the Board include in its terms of reference to its Financial Consultants that it identify the effect of the harmonization of the Federal and Provincial Sales Taxes, if such harmonization is implemented as proposed in the Memorandum of Understanding signed by the Governments concerned; and
- (4) the Applicant update its circular to its customers (distributed as a bill stuffer) because of the amended application.

After hearing the above application of the Consumer Advocate on May 10, 1996, the Board issued Order No. P.U. 2 (1996-97) which dealt as follows with the foregoing requests:

- (1) The Board agreed to hear the matter on May 10, 1996 and, after the hearing, denied the request;
- (2) The Board denied the request since it considered appropriate notice was given, and did not consider further action was warranted;
- (3) The Board agreed to ensure that such a matter would be identified by its consultants; and
- (4) The Board concurred and suggested that participants to the hearing be polled for suggested inputs, with a time limit for responses.

At the Phase I Hearing, the following were in attendance:

Peter S. Alteen, LL.B. & Gerard Hayes, LL.B. on behalf of the Applicant;

Stephen Spracklin, LL.B. on behalf of NewTel Communications Inc. (formerly Newfoundland Telephone Company Limited);

Janet Henley Andrews, LL.B., and Rodney J. Zdebiak (one time) on behalf of Irving Oil Limited;

Dennis M. Browne, LL.B., Government-Appointed Consumer Advocate, assisted by Mark Kennedy, LL.B.;

Ms. Linda Hyde, Fishersperson's Helpline;

Dr. Patricia G. Hempstead, Executive Director, Newfoundland and Labrador Federation of Municipalities;

Ms. Terri Gale, Private Citizen;

Ms. Geraldine Hammond, Pensioners and Senior Citizens Federation of Newfoundland and Labrador;

Mr. Alex House (later Mr. John F. Peddle), Newfoundland and Labrador Health Care Association; and

Jeffrey Brace, LL.B., Councillor-at-Large, City of St. John's.

Letters requesting intervenor status were received from the following:

Mr. Dennis O'Keefe, Co-founder of Consumer Power;

Mr. John Butt, President of the Canadian Oil Heat Association;

Mr. Sam Synard, Chairman of the Newfoundland Light & Power Co. Limited Advisory Council;

Mr. Jack Byrne, M.H.A., Cape St. Francis;

Ms. Mary Ennis, Executive Director, Consumer Organization of Disabled Persons of Newfoundland and Labrador;

Ms. Sylvia Barrett;

Mr. Alan Hayman;

Mr. Tom Osborne, M.H.A., St. John's South;

Mr. William T. Butt, Spaniard's Bay; and

Mr. Peter G. Hiscock General Manager, Baccalieu Trail Chamber of Commerce, Winterton, Trinity Bay.

In addition, seventy-one letters of objection to the application were received during the course of the hearing. A list of the names and addresses is attached as **Appendix I**.

During the hearing, the following made oral presentations to the Board objecting to the application.

1. Dennis O'Keefe - July 19 & August 16, 1996;
2. Nath Mullett - July 26, 1996;
3. Edward Besso, Kelligrews - Submission and Petition - July 26, 1996;
4. Dr. Patricia G. Hempstead and Mr. Gordon Rodgers, Newfoundland and Labrador Federation of Municipalities - July 26, 1996;
5. Don Holloway and Mrs. Olive Atfield, Pensioners and Senior Citizens Federation Newfoundland and Labrador - July 26, 1996;
6. Tom Osborne, M.H.A., St. John's South, July 26, 1996;
7. John C. Butt, President & C.E.O., Canadian Oil Heat Association - August 2, 1996
8. Ms. Terri Gale - August 2, 1996;
9. Sam Synard, Chairman, Newfoundland Light & Power Co. Limited Advisory Council - August 2, 1996;
10. Ed Byrne, M.H.A., Kilbride, August 5, 1996; and
11. Jack Harris, M.H.A., Signal Hill - Quidi Vidi and Leader of the Newfoundland and Labrador New Democratic Party - August 16, 1996.

A summary of each presentation is attached as **Appendix II**.

Written submissions objecting to the application were filed with the Board by:

1. Mr. Reg Gabriel, President, Newfoundland Public Service Pensioners Association - March 25, 1996;
2. Ms. Gladys M. Costella, President, Western Division, Retired Teachers Association of Newfoundland and Labrador - July 13, 1996;
3. Fisheries Association of Newfoundland and Labrador - August 1, 1996; and
4. Marina Redmond, Administrative Assistant, The City of Corner Brook - August 5, 1996.

A summary of each submission is attached as *Appendix III*.

The following petitions objecting to the application were received by mail from:

1. The Residents of Cottrell's Cove, Moores Cove and Fortune Harbour c/o Mr. John Billings on April 4, 1996 - containing 234 signatures;
2. Mr. Alymer Osborne, Mayor, Town of Seal Cove, W.B., on April 8, 1996 - containing 305 signatures;
3. The Cormack Senior Citizens Club on May 17, 1996 - containing 92 signatures;
4. The Residents of Gander Bay on May 24, 1996 - containing 404 signatures; and another on May 30, 1996 - containing 158 signatures.

On March 29, 1996, the Consumer Advocate applied to the Supreme Court of Newfoundland, Trial Division, for an Order of Prohibition to prevent the Board from proceeding further with the hearing until such time as the Board agreed to conduct the hearing pursuant to the rules and practice of procedure provided in the Public Utilities Regulations, 1950. After Briefs of Fact and Law had been filed by the Consumer Advocate, Counsel for the Board, Irving Oil Limited and the Applicant, the Consumer Advocate withdrew his application on April 18, 1996, the day it was to be heard. The Board and the Applicant were awarded their costs.

On April 2, 1996, the Consumer Advocate gave notice to the Supreme Court of Newfoundland, Court of Appeal, that he intended to petition a Judge of that Court, to seek leave to appeal a ruling of the Board, delivered at the Phase I Hearing on March 20, 1996, regarding the Board's alleged error in law of not allowing the Consumer Advocate to use a Notice for Production of Documents procedure rather than the usual procedure of Demand for Particulars which had been traditionally used by the Board. The Consumer Advocate withdrew his notice to appeal on April 23, 1996.

On July 10, 1996, on application by the Consumer Advocate, and after notice being provided to all parties to the hearing, a separate hearing was held to resolve a disagreement between the Consumer Advocate and the Applicant with regard to responses to Demands for Particulars.

After hearing all interested parties and considering all evidence presented, the Board issued Order No. P.U. 4 (1996-97).

The Phase II Hearing

The Phase II Hearing was held on July 15, 16, 17, 18, 19, 22, 23, 24, 25, 26, 29, 30, 31, August 1, 2, 5, 6, 8, 15 and 16, 1996.

The following were in attendance for **the Applicant**:

Peter S. Alteen, LL.B. and Gerard Hayes, LL.B. Counsel for the Applicant;

The following were in attendance in opposition to the application and are sometimes referred to, either collectively or individually, as **the Intervenor(s)**:

Dennis M. Browne, LL.B., Consumer Advocate, assisted by Mark Kennedy, LL.B.;

Janet Henley Andrews, LL.B. and Anne Murphy, LL.B., (one time) as Counsel for Irving Oil Limited;

Stephen Spracklin, LL.B., as Counsel for NewTel Communications Inc.;

Jack Harris, LL.B., M.H.A., Signal Hill-Quidi Vidi;

Dr. Patricia Hempstead, Newfoundland and Labrador Federation of Municipalities;

Mr. John F. Peddle, Newfoundland and Labrador Health Care Association; and

Ms. Linda Hyde, Fisherpersion's Helpline.

The Board was assisted by its Legal Counsel, Sean Hanrahan, LL.B. and William Brushett, C.A., of Doane Raymond, the Board's Financial Consultants.

Evidence was given for **the Applicant** by the following:

Aidan F. Ryan, P.Eng., President and Chief Executive Officer;

Ronald G. Crane, Director of Forecasts;

Karl W. Smith, C.A., Vice-President, Finance;

Mardon J. Erbland, P.Eng., Vice-President, Corporate and Employee Services;

Wallace W. Pinhorn, P.Eng., Vice-President, Technical Services;

Tom A. Connors, M.B.A., P.Eng., Director of Rates and Costs Analysis;

Dr. Roger A. Morin, Professor of Finance, Georgia State University;

Larry B. Brockman, Vice-President, Electronic Data Systems, EDS, Utilities Division;

and William M. Stout, President, Gannett Fleming Valuations and Rate Consultants.

The Consumer Advocate called the following as witnesses:

Dr. Basil A. Kalymon, Professor of Finance, Faculty of Management, University of Toronto and Consulting Associate with Coopers & Lybrand Consulting;

C. Douglas Bowman, Senior Manager, International Resources Group, Washington, D.C.;

and Dr. James Feehan, Associate Professor of Economics, Memorial University of

Newfoundland. **The Board** called as witnesses:

Dr. John W. Wilson, B.Sc., M.Sc., Ph.D. (Economics); and

William R. Brushett, C.A.

In addition to the prefiled evidence and evidence given at the hearing, the Applicant replied to, and filed with the Board, in excess of four hundred and fifty (450) Exhibits, Consents and Responses to Demands for Particulars. The Intervenors submitted approximately sixty Exhibits and Consents and most provided prefiled evidence.

The Applicant, in its revised application, is seeking an increase in revenue, which if implemented on November 1, 1996, would provide an additional \$1,435,000 in 1996 and an additional \$10,863,000 in 1997, based on its forecasts of sales and expenditures, and a rate of return on average common equity of 12.00%. The additional revenue would equate to an overall average increase to ratepayers of 2.92%. The increase to individual customers would vary from +10.50% to -26.20%, depending on the level of electric power consumed.

The Applicant proposed to restructure both its domestic and general service rates with changes (from TAC-7, 2nd Revision) as shown below:

	<u>Average Increase</u>	<u>High</u>	<u>Low</u>
Domestic 1.1	3.85%	10.50%	- 1.60%
General Service 2.1	3.03%	8.60%	- 2.50%
General Service 2.2	-1.00%	10.40%	-26.20%
General Service 2.3	2.91%	7.50%	-26.10%
General Service 2.4	3.27%	5.50%	- 0.70%
Street & Area Lighting 4.1	1.95%	1.95%	1.95%

Other requests included fixing and determining average rate base for the test year (1997) and the intervening years since the previous rate hearing (1991); approving revised rates of depreciation; approving a revised Schedule of Rates, Tolls and Charges to be effective November 1, 1996; and approving revisions to some of the Rules and Regulations.

The variance in the percentage of change in the proposed rates was caused in part by the Applicant's proposal to place a surcharge on the first 700 kWh in rates # 1.1 and # 2.1, and to introduce a new basic customer charge in rates # 2.2, # 2.3, and # 2.4.

The proposed rates were based on, or influenced by, the following factors (among others):

- (1) The provincial government's policy at one time had been to subsidize Newfoundland and Labrador Hydro (Hydro) for its unrecovered cost of providing service to isolated areas and areas that were not connected to the provincial electrical grid. When the Government stopped providing the subsidy to Hydro, Hydro then had to recover these costs from its other customers. As the Applicant is Hydro's major customer, it claimed that its rates to its customers were 6.8% higher as a result of this Government decision. The Applicant considered this cost to be in effect, a tax. It thus proposed a surcharge on the first 700 kWh used per month per customer in Rate Classes # 1.1 and # 2.1, which would partially offset the lack of subsidy;
- (2) There would also be advantages to electric heat customers in that the energy charge would be reduced and electric heat customers on average would see a lesser increase in rates; and, in the case of the largest users, a decrease in rates.

To achieve the additional required funds, the Applicant proposed the following rates (shown with existing rates). Both sets of rates exclude the Rate Stabilization Adjustment and the Municipal Tax Adjustment.

RATE # 1.1
DOMESTIC SERVICE

	<u>Existing</u> <u>Jan 1, 1992</u>	<u>Proposed</u> <u>November 1, 1996</u>
Basic Customer Charge	\$ 16.32 per month	\$16.94 per month
Energy Charge: All kilowatt-hours	@ 6.373 4 per kWh	@ 6.090 4 per kWh
Minimum Monthly Charge	\$ 16.32	\$ 16.94
Provincial Electricity Surcharge First 700 kWh/month	N/A	@ 1.112 4 per kWh

RATE # 2.1
GENERAL SERVICE 0-10 kW

	<u>Existing</u> <u>Jan 1, 1992</u>	<u>Proposed</u> <u>November 1, 1996</u>
Basic Customer Charge	\$ 18.57 per month	\$19.12 per month
Energy Charge: All kilowatt-hours	@ 8.367 4 per kWh	@ 7.908 4 per kWh
Minimum Monthly Charge,	Single Phase \$ 18.57	\$ 19.12
	Three Phase \$ 37.14	\$ 38.24
Provincial Electricity Surcharge First 700 kWh/month	N/A	@ 1.333 4 per kWh

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RATE # 2.2

GENERAL SERVICE 10-100 kW(110 kVA)

Existing

Jan. 1, 1992

**BILLING WILL BE BASED ON
THE LESSOR OF THE
FOLLOWING MONTHLY
RATES:**

Proposed

November 1, 1996

EITHER

Basic Customer Charge

\$ N/A

\$22.00 per month

Demand Charge:

\$7.96/kW of billing demand in
the months of Dec, Jan. Feb.& Mar.

\$7.90/kW of billing demand in the
mos. Of Dec., Jan., Feb. & Mar.

\$7.23/kW in all other months
In the case of churches and
schools the billing demand shall
be reduced by \$0.49/kW. The
billing demand shall be the higher
of: a) the maximum demand
registered on the meter in the

\$7.17/kW in all other
months. The billing
demand shall be the
maximum demand
registered on the
meter in the current
month.

Energy Charge:

First 150 kWh/kW
of billing demand
All excess kWh

@ 6.956 4 per kWh
@ 4.518 4 per kWh

@ 6.638 4 per kWh
@ 4.210 4 per kWh

OR

Alternate

Energy Charge:

All kWh

@ 20.0 4 per kWh

Maximum Monthly Charge:

The Maximum Month
Charge shall be
14.0 cents per kWh plus the Basic
Customer Charge of
per month, but not less than the
Minimum Monthly charge.

Minimum Monthly Charge:

An amount equal to \$2.25 per kW
of maximum demand occurring in
the 12 months ending with the current
month but not less than \$37.14 for a
three phase service.

An amount equal to \$2.35 per kW
of maximum demand occurring in
the 12 months ending with the current
month but not less than \$38.24 for a
three phase service.

RATE # 2.3
GENERAL SERVICE 110 kVA(110 kW) - 1000kVA

Existing
Jan. 1, 1992

Proposed
November 1, 1996

**BILLING WILL BE BASED ON
THE LESSOR OF THE FOLLOWING
MONTHLY RATES:**

EITHER

Basic Customer Charge	\$ N/A	\$100.00 per month
Demand Charge:	<p>\$6.62/kVA of billing demand in the mos. of Dec.,Jan., Feb.&Mar.</p> <p>\$5.89/kVA in all other months. The billing demand shall be the higher of: a) the maximum demand registered on the meter in the current month, or b) 110 kVA.</p>	<p>\$6.81/kVA of billing demand in the mos. of Dec., Jan.,Feb., & Mar.</p> <p>\$6.08/kVA in all other months. The billing demand shall be the maximum demand registered on the meter in the current month.</p>

Energy Charge:

First 150 kWh/kW
of billing demand, up to a
maximum of 30,000 kW
All excess kWh

@ 6.3774 per kWh
@ 3.978 4 per kWh

@ 6.485 4 per kWh
@ 4.090 4 per kWh

OR

**Alternate
Energy Charge:**

All kWh

@ 20.0 4 per kWh

Maximum Monthly Charge:

The Maximum Month Charge shall be 14.0 cents per kWh plus the Basic Customer Charge of \$100.00 per month, but not less than the Minimum Monthly Charge.

Minimum Monthly Charge:

An amount equal to \$2.25 per kVA of maximum demand occurring in the 12 months ending with the current month.

An amount equal to \$2.35 per kVA of maximum demand occurring in the 12 months ending with the current month.

RATE # 2.4
GENERAL SERVICE - 1000kVA AND OVER

Existing
Jan. 1, 1992

Proposed
November 1, 1996

BILLING WILL BE BASED ON
THE LESSOR OF THE FOLLOWING
MONTHLY RATES:

EITHER

Basic Customer Charge	\$ N/A	\$200.00 per month
Demand Charge:	\$6.24/kVA of billing demand in the mos. of Dec., Jan., Feb. & Mar. \$5.50/kVA in all other months. The billing demand shall be the higher of: a) the maximum demand registered on the meter in the current month, or b) 1000 kVA.	\$6.58/kVA of billing demand in the mos. of Dec., Jan., Feb., & Mar. \$5.85/kVA in all other months. The billing demand shall be the maximum demand registered on the meter in the current month.
Energy Charge:		
First 100,000 kWh	@ 5.625 4 per kWh	@ 5.328 4 per kWh
All excess kWh	@ 3.844 4 per kWh	@ 3.990 4 per kWh

OR

Alternate Energy Charge:	
All kWh	@ 20.0 4 per kWh

Maximum Monthly Charge:	The Maximum Month Charge shall be 14.0 cents per kWh plus the Basic Customer Charge of \$200.00 per month, but not less than the Minimum Monthly Charge.
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Minimum Monthly Charge:	An amount equal to \$2.25 per kVA of maximum demand occurring in the 12 months ending with the current month.	An amount equal to \$2.35 per kVA of maximum demand occurring in the 12 months ending with the current month.
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RATE # 4.1
STREET AND AREA LIGHTING SERVICE

MONTHLY RATE

	<u>Existing</u> <u>Jan. 1, 1992</u>				<u>Proposed</u> <u>November 1, 1996</u>	
		<u>Standard</u>				
Mercury Vapour	Sentinel	<u>2" Bkt</u>	<u>6' Bkt</u>	<u>Post Top</u>	<u>Sentinel/Standard</u>	<u>Post Top</u>
175 W(7,000 lumens)	\$ 12.99	\$12.99	\$13.19	\$13.95	\$13.17	\$14.58
250W (9,400 lumens)	15.32	15.32	15.54	-	15.01	-
400W(17,200 lumens)	21.75	21.75	21.97	22.39	21.43	-
700W(29,600 lumens)	-	-	34.35	-	33.67	-
1000W(48,000 lumens)	-	-	46.71	-	50.23	-
 High Pressure Sodium*						
100W(8,600 lumens)	-	\$12.99	\$13.19	\$13.95	\$13.17	\$14.58
150W(14,400 lumens)	-	15.96	16.48	17.08	16.57	17.83
250W(23,200 lumens)	-	-	20.39	-	21.21	-
400W(45,000 lumens)	-	-	28.34	-	27.90	-

* For all new installations and replacements.

Special poles used exclusively for lighting service **

	<u>Existing</u> <u>Jan. 1, 1992</u>	<u>Proposed</u> <u>November 1, 1996</u>
Wood	\$ 5.79	\$ 6.25
30' Concrete or Metal, direct buried	8.35	10.15
45' Concrete or Metal, direct buried	14.32	14.64
25' Concrete or Metal, Post Top, direct buried	7.99	8.84

Underground Wiring (per run) **

All sizes and types of fixtures	14.88	14.86
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** Where a pole or underground wiring run serves two fixtures paid for by different parties, the above rates for such poles and underground wiring may be shared equally between the two parties.

The Applicant requested confirmation of the interim approval of a curtailable rate which was granted October 4, 1994. Since interim approval was granted, nine customers (four hospitals, three nursing homes, one hotel and one ski resort) signed up for the program. The curtailable load was approximately 5 MW. In 1994-95 (the last full year) customers were paid \$29/kVA for curtailment. In this application, it is proposed to continue the same rate even though Hydro had indicated that its Loss of Load Expectation (LOLE) Forecast has increased substantially, which would increase the calculated value of a curtailable credit. The curtailable credit value varies with the LOLE. It was anticipated that the proposed rate would be in place for three years.

The curtailable rate was described as a very valuable tool when Hydro was having technical problems in supplying the Applicant; however, its impact was considered very small in the overall picture and, in fact Hydro did not take their curtailable load into account when making their forecasts.

Since the Applicant flowed the credit through the Rate Stabilization Account, it was revenue neutral.

Rules and Regulations

The Applicant also proposed fourteen changes to its Rules and Regulations.

The changes were made for clarification; to adjust some fees; to institute new fees and cancel others; to allow the Applicant to make certain changes for technical or safety reasons; and to give specific customers relief, under certain circumstances.

BOARD CONSIDERATIONS

The Board has given careful consideration to all the evidence and representations submitted but reference will be made herein to only those matters required to explain the reasons for its decision. The Board in arriving at its decisions is guided by the direction provided in the Acts it administers relating to public utilities.

II REASONS FOR DECISION

1. CAPITAL STRUCTURE

Introduction

The rate base of the Applicant is financed with equity capital and with debt. The equity component is comprised of common equity and preferred shares. The debt component is comprised of a variety of debt instruments, mainly long-term debt. The allowed rate of return on rate base or on common equity will influence, among other things, the revenue requirements of the Applicant and the need for any rate changes.

In minimizing the cost of financial capital, the Applicant must choose an efficient capital structure by which to finance its operation. In seeking an optimum capital structure, the objective is to achieve a balance between financial strength, as measured by the Applicant's external credit rating, and the cost of capital which must be borne by the ratepayer. Increased equity may enhance financial strength, but it may also increase the cost of capital.

The Applicant's financial objectives, as stated in Vice-President Smith's pre-filed evidence, are as follows:

- * To maintain a rate of return on common equity in the range of 11.75% - 12.25%;
- * To maintain an interest coverage ratio on total debt in the range of 2.75 times to 3.25 times; and
- * To maintain a capital structure that supports adequate interest coverages and reasonable return on equity, specifically within the following ranges:

Debt	45%-50%
Preferred Shares	2% - 3%
Common Shares	47%-53%.

The rate increase proposed by the Applicant is projected to provide a rate of return of 12.0% on average common equity, both in 1996 and in 1997. Interest coverage is forecast to be 2.7 times in 1996 and 2.9 times in 1997. These financial results are shown in Exhibit KWS-1. The projected average level of common equity in 1996 is 46.37%, while in 1997 it is projected at 45.55%. These projections are below the range targeted by the Applicant, namely, 47%-53%, and, indeed, diverge from this range progressively over the two year projection period. The proportion of debt is projected under the proposed rates to increase from an average of 49.93% in 1995 to 51.65% in 1996 and to 52.52% in 1997. Again, these are outside of the target ranges established by the Applicant. The Applicant is proposing that the relative proportion of preferred equity be reduced from an average of 2.17% in 1995 to 1.98% in 1996 and 1.93% in 1997. In 1991, preferred shares amounted to an average of 6.97%. The Applicant has redeemed \$21,000,000 in preferred shares since 1991. These shares were redeemed in an effort to reduce the overall cost of capital, since the Applicant believed they could be replaced by debt, with a lower after-tax cost. The issues of preferred shares which remain (approximately \$10,000,000) have not been redeemed, due to the low dividend rate attached to these

issues. The Applicant believes that preferred equity is no longer an attractive source of capital because of changing market conditions and accounting rules.

The Applicant's position is that perpetual preferred shares are well suited for capital financing but that the short maturity issues presently available are not attractive. The remaining issues of preferred shares are perpetual in nature and are not affected by the change in accounting rules. In light of the change in the preference share market, the Applicant is not planning further issues of preferred shares in its capital plan.

Order No. P.U. 6 (1991)

In Order No. P.U. 6 (1991) the Board ordered that a range of 13% to 13.5% be adopted as the Applicant's rate of return on common equity, with rates being set at the midpoint of the range, 13.25%. In the same Order, the Board found that a just and reasonable return for the Applicant in the calendar year 1992 lay between 10.96% and 11.19% on its estimated average rate base. The allowed rate of return was intended to give an interest coverage in 1992 of 2.87 times.

In the 1991 General Rate Hearing, the Applicant proposed a capital structure for 1991 and 1992 as follows:

Debt	45%-50%
Preferred Shares	5%-10%
Common Equity	40%-45%.

In Order No. P.U. 6 (1991) the Board adopted the proposed capital structure as the basis for the Applicant's financial plan, noting that the forecasted common equity ratio of 45.7% in 1992 "is approved with the exception that NP design its 1993 financial plan to bring the common equity ratio

back within the approved range of 40% to 45%”[p.45 of Order No. P.U.6 (1991)].

For 1992, the common equity ratio was estimated to be 45.7%, whereas the maximum ratio dictated by the Applicant’s financial plan was 45%. In defending this deviation, the Applicant stated that “this change means the common equity ratio will temporarily be slightly higher than the target ratio of 45%. This ratio will revert back to less than 45% in 1993 and at that time we plan to issue preference shares instead of common shares”.

Financial Results 1992-1995

In reviewing the financial results from 1992 to 1995, it is evident that the proportion of common equity increased from 1992 to 1993, and again from 1993 to 1994. Furthermore, preferred equity declined from 6.97% in 1991 to 2.17% in 1995. Over the same period, debt, as a proportion of the capital structure, increased slightly from 48.67% in 1991 to 49.93% in 1995. The embedded cost of debt declined from 10.12% in 1991 to 9.49% in 1995.

The Applicant’s return on rate base for the years 1992 to 1995 is summarized as follows:

1992	11.43%
1993	11.37%
1994	10.97%
1995	10.94%.

In 1992 and 1993, the return on rate base was higher than 11.19%, the upper limit of the approved range.

The Applicant's return on common equity for the years 1992 to 1995 is summarized as follows:

1992	13.47%
1993	12.79%
1994	12.03%
1995	12.07%.

These returns do not exceed the upper limit of the range of 13.0% to 13.5% approved by the Board in Order No. P.U.6 (1991).

Capital expenditures averaged \$37.2 million per year for 1991 to 1995. In terms of transactions, the Applicant issued an additional \$6,000,000 in common shares from 1991 to 1994 through the Consumer Share Purchase Plan and the Employee Share Purchase Plan. There were no issues of preferred shares. Preferred shares in the amount of \$21,000,000 have been redeemed. New bond issues amounting to more than \$118,000,000 were placed in the 1991-1995 period. Bond redemptions amounted to \$80,000,000. In addition, a \$40,000,000 bond issue was placed in May of 1996. To reduce the amount of common equity, a special dividend of \$12.0 million was paid in 1994 and another of \$15.5 million in July, 1996.

Capital Structure - Analysis of Proposal

The Applicant's position was that its business risk over the last five years has increased, arising from reduced growth attributable to general economic conditions and from rigorous competition in the heating market. The Applicant's Financial Consultant, Dr. R. Morin, stated that the Applicant was able to preserve its overall investment risk and to counter balance the negative influences arising from the declining provincial economy by strengthening its capital structure.

In support of the statement that overall investment risk has been maintained, Dr. Morin cited the Applicant's average bond rating by both the Canadian Bond Rating Service (CBRS) and the Dominion Bond Rating Service (DBRS), as well as the Applicant's average risk factor.

The Applicant takes the position that the Board's acceptance of its financial objectives with respect to interest coverage, return on common equity and capital structure would enable it to maintain its credit rating with the major rating agencies and that it must maintain at least an AA@ credit rating in order to market its debt securities at the lowest possible interest rates.

Dr. Kalymon, on behalf of the Consumer Advocate, objected to the capital structure as proposed by the Applicant. His recommendation was that the capital structure should be deemed to be 40% common equity, with a target of 15% preferred shares and 45% debt. Any equity capital exceeding 40% should be allowed only the current preferred share cost. He testified that a 40% common equity ratio would place the Applicant at the most efficient end of the 40%-45% range approved by the Board in 1991.

The Applicant stated that adoption of the proposal to deem equity at 40% could lead to a downgrade in the Applicant's credit rating. Dr. Kalymon testified that many other companies, with comparable risk, operate with a common equity component in the 40% range. Dr. Kalymon testified that he believed that the Applicant would continue to maintain its AA@ credit rating, notwithstanding such a change in its capital structure.

Preference Shares

All parties acknowledged that common equity capital is most expensive, followed by preferred shares, with the after-tax cost of debt being the least costly form of financing. The

Applicant believes preference shares to be unattractive because of the higher cost and the inappropriately short terms characteristic of the present preference share market. Dr. Kalymon testified that preferred shares are a form of capital which is intermediate between debt and common equity, with equity characteristics which add to the financial strength of the Applicant and a cost close to that of debt.

In response to questions as to why Fortis Inc. found it advantageous to issue preference shares in the amount of \$50,000,000, while the Applicant was reducing its preferred shares, the Applicant responded that Fortis Inc., as a holding company, was faced with very different tax consequences from those facing the Applicant. Fortis Inc. does not have taxable income and therefore cannot write off interest expense, as can the Applicant.

Board Determination

The Board has heard no convincing arguments to suggest that the range for common equity approved in 1991 has become inappropriate. **The Board is of the opinion that the proportion of common equity should be in the range of 40% to 45%.**

With respect to preferred shares, the Applicant has requested a targeted range of 2%-3%, while the Consumer Advocate has recommended that a target level of 15% be established. **The Board has determined a range of 3%-6% for preferred shares.**

The Board hereby approves the following capital structure:

Common Equity	40%-45%
Preferred Shares	3%- 6%
Debt	47%-55%.

To the extent that common equity in 1996 and 1997 exceeds 45%, this excess equity will be deemed as preferred shares and will be allowed a return of 6.33%, which is the blended cost of existing preferred shares.

2. RATE OF RETURN ON EQUITY

Introduction

Section 80(1) of the Act states that “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...”. *The Electrical Power Control Act, 1994* declares the power policy of the Province to be that the rates to be charged “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 ...”. The requirement for a fair return on invested capital is based upon the principle that, in order to attract capital, a utility must offer a rate of return to the investor comparable to investments of similar risk. The required return is the opportunity cost on alternative investments whose risk is of comparable magnitude to that of investment in the utility.

The requirement of a fair return on invested capital has been historically and consistently endorsed by Canadian Supreme Courts. In 1929, the Supreme Court of Canada stated, in *Northwestern Utilities vs. City of Edmonton* [1929] 2 D.L.R. (4th) at p. 8, that rate levels should be fair and reasonable to the consumer as well as to the utility and should yield a fair rate of

return on money invested. In 1961, the Supreme Court of Canada stated, in *British Columbia Electric Railway vs. Public Utilities Commission of British Columbia, et al*, [1961] 25 D.L.R. (2d) 689, at pp.697-698, that “earnings must be sufficient ... to enable [the utility] to ... attract capital either by the sale of shares or securities.”

These principles were also articulated in landmark decisions of the United States Supreme Court in the *Federal Power Commission vs. Hope Natural Electric Company*, 320 U.S. 591 (1944) and in *Bluefield Waterworks and Improvements Company vs. Public Service Commission of West Virginia*, 262 U.S. 679 (1923).

The Board heard evidence with respect to the appropriate return on equity from Dr. Roger Morin for the Applicant, and from Dr. Basil Kalymon for the Consumer Advocate.

Dr. Roger Morin

Dr. Morin bases his analysis upon a stable interest rate environment. He has determined that inflation is low and economic growth is “fragile”. He testified that forecasting agencies expect the yield on government bonds with maturities of 10 years or more to remain relatively flat and to average 7.7% over 1996. Both the Conference Board of Canada and Consensus Economics forecast stable to slightly rising rates.

Dr. Morin views 7.25% to 7.75% as a reasonable range for long-term Canada Bonds. In his measurement of the cost of capital he has used 7.6%, which was the current yield on 30-year Canada bonds as of January, 1996.

Dr. Morin employed four generic tests, namely: (1) the comparable earnings test; (2) the discounted cash flow approach; (3) the risk premium approach; and (4) the capital asset pricing model (CAPM). The CAPM approach is a variant on the risk premium approach.

Dr. Morin believes that no one single measure should be employed and that each of these four approaches provides valuable information. He feels that judgement should be exercised in assessing the results derived from each approach.

The total investment risk faced by an investor in the Applicant has two components: business risk and financial risk. Total risk has not changed since 1991 and the Applicant continues to possess average total risk. However, Dr. Morin believes that business risk has increased, particularly as a result of the Provincial economic environment and the intense competition in the space and water heating markets from oil heating companies. Dr. Morin traces this weakening in the Provincial economy to the decline in the fishery sector, the completion of the Hibernia project and Government fiscal restraint. Dr. Morin believes that the above average business risk of the Applicant is offset by its stronger capital structure, high equity level and supportive regulatory structure.

Comparable Earnings Approach

The comparable earnings approach uses the return earned on book equity by enterprises of comparable risk, as a measure of fair return. Dr. Morin has taken a low risk group of industrials selected from equities listed on the Toronto Stock Exchange (TSE). The average return on equity 1985-1994 for this sample of 22 companies is estimated at 11.79%.

Risk Premium Approach

Dr. Morin calculates five risk premium measures based upon Canadian and United States utility returns and upon Canadian regulatory awards.

All five of these risk premium estimates are based upon regulatory decisions and are, therefore, open to question on the grounds of circularity of reasoning. (Dr. Kalymon argued that utility based returns should not be used, in order to avoid such circularity biases.)

Dr. Morin's sixth estimate follows the Capital Assets Pricing Model (CAPM), which quantifies the additional risk premium required by investors for bearing increased risk. It requires an estimate of total market risk premium and of company-specific risk, the amount of such risk which is shared by the regulated company.

The market risk premium derived by Dr. Morin was estimated from five historical studies covering a wide range of industries. The resulting estimate of the cost of equity capital is 11.76%.

The seventh risk premium estimate is an expanded version of the CAPM model, known as the Empirical Capital Assets Pricing Model (ECAPM). This model produces an estimate of the cost of equity capital at 12.32%.

Discounted Cash Flow Estimates

Dr. Morin also uses the Discounted Cash Flow (DCF) model which is based upon the expected discounted value of the future stream of dividends arising from an investment decision. This model can also be viewed in terms of an investor's expectation of future benefits arising from a stream of dividends, along with an expected capital appreciation of the equity. The flow

of discounted returns must be inferred from market information. The model suffers from a

number of methodological shortcomings.

Dr. Morin applied the model to Fortis Inc., as well as to a group of telephone companies and a group of electric utilities. Again, these tests are circular, by virtue of the fact that they draw upon regulatory decisions.

Application of the DCF model for 19 low risk individuals results in an return on equity of 13.36%. When the natural resource and diversified holding companies are removed, the return on equity is 12.81%.

Recommendation of Dr. Morin

Dr. Morin recommended that the average rate of return on equity, based upon all results, is 12.12%. His opinion is that a just and reasonable return on the common equity of the Applicant lies in the range of 11.75% to 12.25%. Rates should be set at the midpoint, which is 12.0%. This recommendation is based upon the assumption that common equity capital remains at its present level. It is also based upon the assumption that the risks of the Applicant are average relative to the utility industry.

Dr. Basil Kalymon

Dr. Kalymon expects that economic conditions will continue to be stable and that inflation levels will be modest. He has determined that the easing of pressures upon financial markets has stabilized interest rates. Reduced financial requirements by government, particularly provincial governments, have been a major contributor to this trend.

Nominal interest rates have declined, but high real yields have persisted. Dr. Kalymon

testified that the current long term Canadian bond rate (15 years) is 8.01% but, combined with an inflation rate of 1.6%, the result is a real rate of 6.41%. This is well above the 20-year average real rate of 4.69%.

Equity markets have shown strong performance, in terms of prices and profits. Price stability has contributed to low dividend levels. Utilities and pipeline companies have outperformed the TSE 300 over the past 20 years.

Dr. Kalymon feels that the overall risk for the Applicant is low and that its main business risk arises from the state of the economy. The price of purchased power is stable and the automatic “pass-through” provisions of the Rate Stabilization Plan (RSP) have the effect of reducing risk. The high reliance upon hydro-electric power keeps energy costs down. Relatively high dependency upon retail customers, and low dependence on industrial customers, also reduces risk. Dr. Kalymon views the competitive pressures facing the Applicant to be lower than those faced by other Canadian utilities.

With its reduced capital program, the Applicant has no major capital requirements and no construction risk. He is of the opinion that financial requirements can be met through internal resources.

Dr. Kalymon recommends a rate of return on equity of 10.0% to 10.5%, based upon his findings derived from applying the risk premium method, the comparable earnings test and the discounted cash flow (DCF) approach.

Risk Premium Approach

Dr. Kalymon studied the historical risk premium achieved by companies listed on the

TSE, compared with the yield on long-term Canada bonds, over the 1975-95 period. From this analysis, Dr. Kalymon concludes that a risk premium of 1.50% to 2.00% should be added to the 15-year Canada bond rate of 8.01% (June 10, 1996). The indicated cost of equity, based upon average market risk, is 9.51% to 10.01%.

Comparative Earnings Test

Dr. Kalymon took a sample of low risk industrials and a sample of privately-owned Canadian regulated utilities. Profitability among the industrials peaked in 1989 and has declined significantly in the past six years. Dr. Kalymon adjusted the historical returns, based upon market to book ratios. This adjustment lowers the achieved returns, on the assumption by Dr. Kalymon that shareholders today do not require the historically achieved level of book returns.

The estimated adjusted earnings for the low risk industrial group are in the range 8.39% to 9.69%. Dr. Kalymon's conclusion is that the current average required return on equity is in the range of 9.22% to 9.54%. In his view, the required returns for regulated companies are well below currently awarded levels and reflect continued decreases in costs that have occurred in capital markets.

Dr. Kalymon observes that Fortis Inc. shares continue to trade at levels well above book value and above the 1.10 level which is generally recognized as a reasonable target and that the price performance of Fortis Inc. shares indicates that lower levels of return would be acceptable to investors.

Discounted Cash Flow Approach

The stability of dividends and earnings in the utility sample is generally conducive to the

application of the DCF model. The DCF approach requires that current dividend levels be added to growth in book value. Dr. Kalymon has adjusted the observed growth in book values to recognize that inflation rates, over the 1985 to 1995 period, averaged 3.4% and exceeded the current inflation rate of 1.6%. This leads to the DCF-based assessment of 8.19% to 9.09% as the cost of equity to the Applicant. However, there are circularity problems because the assessment is based upon a utility sample.

Dr. Kalymon applied the same approach to the low risk industrial sample. His conclusion is that the cost of equity, with book value growth adjusted for inflation, is 8.27% to 9.39%.

Recommendation of Dr. Kalymon

Dr. Kalymon concluded that the DCF test and the risk premium test are more reliable than the comparable earnings test. He concluded that the cost of equity to the Applicant is in the range of 8.19% to 10.01%. After adjustment of 50 basis points for market pressure, the cost of equity to the Applicant is in the range of 8.69% to 10.51%.

Based upon his recommended change to a deemed capital structure, Dr. Kalymon proposes a range of rate of return of 10.00% to 10.50% for the deemed equity component of 40%.

Board Determination

The table below provides a summary of the evidence presented to the Board with respect to the appropriate rate of return on common equity (“ROE”).

TABLE A

Comparison of ROE Results between Morin and Kalymon

	<u>Dr. Morin</u>	<u>Dr. Kalymon</u>
<u>Long Term Canada Bonds</u>	7.6% (plus premium) (30 year Canada Bonds, January 1996)	8.01% (plus premium) (15 year Canada Bonds, June 10, 1996)
<u>Risk Premium Approach</u>	11.76% (CAPM)	9.51% to 10.01%
<u>Discounted Cash Flow Approach</u> (Canadian Industrials)	12.81%	8.27% to 9.39%
<u>Comparable Earnings Approach</u> (Low Risk Industrials)	11.79%	8.39% to 9.69%
<u>Recommended Range</u>	11.75% to 12.25%	10.0% to 10.50%
Midpoint	12.00%	10.25%

Many of the tests conducted used historical utility data, and, accordingly, are open to circularity problems as was pointed out in the hearing. The Board prefers to estimate the opportunity cost of capital using as broad an industrial base as possible and recognizing that the most comparable companies are those with low risk.

There are significant differences in the estimates presented by Dr. Morin and by Dr. Kalymon. These differences arise from a number of factors, including adjustments for differences in assumptions with regard to inflation, adjustments for differences in market to book ratios, difference in time periods as well as differences in sample data.

The Board concludes that a fair return on equity to the Applicant is in the range of 10.75% to 11.25%, with a midpoint of 11.00%. This range of return on equity shall apply to 1996 and 1997. The midpoint of 11.00% will be adopted by the Board for rate setting

purposes in establishing the revenue requirements of the Applicant.

The corresponding return on rate base is 10.65%, within a range of 10.50% to 10.80%.

3. INTEREST COVERAGE

Introduction

The Applicant identified an interest coverage ratio in the range of 2.75 times to 3.25 times as necessary to maintain its credit rating. In support of its application, the Applicant provided Exhibit KWS-4, which shows interest coverage data for a selected group of investor owned utilities for the period 1991 to 1995, inclusive. The average interest coverage on total debt, for all the utilities in the exhibit, was 2.9 times in 1991, declining to a coverage of 2.7 times in 1995. During this period, the Applicant maintained a similar trend in interest coverage. Coverage on total debt stayed within the range 2.8 times to 2.9 times from 1991 to 1995, with the exception of 1995, when coverage was 2.7 times.

Exhibit KWS-1 showed the forecasted financial results for 1996 and 1997, under existing and proposed rates. Under existing rates, projected interest coverage of 2.5 times in 1997 is below the Applicant's target range. Under the proposed rates, interest cover would remain at 2.7 for 1996 and would rise to 2.9 for 1997.

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Assessment by Dr. Morin

Dr. Morin testified that, if coverage is not in the 2.75 to 3.00 range, it will be difficult to maintain an "A" bond rating. He stated that the cost of capital recommendations of Dr. Kalymon could lead to a danger of a downgrade in the credit rating of the Applicant. Dr. Morin stated that

the cost of interest spreads between B++ and A rated utilities have increased. Investors have become very selective and, when utilities drop below the A level into the B++ level, the cost goes up significantly. He stated that flotation costs will be higher and that it may not be possible to achieve the long maturity dates that the borrower may be seeking. Instead of a placement for 25-years it may be possible only to issue bonds with 10-year maturity dates.

Assessment by Dr. Kalymon

Dr. Kalymon testified that the debt interest coverage ratio of the Applicant in 1995 is comparable to the mean value of 2.87 achieved in 1995 by the regulated sample which he presented in Schedule 14 of his prefiled evidence. He stated that three of the regulated companies (namely, BCE Inc., Maritime Tel & Tel, and West Coast) were able to operate with lower interest coverage ratios, and, in the case of West Coast, as low as 1.67. He stated that even the lower forecasted coverages for 1996 and 1997 (without a rate increase) well exceed the lower limits shown in his regulated company sample. Dr. Kalymon stated that an interest coverage level of 2.5 is not unreasonable. He said that the lower limit of the DBRS requirements is 2.0. The bond covenant for the recently issued bonds of the Applicant requires only a 2.0 interest coverage ratio. Furthermore, Dr. Kalymon said that Fortis Inc. in 1995 had only a 2.42 interest coverage ratio. Dr. Kalymon said that his estimate

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of the impact of his recommendations is that the interest coverage ratio would be around 2.69 in 1997. He subsequently tabled his detailed calculations in response to a question from the Applicant. This calculation was subsequently tabled as Exhibit CA-19.

In his final argument, Mr. Alteen commented upon Exhibit NP-101, which estimated the

projected results using Dr. Kalymon's recommendations with respect to rate of return on common equity and capital structure. Mr. Alteen pointed out that Dr. Kalymon does not use the CBRS Methodology which requires gross interest charges to be used in the interest coverage calculation.

Board Determination

The interest cover projected for 1997 from the Applicant's financial model is 2.7, based upon the Board's determinations with respect to return on equity and capital structure. **The Board finds an interest coverage level of 2.7 to be appropriate for the test year 1997.**

4. REVENUE AND LOAD FORECASTS

Introduction

The Applicant's revenue forecast is a critical determinant as to whether a rate increase is justified. The Applicant has forecasted its 1997 revenue, based upon existing rates, as \$337,681,000. The proposed rates are estimated to generate revenues of \$347,528,000. In its review of these projections, the Board examined the underlying customer and energy sales projections as provided in the direct testimony and cross-examination of Mr. Ronald Crane, Director of Forecasts. In his evidence, Mr. Crane detailed customer and energy sales, by rate category, for the periods 1985-1990 and 1990-1995. Over these two periods, energy sales have shifted, according

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to Mr. Crane, from a period of high growth to one of low growth.

Factors Regarding Growth Trends

Mr. Crane testified that the two major factors responsible for the decline in the rate of

growth are the downturn in the provincial economy and the increased competition in the space heating market. His forecasts for 1996 and 1997 are heavily influenced by these two factors.

With respect to the provincial economy, Mr. Crane testified that Gross Domestic Product (GDP) grew at an annual rate of 1.9% from 1985-1990, but, during the second period (1990-1995), declined at an annual rate of 0.2%. Mr. Crane attributes this reduction in growth to a number of factors including: the recession of the early 1990's; the moratoria on groundfish harvesting; and the aggressive deficit reduction effort by Government. Restructuring and downsizing in the private sector were also cited. Mr. Crane testified that the only bright spot is the Hibernia Project currently under construction at Bull Arm.

The second factor resulting in a reduced load growth is competition in the space heating market. The effect of such competition, as well as the Applicant's marketing efforts to mitigate the impact, were taken into consideration in the preparation of Mr. Crane's load forecasts for 1996 and 1997. Mr. Crane stated that, in 1995, conversions to other fuels resulted in a net loss of 747 electric space heating customers, or a loss of 11.5 GWh in energy sales. Prior to 1992, energy sales to domestic customers were increasing, but, since that time, average domestic energy use has been declining.

Economic Assumptions

The assumptions used in preparing the customer and energy sales forecasts for 1996 and 1997 were based upon an economic forecast provided by the Conference Board of Canada. This economic forecast reflects the completion of the construction phase of the Hibernia Project in 1997, as well as the continued restraint by Government. It is projected that GDP in real terms

will decline by 1.3% in 1996 and will grow by 1.0% in 1997. However, population in the Applicant's electrical service area will decline in both years, by 0.7% in 1996 and 0.6% in 1997. Construction activity at the Hibernia Project will peak in 1996 and decline in 1997. The Applicant assumes, contrary to the higher numbers forecast by the Conference Board of Canada, that housing starts will be 1600 units in 1996 and 1750 units in 1997. The nine general assumptions used by Mr. Crane in his forecast are set forth on page four of his prefiled evidence.

Forecast of Customer and Energy Sales Growth

Mr. Crane has forecasted that total customers will grow by 1.1% in both 1996 and 1997 while energy sales will increase by 0.6% in 1996 and decline by 0.2% in 1997. These forecasts are shown in Exhibit RGC-3. Energy sales in the domestic sector are forecasted to increase, while Mr. Crane forecasts that energy sales in the general service sector and in the street and area lighting sectors will decline in 1997.

Forecast of Domestic Customers and Energy Sales

Housing starts account for the majority of new domestic customers and the high percentage of new homes installing electric space heating is a major factor in sustaining positive growth in the

number of domestic customers, as compared with the forecast stagnation in general service sales. The percentage of new homes installing electric space heating has remained fairly stable, at about 70%, but housing starts have fallen off substantially since the early 1990's (as documented in Volume 8-12 of the Applicant's Responses to Demands for Particulars). In addition to the reduction in the number of housing starts, the Applicant attributes the decline in domestic

average use, shown in Exhibit RGC-4, to an increase in the number of customers converting from electric space heating to other fuels. In Mr. Crane's forecast for 1996 and 1997, the percentage of new customers installing electric space heating remains at its current level. However, he has forecasted that conversions from electric space heating will decline slightly, as a result of the marketing efforts of the Applicant. Next to electric space heating, the second largest consumer of energy in the home is water heating. Mr. Crane concluded that the installation of electric hot water heating has reached the saturation point. Other major appliances have also reached, or are close to, saturation (Exhibit RGC-5). Mr. Crane believes the only major appliance which may increase its saturation significantly is the automatic dishwasher. Improved insulation levels contribute to a reduction in electrical consumption. Mr. Crane's forecast assumes that total domestic average use will level off at the 1995 level and that growth in domestic energy sales will be 1.0% in 1996 and 1.0% again in 1997.

Forecast for General Service Customers and Energy Sales

With respect to the general service sector, 84% of the Applicant's energy sales are to customers in the service producing sector of the economy. Mr. Crane is forecasting that the number of customers and energy sales in the service sector will decline in 1996 and increase slightly in 1997.

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The goods producing sector is responsible for only 16% of general service sales and the primary factor in Mr. Crane's forecast for the goods producing sector is the Hibernia project. This project is forecasted to require increased energy in 1996, with a significant drop in 1997, reflecting the completion of the construction phase of the project. With the completion of the project in 1997, general service energy sales are forecast to increase by only 0.1% in 1996 and to

decline by 2.0% in 1997.

Sensitivity Analysis of Load Growth and Unit Cost

The Applicant undertook a sensitivity analysis (Demand for Particulars P.U.B.12) to determine the relationship between sales growth and average unit costs. This sensitivity analysis is conducted on the assumption that, with high fixed costs, declines in the volume of sales can have the effect of increasing the unit cost of energy and thereby increasing rates to consumers. Significant increases in sales can also bring about higher costs if new capacity is required or its timing brought forward.

Dr. Feehan's Time Trend in Energy Sales

Dr. James Feehan, a witness for the Consumer Advocate, also testified with respect to the load forecast. Dr. Feehan testified that there is a relationship between GDP in constant dollars and electricity sales. He presented a regression equation to show that there is an underlying upward trend in electricity sales which is so strong that even if real GDP declines, electricity sales will still tend to increase.

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Predictive Power of Service Sector vs. Total GDP

Dr. Feehan was questioned as to whether the use of the service sector GDP might be more effective in predicting energy sales than real GDP and was asked to provide the same regression analysis for the service sector component of GDP as he undertook for real total GDP, so that the two could be compared. These regressions were subsequently tabled as CA-23.

In summation, the Applicant argued: "The service sector analysis, which was filed earlier

this week, produced higher R-square statistics and larger T statistics than the analysis of total GDP” and that if one accepts Dr. Feehan’s methodology this confirms “Crane’s view that service sector GDP is indeed a better predictor of electricity sales...”.

Newfoundland and Labrador Hydro Forecast

Hydro also provided evidence with respect to load forecasting in an affidavit filed by Stephen R. Goudie on July 2, 1996 (NH-2). Mr. Goudie is the Manager of Economic Analysis with Hydro. Hydro undertakes an independent assessment of the expected demand for electric power on the total island interconnected grid. It’s long term load forecast, covering a 20-year period, is influenced by the economic forecasts prepared by the Economics and Statistics Division of the Executive Council. This Division has forecasted substantial declines in real GDP of 4.3% for 1996 and 3.7% for 1997. Hydro’s projected housing starts for 1996 are estimated at 1575. Hydro has estimated approximately 400 electric heat conversions per year in 1996 and 1997.

The economic projections provided to Hydro by the Economics and Statistics Division of the Executive Council indicate a less favourable economy for 1996 and 1997 than the forecasts prepared by the Conference Board of Canada and adopted by the Applicant. Notwithstanding the

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difference in the economic assumptions, the forecast of the Applicant’s load growth by Hydro is not substantially different from the Applicant’s own forecast. Hydro is forecasting growth of 0.8% in 1996 and 0.0% for 1997, subject to adjustment for rate changes. These compare with the Applicant’s own forecast of 0.6% in 1996 and -0.2% for 1997. The Applicant’s forecast energy sales are assumed to be unaffected by any rate increase.

Hydro’s projections for the Applicant’s domestic consumers assume that the proposed

declining rate structure will actually stimulate increased sales. This is based upon the assumption that the elasticity of demand for larger users, such as those who use electric heat, will be greater than the elasticity of demand for smaller customers, who use electricity only for lighting, appliances and other non-electric heat usage. However, while electric heat users of electricity have a more elastic demand, the overall demand for electricity is price in-elastic. The results presented by Hydro suggest that an acceptance of the rate proposals contained in the Applicant's application would result in a reduction in energy sales to customers from 18 to 27 GWh in 1997. Five years after implementation of the rate proposals, the reduction in load is projected to be in the range of 36-46 GWh. Hydro's assessment is that the overall effect of the rate increase upon energy sales would be negative. The energy sales reductions will modify Hydro's energy sales forecast for 1997 from 0.0% to -0.8%.

Issues Raised on Load Forecast

The Consumer Advocate and Irving Oil challenged the load forecast on a number of issues. The issues and assumptions which were contested include the following:

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- * The economic forecast was challenged as being too pessimistic and that positive developments which might contribute to load growth were being overlooked.
- * Arguments were raised with regard to the assumed level of housing starts and exhibits were presented in support of a higher forecast level of housing starts.
- * General service load growth was alleged to be under-estimated and particular reference was made to Hibernia and to load growth potential arising from projects in the mining and petroleum sectors.
- * The Applicant stated that their statistical records of regular and all-electrical customers are inaccurate and they presented a revised estimation procedure. The conversions derived from application of this procedure were challenged as not being accurately

measured. It was argued that improved conservation and a trend toward multi-unit dwellings were being misinterpreted as an indication of a high level of conversions from electric space heating.

- * Based upon the new methodology, regular customers are estimated at 88,854 and all-electric customers at 87,760, a reduction in all-electric customers of 14,838. Previously the number of regular customers in 1995 had been estimated at 74,017, while all-electric customers were estimated at 102,598 (NP-104). In light of the magnitude of this shift it was argued that the numbers should have been verified by direct contact with customers as to whether they had indeed made a conversion.
- * In light of the higher level of housing activity in larger urban centres it was argued that the assumed electric heat penetration rate for new homes (70%) may be too low.

Board Determination

Hydro's forecast for growth in 1997 is below the level predicted by the Applicant. There are two main aspects of Hydro's forecast which merit attention, in comparison with the forecast presented by the Applicant. The first is that Hydro is forecasting a significant decline of real GDP both in 1996 and 1997. The Applicant, on the other hand, is projecting a small decline in 1996 and modest growth of GDP in 1997.

The second factor relates to price elasticity of demand. Hydro has attempted to reflect the

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impact of rate increases, through demand elasticity, upon load growth. The Applicant, on the other hand, has made no effort to measure the impact of demand elasticity. The response to Demand for Particulars PUB-74 indicates that the Applicant has not directly undertaken or commissioned any price elasticity of demand studies during the past five years.

In light of the importance attached to competition from the oil heating market, the Applicant would be well advised to measure elasticity of demand and to ensure that load

forecasts are adjusted to take into consideration the consumer response arising from rate adjustments. The Board believes it would be extremely beneficial for Hydro and the Applicant to work more closely together to ensure that all important factors which impinge upon load growth are properly accounted for, including the impact of GDP growth and changes in relative prices of competing energy sources. In the course of the hearing there was considerable discussion with respect to the measurement of conversions from electricity to oil heating and vice versa. Some of the evidence presented by the Applicant on the number of regular and all-electric heating customers was found to be of questionable value. There has been no contact with customers to confirm the accuracy of the conversions predicted to have taken place through application of the methodology as described in the response to Demand for Particulars DMB-79. Without such confirmation, the estimated conversions remain open to question.

There was considerable discussion at the hearing with respect to the advertising campaign mounted by the Applicant and by its competitors. The Applicant took the position that such an advertising campaign was required in order to sustain energy sales and to avoid a decline, which might have the effect of increasing unit cost and leading to further rate increases. The Applicant's position was predicated upon the sensitivity analysis presented in response to Demand for

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Particulars PUB-12. This sensitivity analysis indicated that any energy sales higher than the load growth contained in the base case might have the effect of increasing the unit cost of electricity. The incremental sales shown in Demand for Particulars PUB-88 as being attributable to the advertising and energy consultancy program are estimated at 12.7 GWh in 1997. However, it is not at all clear to the Board that an advertising campaign can be planned and executed with sufficient precision to sustain energy sales without the risk of overcompensating, and thereby

exacerbating unit costs.

The Board has examined the various forecasts placed before it, along with the underlying economic assumptions. **The Board finds that the load forecast presented by the Applicant is reasonable and that the revenue forecasts based upon them are acceptable for evaluating the proposals contained in the Applicant's rate application. However, the Board directs that the Applicant develop measures of price elasticity and build them into its forecasting methodology, working directly with Hydro. Conversions should also be confirmed by contacting customers.**

5. EXPENDITURE ISSUES

Depreciation

Order No. P.U. 6 (1991), ordered that: "NP will submit its next depreciation study in 1996." The Applicant submitted its application for rate revision on February 19, 1996, indicating on page 3 of the petition: "By Order No. P.U. 6 (1991), the Board determined rates of depreciation for the property of the Applicant based on data to the end of 1990. The Applicant proposes that rates of

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depreciation be revised based on data to the end of 1994 with revised rates effective for 1996 and subsequent years."

On March 28, 1996, as ordered by the Board the Depreciation Report and Exhibits of Gannett Fleming Valuation and Rate Consultants, Inc. were filed. The study indicated significant changes to the rate filing of the Applicant, which, in turn, gave rise to the revised application of the Applicant dated April 29, 1996.

The Applicant provided expert testimony of Mr. William M. Stout, P.E., President of Gannett Fleming Valuation and Rate Consultants, Inc. Mr. Stout explained that the results of his study produces a whole life annual accrual rate composite for the Applicant's total electric plant, which was within 2% of the whole life annual accrual rate determined in the previous 1991 study.(transcript, July 31, p. 127) It was Mr. Stout's opinion that, while such a result required a true-up correction of approximately \$1.6 million annually, it did not represent a very significant change in the results of the study.

At issue during the presentation of depreciation evidence were:

- (i) the change to amortization accounting for computers and telecommunication assets;
- (ii) true-up correction applying only for differences in excess of 5% of calculated accrued depreciation; and
- (iii) true-up amounts being amortized over the composite remaining life of the assets instead of the period between depreciation studies.

The change to amortization accounting for certain accounts was recommended since these assets have shorter useful lives than electric plants and the change produces a better match of

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depreciation expense with the consumption of the assets' service value. This methodology is in use in many U.S. jurisdictions, as well as in the Province of Alberta.

The calculation of the variance between book value and the calculated reserve was \$9,004,488 (over depreciated) as shown in Exhibit WMS-1. Only line items with variances exceeding 5% of the accumulated reserve are selected for true-up. Essentially, this method increases the dollar variance suggested for true-up by approximately \$1.8 million.

The annual provision for true-up was debated during the cross-examination of Mr. Stout. The Consumer Advocate pursued the appropriateness of allocating the true-up over a five year period between depreciation studies. The Applicant presented Exhibit NP-76, which disclosed a five year period for true-up. This exhibit produced an annual provision in 1997 of \$2,106,563, or \$514,388 more than the proposed provision using a remaining life method and corresponding decrease in depreciation. When the Board's Financial Consultant was cross-examined by the Consumer Advocate, his opinion was that the remaining life method was consistent with normal accounting methods wherein assets are remeasured and amortized over their remaining lives. The Financial Consultant acknowledged the validity of the Consumer Advocate's point that a ratepayer, who has paid rates based on overstated depreciated expenses, would wish to reflect the correction over a shorter period of five years, given that they may not remain a ratepayer over the full remaining life of the utility's assets. The Board notes the views of the Applicant in Rebuttal as well as the views expressed by Mr. Stout as an expert in the field of depreciation. The Board believes that it is inappropriate to view the true-up as a precise number, nor to expect that the next depreciation study will fully support the estimates made today. Amortizing the true-up over five years suggests a

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precision that is not warranted. However, the ratepayers do not remain the same over the life time of the utilities' assets. Therefore, from the perspective of correcting a depreciation expense estimate every five years, the five year true-up has the quality of intergenerational fairness.

Board Determination

The Board accepts the change in depreciation methodology for certain General and

Communication Plant accounts to amortization accounting. The change to monitoring and maintenance of the accumulated depreciation reserve at the account level is accepted. Correction of the present variance between the calculated accrued depreciation reserves with the actual book values shall be over the five year period 1996 to 2000. The Applicant will submit its next depreciation study in 2001.

Customer Service System

Pursuant to Board Order No. P.U. 6 (1991), the Applicant was ordered to prepare and file at its next rate hearing a Net Present Value analysis of their Customer Service System (CSS) using an incremental cost/benefit approach. This Net Present Value analysis was contained in Exhibit MJE-3 and dated February 23, 1996. The analysis concluded that the Net Present Value of this system is \$3 million. The break-even point of the project is less than nine years. In addition, qualitative improvements further enhance the investment.

Board Determination

The Board has analysed the evidence related to the CSS and has concluded the

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expenditures were prudent and reasonable. The Board grants final approval of the capital expenditures related to the CSS, which shall be included in rate base.

Other computer related expenditures

During the hearing, the prudence of the capital expenditures relating to micro computer technology was explored. The Applicant filed Exhibit NP-95 in support of its expenditures and practices relating to computers. The Applicant purchased 277 micro computers during the period

1990 - 1995. While cost benefit analysis is performed for major capital decisions, no cost benefit analysis was performed on individual micro computer purchases.

The Consumer Advocate questioned the need to invest \$5.6 million over the period 1994 - 1997. He and other intervenors argued that upgrading computers and software should be reviewed, with a focus on deferring such expenditures as long as possible.

Vice-President Pinhorn testified that the purpose of the expenditures was to accommodate the expansion of the Wide Area Network and to acquire other equipment. The Applicant is of the opinion that these expenditures will contribute to efficiencies in its operations. With respect to deferring expenditures, the computer expenditures are believed to be cost beneficial, efficient, and will lead to better management of the Applicant and better provision of customer services.

The Board has reviewed the evidence related to the capital expenditures of the last six years and two forecast years. The evidence does not reveal any unreasonable items or imprudent expenditures or practices. The Applicant has indicated that, prior to any capital expenditure, an item is reviewed to ensure that it is still necessary, in spite of its prior inclusion in the budget.

The 1997

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test year reflects computer expenditures of \$1.2 million as compared to \$1.4 million on average for the period 1994 to 1997. It is 51% of the 1996 forecast figure.

Board Determination

The Board accepts the forecast computer related capital expenditures included in the 1996 and 1997 forecast costs as reasonable and prudent estimates of the Applicant's costs.

Pension Funding

On August 11, 1995, the Applicant filed an application with respect to accounting methodology changes for general expenses capitalized (GEC). Included in this proposal was an accelerated pension funding arrangement that served to counteract the increased expenses arising from the change in the GEC methodology.

Pursuant to Board Order No. P.U. 3 (1995-96), it was ordered that: “Additional pension funding toward the Applicant’s Unfunded Pension Liability is approved up to a limit of \$12 million in 1995 and \$6 million in 1996....”

The Applicant had contributed \$9.8 million for the 1995 period, since the \$12 million limit was no longer necessary due to the longer phase-in period for GEC ordered by the Board. Two issues arose from this evidence. The first issue was with respect to availability of any unused contribution of the \$18 million of additional pension funding proposed for 1995 and 1996. This unused contribution could be utilized to reduce revenue requirement in the test year. The second issue was whether the Applicant complied with the Board Order, given that the formula it had

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proposed at the GEC hearing arrives at a different funding amount than the actual \$9.8 million. The Consumer Advocate argued that the use of the additional pension funding mechanism to effect short term rate relief is still as appropriate for this application as it was in the GEC application. Since there had been up to \$18 million proposed, any unused portion should now be utilized as an offset to the increased revenue requirement. During final argument, the Consumer Advocate proposed that \$2.657 million be used to fund pensions, for a \$1.2 million decrease in revenue requirement in the 1997 test year. Vice-President Smith indicated during cross-

examination that he believed such use would now be inappropriate. It would act as a timing difference. It would reduce tax expense in 1997, but would increase tax expense in periods beyond 1997, when the tax deduction otherwise would have benefitted those future ratepayers. As a matter of policy, the Vice-President of Finance did not agree with deferring expenses that more properly relate to current service; such a deferral being a shifting of costs from current ratepayers to future ratepayers. The Board recognizes the dynamics of the additional pension plan funding. The Board also recognizes the fact that it was proposed, outside of a rate application, to avoid asking for rate relief on one item. The change to incremental GEC methodology brought with it a transition period. In this transition period, the higher amortization of the older GECs and the higher general expenses no longer capitalized due to the new method, present a temporary burden to ratepayers. The Board lengthened the transition period to reduce that annual effect. The use of the \$18 million in additional pension funding had a positive net present value for ratepayers. There was no evidence during the hearing to indicate that this situation has changed. The second issue with respect to pension funding is that the Applicant was accused of not complying with Order No. P.U. 3 (1995-96) in that it did not limit the pension contribution to

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that suggested, using the formula proposed in the Applicant's final argument for the GEC hearing. The Board did not direct the Applicant to limit itself to that formula. The Board ordered that the Applicant not exceed the \$12 million proposed for 1995. The Applicant did not violate the Board Order. Therefore, the unused additional pension funding is \$2.2 million.

Board Determination

The Board is concerned with the use of pension funding to temporarily reduce revenue

requirement. Once the additional funding stops, this will cause a shortfall in revenue requirement. To smooth the impact of the GEC changes, a five year phase-in was adopted, as well as temporary use of additional pension funding up to the date of the next rate order. The Board continues to believe that rates should begin to absorb the effect of the incremental GEC policy, as the postponement of the effect continues the intergenerational inequity that the change in accounting methods was designed to address.

The Board orders that there will be no change to 1997 revenue requirement for unused additional pension funding.

Pension Uniformity Plan

The Board's Financial Consultants, Doane Raymond, stated in its Report to the Board:

“A third addition [to pension expense] relates to a Pension Uniformity Plan adopted by the Company in 1993 which provides improved benefits which are intended to ensure equivalent treatment of all employees covered under the pension plan. This plan was submitted to the Board in 1992 and was to be dealt with at the next

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scheduled rate hearing.”

The Pension Uniformity Plan is designed to eliminate the imbalance in the regular pension plan related to the members of the plan that earn more than the maximum level prescribed under federal income tax legislation. Senior Managers and Executives do not benefit to the same relative extent as the other plan members. The Pension Uniformity Plan rectifies this imbalance by increasing pension benefits to the extent necessary to bring a member's pension benefits to the level dictated by the formula for the registered plan, but without the limit.

Sedgwick James conducted a survey in 1991 which indicated that 83% of the large corporations surveyed had made arrangements to respond to the pension limit through additional pensions. Demand for Particulars PUB - 89 disclosed similar plans are in place for such organizations as Fishery Products International, NewTel Communications, the Provincial Government of Newfoundland and Memorial University of Newfoundland. A survey of nine Canadian utilities disclosed all but two have a plan to allow benefits above the maximum. Of those seven, six utilities confirmed the expense was part of their regulated expense or rate base. The seventh utility did not have the information available at the time of the survey.

Pension uniformity cost amounted to \$138,000 in 1995 and is forecast to be \$151,000 and \$167,000 in 1996 and 1997 respectively. Doane Raymond considered the expense to be reasonable. The Applicant stated in final argument that the first Pension Uniformity Plan appeared in 1982 and that it's position is that this is an appropriate regulatory expense.

Board Determination

The *Act* provides for the utility practice of expensing pension payments. The Board

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concludes the pension uniformity plan is a reasonable expense to be included in the Applicant's revenue requirement.

Demand Side Management Spending (DSM)

The Applicant's 1990 DSM initiatives were reported to the Board jointly with Hydro. The cost associated with these projects, with the exception of recurring labour expense, was

amortized over a five year period, as directed by Order No. P.U. 6 (1991). During the hearing, issues relating to DSM arose with respect to:

- (i) the nature of the programs and the extent to which they are presently being offered,
and
- (ii) the accounting mechanisms used for these programs.

The Applicant has provided its programs and objectives for DSM. There is no evidence that the programs or objectives are inappropriate. Concern was raised with respect to the advertisement of certain programs. Concern was also expressed that conservation programs are winners for consumers and should not be de-emphasized. (The Holiday Inn Heat Pumps will be dealt with under inter-company transactions.)

Board Determination

The Board concludes that the nature of the DSM program must remain one of managing demand side use of electricity in a manner that minimizes rates. Programs must be

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evaluated with respect to rate impact, as well as to total resource costs. The Applicant shall continue to file DSM progress reports annually with the Board, indicating the validity of its individual programs and documenting their impact on conservation, valley Filling, peak shifting, peak clipping and strategic load growth, their impact on minimizing customer rates; and their impact on the next generation planning.

On the issue of accounting for DSM expenditures, the Applicant filed Exhibit KSW - 6. This exhibit re-visits the practices used by North American utilities in 1996. The survey indicates utilities are spending less than they did in 1991 on DSM programs. It also indicated, where utilities spend less than \$1.5 million on DSM, the expenditures are expensed in the year incurred.

The Applicant recommended changing its methodology from capitalizing and amortizing its costs to expensing their costs in the year incurred. In 1996, the Applicant's DSM expenditures are forecast at approximately \$90,000 (prefiled testimony of K. W. Smith, p. 28). This issue was not opposed by any intervenor. The Board's Financial Consultant reported that this methodology would be reasonable. Acceptance of this proposal would override the policy directed in Order No. P.U. 6 (1995-96).

Board Determination

The Board accepts the Applicant's proposal to expense its DSM costs as incurred. Effective January 1, 1996 all DSM expenditures for the period 1996 onward should be expensed as incurred. Any expenditures capitalized before 1996 shall be amortized in accordance with the policy in place in the year incurred.

Advertising and Energy Consultant Expenses

One of the most contentious expenses during this hearing has been the expenses relating to the Advertising and Energy Consultant program of the Applicant. Advertising expenses averaged \$375,000 over the period 1991 to 1994. In 1995, the cost of advertising programs increased to \$1,092,000. In addition, the Applicant increased Corporate Planning and Development expenses by \$700,000 relating to the costs of the Applicant's Energy Consultants.

Similar concerns surfaced during the 1991 rate hearing, when the Applicant was proposing advertising expenses of \$779,000 for its 1992 test year. The Board stated on page 39 of Order No. P.U. No. 6 (1991):

"The Board does not allow advertising expenditures that are solely for corporate image building and do not have any direct link to the supply of service. The Board believes that DSM advertising of NP is in the best interests of its customers.

The Board accepts NP's advertising expense forecasts as reasonable and prudent."

Evaluating 1995 advertising expenses alone, there has been a 191 % increase from the 1991 to 1994 average. With respect to the increase in Corporate Planning and Development for Energy Consultants, it is difficult to evaluate the overall impact. as most of these positions have been transferred from other departments.

The forecast level of advertising costs for 1996 and 1997 are \$1,296,000 and \$1,071,000, respectively. The increased level of advertising expense is directly related to combatting competition in the home heating market. Throughout the hearing, the Applicant's witnesses have maintained that increased expenses of this nature are fully justified on the basis that efforts to protect

its customer and revenue base benefit the ratepayers generally by maintaining minimum rates. The Board's Financial Consultant recommended that the Board obtain further evidence with respect to the costs and benefits of the increased level of Advertising and Energy Consultant expenditures. This gave rise to a further supplementary examination by Doane Raymond as well as to Demand for Particulars PUB - 88, the response to which examined the cost benefit analysis of the Energy Consultants.

Doane Raymond reviewed eight marketing reports, referred to by the Applicant, as part of its advertising and marketing program. These reports included heating survey reports that provided information regarding the Applicant's market. These reports indicated that the home heating market is becoming very competitive, with more home owners considering conversions.

The most contentious report was that of Target Marketing. Target had stated that the objective of its assignment included increasing the Applicant's home heating market share. The Applicant's officials maintained that Target Marketing's proposal was "overstated" with respect to increasing the number of electrically heated homes as well as the Applicant's share of the home heating market. Rather, the Applicant's stated objective was to maintain its existing market share.

The Applicant's Net Present Value (NPV) analysis on residential marketing expenditures indicated that the Applicant's expenditures in 1996 and 1997 were beneficial to its customers. The results forecast a benefit to cost ratio of 1.25 for these two years,

Demand for Particulars PUB - 12 indicates the sensitivity of rates to changes in load growth. Within the bounds of various critical assumptions, five load growth scenarios were selected and evaluated, resulting in the base case as the scenario with the least upward impact on rates over the forecast period. The base case represented the current energy sales forecast. Both increases as well

as decreases in load growth resulted in upward pressure on rates. Therefore, the Applicant stressed that the evidence in this sensitivity analysis provided the reason for entering into an advertising and marketing program to maintain sales.

The Consumer Advocate maintained that no proof had been provided that conversions from electricity to oil had taken place, as suggested by the Applicant. The Consumer Advocate suggested that the Applicant should have provided follow-up calls to the 747 customers identified as having converted from electricity to oil.

Statistics Canada's evidence indicated that oil heat, as a principal heating fuel, was approximately 35.7% in 1985 and 35.1% in 1995. Therefore, in the Consumer Advocate's opinion, an advertising campaign against oil heat was not warranted and, in fact, was "predatory" in nature and should be borne solely by shareholders.

With respect to the costs of the Marketing Department, the Consumer Advocate argued that these costs should not be allowed out of regulated funds. The reasons associated with that contention are the same as those provided regarding the advertising expenses. As further support for that position, the Consumer Advocate cited the opinion provided by the previous Financial Consultant of the Board: that with every new department that is created, or for which a manager is appointed, there is a danger of "empire building".

With regard to marketing, the Consumer Advocate has identified, for the years 1996 and 1997, savings of \$200,000 and \$450,000 respectively. These savings relate to the "Home Sweet Home " Program. He recommends that these program expenses be removed as operating expenses and treated as non-regulated.

Irving 011 stated that competition in the space heating market exists and that such an

environment is good. However, the Applicant's proposed advertising campaign is directed at gaining market share at the expense of existing consumers. Irving Oil calculated that the Applicant's combined advertising and marketing budget is \$2.5 million per annum, an amount which the private competing market place in this Province is unable to match. The "Home Sweet Home" campaign, as well as some of the "Power Smart" ad campaign, is competitive advertising. For the Applicant to conduct advertising aimed at reducing electricity use through conservation, while at the same time engaging in advertising to increase the use of electricity as a home heating alternative, is suggested to be a paradox by Irving Oil. Irving Oil does not believe that the Applicant should be able to recover the costs of both advertising campaigns through rates.

The evidence clearly states that the Applicant's position with respect to advertising and marketing has changed. There was a substantial increase in the advertising expenditures when comparing 1994 to 1995. Evidence has been provided with respect to the existence of competition. There is evidence that conversions had taken place from electricity to other sources of home heating. The Applicant did study the market extensively through numerous surveys and by hiring marketing and advertising experts. The conclusions by the outside experts supported the Applicant's opinion that conversions were taking place and that competition was potentially able to reduce the Applicant's energy sales level. The Board agrees with the Applicant that the question is not one of whether competition exists. The question is really: how much advertising and marketing expense is reasonable and prudent?

Dr. Wilson stated that the Applicant will always concern itself with the loss of sales. The Applicant is emphasizing this issue now, probably more than is rational from the point of view of a profit-maximizing firm. Dr. Wilson provided the opinion that the impact of the loss of sales would

be greater for the generator, than for the distributor. The Applicant's exposure to the risk of lost sales is perhaps due to regulatory lag.

The Board's policy has been to approve reasonable and prudent advertising where it is informative and related to electrical service. Past policy stated that it should not include promotion advertising that will require an increase in capital expenditures. Order No. P.U. 6 (199 1) stated that the Board does not allow advertising for corporate image building.

Board Determination

The Board limits the allowable regulated advertising expenses in 1997 to 5700,000 maximum. This limit represents a prudent balance between the desires of the Applicant and the benefits to the ratepayers. Regulated advertising expenses should be limited to conservation, safety and factual consumer information. Advertising directed solely at image building is not a regulated expense. The Applicant shall file annually, by April 1st of each year, a report on its advertising and marketing programs, detailing its objectives for the year, and the qualitative measures of success. The Board accepts the cost of the energy consultants as reasonable and prudent.

Donations and Related Expenses

The Board has a long established policy with respect to donations, as set out in Order No. P.U. 47 (1982). This policy dictates that donations are non-regulated expenses. This policy was stated as follows:

"The Board believes that charitable donations should not be included in expenses
for

rate making purposes but be considered as a contribution by the shareholders.

Charitable donations and community and charitable advertisements will not be allowed for rate making purposes with the exception of any commitments already entered into by NLP prior to the issuance of this Order."

During the hearing, issues arose with respect to donations and other closely related items and included: (i) the treatment of the Share the Light expenses during 1991 - 1993 as a regulated expense; (ii) Scholarships and Grants; (iii) Community relations, and (iv) Memberships and Associations. These were items that might otherwise be considered as similar in nature to donations but were treated as regulated expenses.

The Applicant treated the donation to Share the Light inconsistently. During 1991 - 1993, the Applicant treated it as a regulated expense, but subsequent to that time, treated it as a non-regulated expense.

Fairness to ratepayers should apply to any corporate donation or support. It may be that the shareholders, through its Board of Directors, wish to support certain organizations by donations, memberships, community support or scholarships. However, such support brings no particular benefit to ratepayers who are asked to cover all regulated expenses. In fact, some ratepayers may strongly object to being forced to fund such ventures.

The Board agrees that the Applicant should be good corporate citizens. However, it cannot ask the ratepayers to fund organizations and community activities and events (Subclass 621) that

have no bearing on the supply of electricity. With respect to the Share the Light Program, the Board agrees with the Applicant's current treatment: it is a non-regulated expense like any other donation.

Board Determination

The Board will provide further clarification of the intended scope of its policy of deeming as non-regulated expenses, expenditures in the form of charitable donations, community and charitable advertisement, as well as grants, subsidies, scholarships, memberships and dues to organizations whose purpose is not reasonably related to the provision of regulated utility services.

Reduction in forecast discretionary expenditures

In any rate hearing, it is necessary to review all revenue requirement categories to ensure that all requirements are reasonable, prudent and justifiable. During this hearing, particular attention was drawn to operating expenses in an effort to identify amounts that should be deferred and not included in revenue requirement. The Consumer Advocate, as well as other intervenors, stressed that expenses should be kept to a minimum level, even if it meant deferring costs into 1998 and beyond, when the economic forecast is more promising. In final argument, the Consumer Advocate identified travel expenses, brush clearing and Board hearings as expenses that could be reduced,

It is the Applicant's position that the travel budget is sound and primarily reflects the travel of its line staff. The Applicant stated that it was not appropriate to defer one year's cost to later

years. It is felt to be a safety and service issue as well as an intergenerational issue. It was pointed out that in comparison to the 1991 travel expense, 1996 is approximately \$1 00,000 less.

The Consumer Advocate's position was that travel expenses be budgeted at the least annual expenditure level in the last five years, which was 1993. This represents \$355,000 in reduced travel expense. The Consumer Advocate did not specify which type of travel was to be eliminated or the related activities that would be eliminated or deferred into the future.

The Board's Financial Consultant concluded that the forecast costs for travel are reasonable. With respect to 1993, the Financial Consultant concluded that all travel which was not essential was deferred. In particular, training was deferred to future years. Deferrals resulted in temporary reductions only.

The Board has analysed the travel budget, detailed by region and functional department groups. in Volume 6, Tab 8 of the Applicant's Responses to Demands for Particulars. The Board is not convinced that elimination of \$355,000 can be accomplished without affecting normal operations. The 1993 year has been shown to be the exception and should not be used as a basis for forecasting a test year's cost. While the Board agrees that costs must be contained, they should not be reduced to exceptional levels for rate setting purposes. These costs have decreased from 1991 levels by 10%. They are described by the Board's Financial Consultant as reasonable.

Board Determination

The Board concludes that no adjustment to this category is warranted.

Brush Clearing

Brush clearing is a necessary maintenance item, required to manage access to electrical plant throughout the service jurisdiction, as well as to maintain safety and reliability of service, by preventing brush and trees from coming into contact with power lines. Brush clearing expense was reviewed by the Financial Consultant and no specific issue relating to the item was raised. Expenses were considered to be reasonable.

The Consumer Advocate has targeted \$220,000 of brush clearing for deferral. Brush clearing was detailed in Demand for Particulars DMB - 29. Brush clearing was detailed in two forms: chemical treatment and mechanical clearing. Mechanical clearing (cutting) took place in 1994. Exhibit NP - 58 states that to minimize costs., it is necessary to chemically treat the same area within two years of cutting to prevent the more expensive mechanical treatment from becoming necessary again. The 1997 test year reflects a combined budget of \$400,000, of which \$222,000 is for chemical treatment.

For the purpose of sound rate making, expenses included in the revenue requirement should be stable, reasonable and prudent. If deferring chemical treatment leads to higher costs, such a practice would make future expenses, and future rate making, erratic. Hence, sound rate making dictates a provision for brush clearing that minimizes expenses overall.

Board Determination

The Board concludes the brush clearing expenses in the 1997 test year are reasonable.

Board Hearing Costs

The Consumer Advocate has suggested that one half of the costs associated with Board hearings should be cut. The rationale was that the Applicant could not identify any specific hearings and therefore the cost should be considered as a soft cost and subject to deferral.

The Board notes that the utility was criticized repeatedly for not being subject to enough public review. It was submitted that the Applicant's meetings with the Board, for the purpose of general supervision, need to be more transparent and that it was regulating itself. Hence, the Board finds it inconsistent to suggest that the regulatory costs should be rolled back or cut.

Board Determination

The Board concludes forecast regulatory costs are reasonable.

Discretionary Expenses

Both the Consumer Advocate and Irving Oil argued for overall cost containment on the part of the Applicant. The Consumer Advocate was concerned that the Applicant could not identify anything that could be deferred from its growing \$60.7 million operating expense budget. The Board notes that, prior to restructuring, the Applicant was managing its operating expenses at the \$50 million level. The Board also notes that considerable cutbacks to contain costs were made during 1993,

The Board believes that productivity often is maximized during periods between rate cases, in an effort to defer rate applications. The Board believes that the operating expense budget reflects reasonable and normal expense levels and has been adjusted for inflation. The Board also believes

it is reasonable to adjust these normal expense levels downward to reflect a 4% productivity gain. No specific expense has been targeted by the Board, since, as noted by the Board's Financial Consultants, individual expense items vary from year to year, with no clear trends being evident.

The productivity allowance of 4% provides the incentive to ensure optimal efficiency is targeted. Operating expenses (per KWS - 3) are forecast as \$60.7 million before transfers. Labour represents \$35.5 million (per Volume 6, Tab 9, page 5) for a difference at \$25.2 million. Hence, the productivity adjustment of 4.0% is calculated as \$1,000,000.

Board Determination

The Board will order that operating expenses be reduced by \$1,000,000 for the test year.

Inflation adjustments

The Applicant has submitted 1997 as its test year, for rate making purposes. It has used 1995 actual expenditures as the basis for most of its operating expense forecast. To forecast these costs, the Applicant has utilized the expected inflation rates for 1996 and 1997. The chosen inflation rates have become an issue.

Doane Raymond's report describes the inflation adjustments as follows:

"The 1996 budgeted operating expenses included approximately \$548,000 in inflation adjustment at 4%. which overstates these expenses by \$301,000, as the assumed inflation adjustment of 1.8% should be \$247,000. The correct inflation rate of 2% was used in 1997, however, the base for estimating 1997 expenses was the

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1996 expense. Consequently, the 1997 expenses are overstated by \$307,000 (\$301,000 in 1996 plus 2% inflation)."

The Financial Consultant also considered using the updated Consumer Price Index (CPI) for Newfoundland. This gave rise to an inflation adjustment of \$726,500 for the 1-997 test year. The Financial Consultant agreed that the more recent CPI for Newfoundland was more appropriate.

The Applicant recognized that the forecast was made during 1995 and that the experienced inflation for 1996 turned out to be less than that. The Applicant considered that the Gross Domestic Product (GDP) deflator better tracked inflation on non-labour expenditures. The Applicant conceded that costs should be adjusted from their initial proposal by \$282,220 and \$407,845 in 1996 and 1997 respectively. The Applicant stated that the Newfoundland CPI is not a reasonable index of inflation for utility materials.

The Board has considered the merits of using the alternate inflation factors for non-labour expenditures. The Board agrees that these purchases are not typically represented by food, shelter, household operation and other consumer expenditures. The primary merit of adopting CPI Newfoundland indices was to reflect Newfoundland exposure.

Board Determination

The Board concludes that the use of the GDP deflator is more suitable for forecasting non-labour operating expenditures. The Applicant should ensure a suitable inflation index can be found that measures Newfoundland industrial cost inflation before the next rate hearing. Revenue requirement is reduced by 5282,220 and 5407,845 in 1996 and 1997 respectively to account for overstatement of inflation.

Short-term Incentive Program

During 1995, the Applicant completed contract negotiations with its unions. This process established a uniform incentive program available to all employees. Evidence on this incentive package was provided in the prefiled testimony of Vice-President Erbland and in several Exhibits and Demands for Particulars.

This evidence indicated that the new collective agreement avoided any increase in base pay but, at the same time, if the Applicant was within its return on equity target, additional incentive pay could be earned. These incentives are earned if the Applicant's targets are achieved for reliability, attendance, safety, domestic sales, and controllable operating expenses.

This plan will increase the cost of the previous incentive program by \$550,000 in 1996. The Short-term Incentive Program was permitted as a regulated expense at the last rate proceeding. At that time, the plan did not extend to union and managerial staff.

The Consumer Advocate suggested, in final argument, that the cost of the incentive program should be borne equally between shareholders and customers in a manner consistent with the recent Nova Scotia Utility and Review Board decision NSUARB-P-868. The Applicant argued that this program is currently fully funded by the shareholder since the Applicant must first be above the minimum level of rate of return on equity before it can be paid out at all.

The agreement was accepted by the union in lieu of wage increase proposals. While the targets are not perceived by the parties as aggressive, they set appropriate levels in terms of operating expenses, residential sales, sick days, injuries and reliability.

For the purpose of determining revenue requirement, the Applicant includes incentive program costs as well as rate of return on equity for the shareholders. To the extent that incentive pay costs exceed the amount forecast, the excess would be fully absorbed by the shareholders, otherwise it is funded by ratepayers.

Board Determination

The incentive system appears to reflect ordinary employee compensation, which is put at risk only if performance is not up to standard. If incentive pay exceeds that forecast, it is fully paid by shareholders.

The Board accepts the forecast of compensation including incentive pay. At the next rate hearing, the Applicant will be ordered to review executive and management compensation in detail.

Bi-Monthly Meter Reading

The Applicant has proposed a return to monthly meter reading from its current practice of bi-monthly meter reading. The rationale for such a change was the implementation of the provincial electricity surcharge. However, the Applicant indicated, during the hearing, that a return to monthly meter reading was necessary, even if the Board should decide not to approve the implementation of the provincial electricity surcharge,

The Applicant and the Board have received numerous calls of complaint and concern regarding the use of bimonthly meter reading. The Applicant conducted a survey related to bimonthly meter reading. One of the conclusions reached through the survey was that the majority

of customers did not wish to return to monthly meter reading, if such a return resulted in increased rates.

The preferred course in changing from bimonthly meter reading to monthly meter reading would be to co-ordinate this with the optimization of meter reading routes. As a result, the Applicant will read meters on a monthly basis at a cost in 1998 that is approximately equal to the cost of reading meters in 1996. The most appropriate year for comparison purposes is 1998, as both options would be optimized for the entire year. The difference in cost between optimized monthly meter reading and optimized bimonthly meter reading for 1998 is approximately \$160,000, which is less than \$1 per year per customer.

Board Determination

The Board supports the proposal for route optimization. Although certain problems may arise due to the transition from the previous meter reading schedules to the optimized meter reading schedules and routes, the Board believes that such a change would be of long term benefit to all customers. The Board also believes that arrangements should be made to smooth the transition for customers who are negatively affected by a change in their meter reading route.

The Board has taken note of the evidence associated with customer dissatisfaction with bimonthly meter reading. While bimonthly meter reading has reduced costs, (albeit a very small cost per customer per month) many customers have found it to be unfair. Bi-monthly meter readings and estimates have been largely misunderstood by domestic customers. While the Board appreciates the necessity of minimizing all costs and thereby minimizing rates, a balance must be struck between customer service and reducing costs. The Board believes customer service would improve if the

Applicant were to revert back to monthly meter reading.

The Board approves the Applicant's proposal to return, in 1997, to monthly meter reading. The Board also agrees this should be phased in at the same time as the optimization of meter reading routes.

Value Added Tax

On April 23, 1996, the Honourable Paul Dicks, Q. C., Minister of Finance and Treasury Board, announced the signing of a Memorandum of Understanding (MOU) with the Federal Government for the harmonization of the Goods and Services Tax (GST) and the Provincial Retail Sales Tax (RST). This new tax will be called the Value Added Tax (VAT) for the Province of Newfoundland and Labrador. The Provincial component would be 8%, and the Federal component would continue to be 7%, for a combined tax of 15%.

The Applicant will be affected by the introduction of the VAT. The new VAT would allow the previous RST component to become refundable through the Input Tax Credit mechanism. Harmonization of taxes will potentially reduce the expenses of the Applicant.

The Board's Financial Consultant conducted a review of expenses contained in the 1997 test year. Schedule 5 of Doane Raymond's report to the Board indicated that approximate 1997 direct savings for nine months of 1997 would be \$2,521,000, which is \$3,362,000 for a full year including the savings to Hydro. In addition, certain savings will occur in the costs of suppliers that would no longer be passed through to the Applicant. The annual savings through this indirect mechanism cannot be estimated at this time.

Demand for Particulars DMB - 199 contains the recommendations of the Board's
Financial

Consultant with respect to the implementation of the VAT on April 1, 1997. The Financial Consultant identified three options that could be used to deal with the impact of the implementation of the VAT. These options are as follows:

- (1) The Board may order the Applicant, upon implementation of the VAT, to reappear before them at a new hearing to address the impact on rates;
- (2) The Board may set interim rates at this hearing to be reviewed and adjusted upon implementation of the VAT; or
- (3) The Board may require the Applicant to establish appropriate mechanisms to identify the cost savings related to the new VAT and credit or rebate these savings to customers.

The Board does not believe that an option requiring a further hearing would be cost effective for the Applicant and its ratepayers. Rather, the Board believes it to be prudent that the direct savings of \$2,521,000 be deducted from the revenue requirement of 1997 and affect rates as of the VAT implementation date. This assumes that the direct savings to Hydro will also be passed along to consumers. With respect to the indirect savings predicted, the Board is reluctant to establish a reduction from revenue requirement at this time, due to the fact that no substantive evidence on savings can be provided.

Board Determination

The Board orders a study of the tax benefits associated with the implementation of the VAT system, should it occur as planned. This study shall be conducted by the Board's Financial Consultant to cover the period related to the VAT implementation during the 1997

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 540,000.

Inter-corporate Transactions and -barges

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

the transaction, ensure fair prices that protect the ratepayers and provide transparency so that all stakeholders are able to follow each transaction.

To monitor such transactions among related companies, the Board directed in Order No. P.U. 6 (1991) that a quarterly reporting mechanism be put in place, that the code of accounts be modified to identify all inter-corporate transactions and that the Applicant conduct a study into the financial policies of regulated Canadian utilities with respect to mark up percentages on related party transactions. While a quarterly reporting mechanism was put in place, the reports were not always timely. The 1991 Board Order did not specify deadlines. This Order will rectify this matter.

While the code of accounts was expanded to identify all Fortis Inc. transactions, specific codes were not used to identify transactions with other Fortis Inc. subsidiaries, such as Unitel Communications Inc. (Unitel). The Board believes that such codes are necessary and requires the Applicant to begin tracking inter-corporate transactions for all subsidiaries of Fortis Inc., by account codes similar to Fortis Inc.'s codes. The Applicant filed its study by Deloitte and Touche into the financial policies of regulated Canadian utilities with respect to inter-corporate charges as of March 20, 1996.

According to Deloitte Touche, many of the items allocated by Fortis Inc. are transferred to non-regulated expenses. These included: directors' fees, annual report expenses for Fortis Inc., management fees, and any trustee fees and listing fees attributable to financing non-regulated operations. Deloitte Touche also stated that the Applicant allocates any costs considered to represent a duplication of amounts already incurred entirely to non-regulated operations. Non-regulated intercorporate transactions represented 57.0% of 1993 inter-corporate costs, 35.0% of 1994 intercorporate costs and 47.0% of 1995 inter-corporate costs.

Deloitte Touche concludes regarding the allocation of costs:

"To summarize, in determining the principles to be followed in allocating costs to a regulated entity, the core principle is that the regulated entity should only be paying for costs which are undertaken on its behalf and which can be-traced to it, or for which it can be identified as receiving a benefit. Similarly, an affiliate of a regulated entity should be charged for costs undertaken on its behalf and which can be traced to it, or for which it can be identified as receiving a benefit."

During final argument, intervenors still expressed concerns with respect to inter-corporate charges. These concerns included: timeliness of quarterly reports. early representations of the Applicant regarding costs of Fortis Inc. with respect to trustee fees and keeping time cards, executive salary allocations, alleged cross subsidization of capital structures, acquisition of excess fibre optic capacity, mark-up of services provided to related parties to avoid undue advantage given to affiliates and the Holiday Inns DSM commercial heat pumps project.

With respect to the timeliness of quarterly reports, intervenors took serious exception to the delays in their preparation from time to time. While the delay(s) may have been explained to the Board when they occurred, the Board believes mechanisms should be put in place to allow the generation of reports regardless of logistical problems that have arisen.

Board Determination

The Board orders that inter-corporate quarterly transaction reports be filed with the Board within 60 days following the quarter end. Since code of accounts changes were ordered in Order No. P.U. 6 (1991) 60 days is considered to be reasonable to facilitate such preparation.

The intervenors argued that the 1987 representations relating to trustee fees should bind the Applicant and Fortis Inc. to the practice of treating trustee fees as non-regulated. The Applicant stated, in its rebuttal, that these representations were made at a time when Fortis Inc. did not even exist. Further, since Fortis Inc's formation, the Board has allowed trustee fees. The Board notes that Deloitte Touche's survey of Canadian utilities shows no evidence that such fees should be disallowed in principle.

Board Determination

The Board concludes that trustee fees are justifiable inter-corporate transactions. The Board accepts the recommendation of Deloitte Touche that in allocating charges from Fortis Inc. to the Applicant for costs related to raising equity capital, equity, rather than net assets, should be used as the basis of allocation.

With respect to time sheets as the basis of executive salary allocations, the intervenors pointed to early representations by the Applicant that this would be done. There was direction provided by the Board on this matter, as well as the reports of NKHK Chartered Accountants, Deloitte Touche and Doane Raymond which indicated time support documentation was necessary.

The Board cannot accept as a regulatory cost any unsupported transactions. Salary allocations from another entity are essentially unsupportable without time and project records.

Board Determination

The Board orders the charges of Fortis Inc for Chairman's fees in 1996 be treated as non-

regulated. All future salary allocations must be supported by time records indicating the duty and time spent on the Applicant's business. Similarly, the Applicant's executive and staff must record time spent on duties for the benefit of Fortis and its subsidiaries.

Deloitte Touche stated that the Applicant's policy is that any costs considered to represent a duplication of amounts already incurred shall be treated as non-regulated. The Board notes that the Applicant has a full executive team and legal department with over eight years of experience since the creation of Fortis Inc. Hence, the Board views any executive time of Fortis Inc. as a duplication with the exception of time documented by the Corporate Secretary. Fortis Inc.'s executive time spent as the parent investor of the Applicant is fully to the benefit of Fortis Inc.'s shareholders, not to ratepayers of the Applicant.

Board Determination

The Board orders that executive salary transfers from Fortis Inc. be treated as non-regulated expenditures unless sufficient evidence can be provided to support that the time was not a duplication of executive services expected to be provided by the Applicant's Executives.

With respect to cross subsidization of capital structure, intervenors and the Consumer Advocate's expert witness, Dr. Kalymon, argued that the capital structure of the Applicant can be manipulated to pass on a benefit to its parent company, which maintains a different capital structure. The Board has attempted to evaluate the capital structure necessary for the Applicant as a regulated utility. Since Fortis Inc. does not issue, and is not expected to issue, interest bearing long term debt, the capital structures will never be the same. The Board believes that rates should be set in a manner that reflects the optimum capital structure of the Applicant, at the time of the rate application. The

capital structure of the Applicant has not, in the Board's opinion, been modified to cross subsidize the parent company.

With respect to excess fibre optic capacity, NewTel Communications (NewTel) argued that the Applicant has no need for the excess capacity installed in its fibre optic network and that it has been engineered to a level that far exceeds the Applicant's operational requirements. NewTel indicated that the cost of the excess capacity is not used and useful, should not be part of rate base and could in the future be offered to the Applicant's affiliate, Unitel.

The Applicant could not provide any evidence to establish why it invested in this excess capacity, other than indicating that the incremental cost of acquiring additional fibres was not significant. For the fibre optic cables installed in the last five years, the incremental cost per cable was stated to be \$5,600.

The Board has considered the cost of the additional excess capacity acquired during the last five years. The Board believes the overall cost of the excess capacity is too low to track independently in relation to rate base. However, the Board is not swayed by the view that because the magnitude of excess capacity investment is not material, it therefore should continue to be made. In the event of the fibre optic network being leased in the future to any telecommunication entity, the Board would equate such a lease to a pole attachment arrangement. It would be subject to a full rate review and establishment of proper cost allocation rules.

With respect to mark-up pricing of inter-corporate transactions, intervenors raised concerns that the ratepayers should be protected, through proper cost allocations. NewTel argued that if the Applicant recovered less than full cost, plus an appropriate mark-up, from an affiliated company receiving the Applicant's service, then the shortage would be recovered from ratepayers.

By the same token, NewTel argued that, when the Applicant acquires services from an affiliated company, then that affiliate must be the lowest cost supplier, based on a proper cost benefit analysis.

The Deloitte Touche study concluded that inter-corporate charges should be at market price, where market can be demonstrated to exist, and at cost, if there is no market. In a cost-sharing situation, a mark-up ought to be provided only to permit the recovery of overhead costs. In all cases where the costs are distributed, their allocation should be supported by a study. Mark-up to cover cost of capital would apply only where assets are utilized in generating the service or good provided.

In addition to this guiding policy direction, the Board noted that Deloitte Touche identified that postage and courier charges by the Applicant should include a charge for labour and a reasonable mark-up of overhead. Also, under pole attachment charges, the Applicant is using the same methodology as used for Terra Nova Telecommunications. The methodology identified in the more recent joint use agreement or the methodology used for CATV rates should be considered, since they represent current market rates.

The Applicant stated in rebuttal that services, specifically telecommunications services, are purchased on the basis of competitive bids. The Applicant does not see the necessity for any special rules in respect of dealing with competitive services purchased from an affiliated company.

Board Determination

The Board continues to hold the position that inter-corporate transactions deserve special attention. The Board accepts the guidance of the principles established in the conclusions of the Deloitte Touche Report. The Board orders that inter-corporate transactions

that can be obtained from a competitive market must be valued at market for regulatory purposes. In acquiring a competitive service from an affiliate, the allowed regulated expense shall be the lowest cost bid or tariff. In cost allocations from affiliates and the parent, transactions must be supported by documentation, for example time sheets. -The mark-up on the cost must also be supported by reasonable documentation. A mark-up may include a return on capital only where the assets are used to deliver the service or good. Inter-corporate loans involving the Applicant must be valued at their opportunity cost and full documentation must support the rate. Pole attachment charges to Unitel should be valued at the same rates as offered to NewTel or CATV operators. Postage and courier charges must include labour and the standard overhead charge.

Heat Pump Project

During the hearing, the propriety and prudence of the Holiday Inns Heat Pump DSM Project was examined. The nature of the program was explained by Vice-President Erbland as a pilot project in supplying energy for large commercial water and air conditioning, using ground source heat pumps. Demand for Particulars DMB - 148 indicates some of the background of this specific project.

Ground source heat pumps were identified as potential DSM projects for a significant period before 1995. They are referenced in DSM Progress Reports of February 1991, December 31, 1992, December 31, 1993 and December 31, 1994. In the 1994 Report, a 1994 Domestic Heat Pump Project of \$9,800 was identified.

The evidence in Demand for Particulars DMB - 148 provides the particular chronology of the events surrounding what has been called the Holiday Inn Heat Pump Project.

Intervenors argued that the Applicant should not have entered into the contract and paid the subsidy, since it potentially could have benefited Fortis Properties Inc., a related company. The Applicant argued that the contract was in place with the Energy Service Company prior to the tender for the purchase of the hotels. Intervenors argue that the expense should be treated as non-regulated.

The Board identified three significant factors to consider in arriving at whether the expense should be regulated or non-regulated.

First, is the nature of the expenditure regulated or non-regulated? DSM pilot projects and related subsidies have been treated as regulated expense.

Second, is the magnitude of the expenditure prudent? In December 1994, the Applicant presented its DSM Budget as part of its Capital Budget Presentation. At that time, Commercial Heat Pumps were identified as a project for 1995. Vice-President Erbland described it as developing a program for Commercial Heat Pumps which would include an information program on a future role that electricity can play in cutting total energy use with heat pumps. The 1995 Deferred DSM Expenditures Budget identified only \$16,168 for Commercial Heat Pumps.

The Board recognizes that the Applicant has included DSM expenditures as items to be reviewed in a manner similar to any other capital expenditure. However, unlike the capital budget, the Applicant did not file quarterly budget reports and seek approval of any variances.

The cost of this project was the highest revealed in Demand for Particulars DMB - 15 by a large degree. While the Board has evidence of large DSM projects, it is not aware of any directed specifically at one entity for that order of magnitude.

Thirdly, is the fact that Fortis Properties Inc. later acquired and resold those hotels sufficient reason to deem the cost as non-regulated? There is no evidence that the DSM project benefits to the Applicant have diminished due to this related party buying the hotels and reselling them; nor is there evidence that Fortis Inc. derived any financial benefit from the project. Hence, the issue is largely one of perceived conflict of interest.

The regulatory accounting for DSM transactions for the 1995 period was to defer the amortized DSM costs over the next five years. Therefore, for regulatory purposes, the investment in the Holiday Inns Ground Source Heat Pumps has an effect on the 1997 test year and must be dealt with in this Order.

Board Determination

The Board notes that, with respect to the 1995 Commercial Heat Pump Project, it approved only a \$16,168 expenditure. The project was \$80,000 over budget. There is no other project of which the Board is aware that devoted approximately \$100,000 in technology benefit to one entity. The Board was not provided with sufficient evidence to prove that such an expenditure would have long term benefits for the ratepayers.

The Board orders the \$96,000 project not be deferred for regulatory purposes and therefore, that the costs are not to be included in 1996 and 1997 regulated expenses. Pursuant to section 41 of the Act, the amount in excess of the approved budgetary amount for Commercial Heat Pumps in 1995 is not allowed in the determination of 1995 regulated earnings.

Customer Relations

The Applicant should review the means by which it consults with its customers. This review should encompass the future role of the Consumer Advisory Council.

Retail Sales Tax Assessment

The Applicant should make every effort to recover outstanding retail sales tax liabilities. The Board has made no adjustment to the revenue requirement to reflect such recoveries.

6. RATE BASE

By Order No. P.U. 6 (199 1), the Board set the Applicant's estimated average Rate Base for the year ending December 31, 1991 at \$436,438,000 and for the year ending December 31, 1992 at \$460,603,000.

At the end of each of these years the realized average Rate Base was \$435,007,000 for 1991 and \$450,418,000 for 1992.

The Applicant is now requesting the Board to make an Order fixing and determining (1) the amended average Rate Base for 1991 and 1992 (as above), (2) the audited average Rate Base for the years ending on December 31, 1993, at \$459,561,000; December 31, 1994 at \$465,333,000, and December 31, 1995 at \$469,676,000, and (3) the estimated average Rate Base for the years ending December 31, 1996 at \$472,631,000, and December 31, 1997 at \$476,103,000.

The Board's Financial Consultants have confirmed that they have examined the carry forward data, the forecast data, the clerical accuracy of the continuity of rate base, the methodology

used in calculation of average rate base as it relates to the Act and established policies and procedures, and have concluded that the average rate base calculations, both estimated and historical, incorporated in the Company's evidence, are accurate and in accordance with established practice.

Board Determination

The Board accepts the Applicant's audited accounts for Rate Base for the years ending December 31, 1991 to December 31, 1995, inclusive, and the forecast accounts for the years ending December 31, 1996 and December 31, 1997, as adjusted in this Order.

7. RATES

The Applicant's proposal incorporates many changes in its rates and their structure. The Board is not prepared to approve the rates as submitted and will order the Applicant to resubmit its rates to address the specific changes as directed. The Board is aware of the inter-relationship of the various inputs in the design of rates, and recognizes that the changes ordered by the Board will result in interrelated adjustments.

The overriding factor in the redesign will be the total revenue as allowed by this Order.

Cost of Service Methodology and Revenue to Cost Ratios

The Applicant, in its 1995 Cost of Service Study, reflected the recommendations of the Board's Report issued after the Generic Cost of Service Hearing held in 1992.

Its results are as follows, showing, for comparison, the results using the historical method of assigning costs.

Rate Class	Historical Method Revenue at a % of Cost(Existing Rates) 1995	Revised Method Revenue as a % of Cost (Existing Rate) 1995	Revised Method Revenue as a % of Cost (Proposed Rate) 1995
# 1. I Domestic	91.9	94.8	95.7
# 2.1 G.S. 0 - 10 kW	106.8	105.2	105.4
# 2.2 G.S. 10 - 100 kW	118.4	115.2	110.8
# 2.3 G.S. 110 -1000 kVA	116.5	107.3	107.3
# 2.4 G. S. over 1000 kVA	107.9	100.2	100.5
# 4.1 Street & Area Lighting	Not Available	106.9	105.9

It is noted that all classes are approaching 100% recovery of costs. The Board agrees with the philosophy that it is not necessary to achieve a 100% revenue to cost ratio for all classes and takes no exception to a variance of up to 10%, i.e. to achieve between 90% to 110.% of the cost of service in revenue.

Board Determination

The Board agrees that the ratios are satisfactory.

The Board approves the changes to the Applicant's cost of service methodology, as proposed, on a temporary basis until the next rate hearing. The Applicant shall provide detailed evidence on its cost of service methodology at that time.

The Board accepts the proposed rate design model for the end block rates of rate classes 2.2 and 2.3, which reflects the similarity of the two classes other than voltage level losses.

The Board accepts the changes to the street and area lighting cost of service, also on a temporary basis, and its resultant rate design.

Rate Design Guidelines

The Applicant has proposed the following guidelines for allocating the proposed rate increases:

1. The revenue to cost ratios of the general service rate classes 2.1, 2.2, 2.3 and 2.4 should be made more equal;
2. The increase to any class should be limited to no more than 1%, plus the overall average increases; and
3. The annual increase to any customer should be limited on an annual basis to 10%, plus the overall percentage increase on that customer's rate class, unless special circumstances prevail or the dollar amount is small.

Board Determination

The guidelines proposed by the Applicant for allocating rate increases among customers and among rate classes are acceptable to the Board.

Proposed Rural Rate Surcharge

The Applicant purchases approximately 90% of its power from Hydro. Hydro not only generates power, but was and is charged with providing electricity to isolated areas. Because of high developing and operating costs, the return from these customers does not pay for their cost of

service. Originally, this shortfall was paid to Hydro by the Government. In 1989, the Government determined that it would discontinue paying the subsidy (the Rural Subsidy) and ordered Hydro to flow through this cost to their remaining customers, the major one being the Applicant. The Applicant has determined that the amount of the Rural Subsidy now charged to them and incorporated in their rates from Hydro is a tax, and, as such, should be shared as equally as possible by every ratepayer. Its proposal is to impose a surcharge on the first 700 kWh used per month by every domestic and small general service customer. By so doing, it will allow the Applicant to reduce its energy rate for the total kWhs of energy used. It will also allow heavy users, such as those with electric heat, to receive a reduction in total billing, rather than sharing in the overall increase. Since the rate charged by Hydro for the first 700 kWh/month to its customers in the rural and isolated areas was mandated by Government policy to be the same as the rates charged to the Applicant's customers, the proposed surcharge would lessen the Rural Subsidy required.

The proposed surcharge did not receive any support from the Intervenors to the hearing.

The matter of whether or not the transfer of the Rural Subsidy from Government to Hydro and then on to its customers is a tax or a cross-subsidy between utility customers was debated before the Board and dealt with in its report entitled "Referral by Newfoundland and Labrador Hydro for the Proposed Cost of Service Methodology" in February 1993. The Board's conclusion in that Report was that the Rural Subsidy was not a tax, but a form of cross-subsidization even though it was in the extreme.

It was pointed out in this hearing that there were many drawbacks to the proposed rate design, some of which were:

1. The "front end loading" would cause the energy price of the tail block to be reduced well below long range marginal cost and thus distort the price signals being sent to users, (e.g., the more you use, the more you save). It could cause inefficient use of a valuable and expensive resource.
2. The proposed imposition of the surcharge would in effect split the domestic and small general service classes into two parts, one that must bear the brunt of the Rural Subsidy, and another contributing less, so that small user customers would have a much larger percentage increase. In effect, this would give the largest users a reduction in total electricity costs and thus establish price discrimination, to the detriment of small energy users.
3. It was perceived by some that this proposal is a method of combatting competition in the space heating market and would be unfair to those who avail of other sources of heating fuel.
4. The Applicant's proposal appears to violate some basic principles of rate making.

The Board confirms its previous opinion in the February 1993 Report (notwithstanding recommendations made in its October 10, 1995 Report which were not accepted by Government) that the Rural Subsidy is a form of cross-subsidization, and must be dealt with as all other expenses.

The Board is also aware that the price for energy that is paid to Hydro was approved by the Board in 1992 and has remained at 4.5310/kWh (plus RSA). The Board was not presented with any evidence on whether Hydro was passing on the total cost of the Rural Subsidy or whether Hydro may be absorbing some cost by earning a less than approved interest coverage amount.

Board Determination

The Applicant will be ordered to submit a redesign of its rates to be effective January 1, 1997, with the surcharge removed, as well as incorporating the other directives of this Order.

The Board supports the Applicant's proposal whereby each customers' contribution to the rural rate subsidy would be identified on monthly bills.

Basic Customer Charge (BCC)

The basic customer charge applies to all the Applicant's customers in rate classes 1. I and 2. 1. These two classes represent over 190,000 of their 2 1 0,000 customers. The largest class by far is the domestic rate class 1. I with approximately 180,000 customers.

The Applicant proposes to increase the basic customer charge: by 3.8% for domestic rate class # 1.1 to \$16.94/mo; by 2.96% for the rate class G.S. 0-10 KW # 2.1 to \$19.12/mo, and to introduce a new basic customer charge for the following classes:

Rate Class # 2.2 G.S. 10 - 100 KW	\$22.00/mo
Rate Class # 2.3 G. S. 110 - I 000 kVA	\$100.00/mo
Rate Class # 2.4 G.S. 1000 kVA and over	\$200.00/mo

Evidence was presented indicating that the Applicant was requesting a rate that would be one of the highest for public utilities across Canada. The Applicant used "the minimum distribution system" methodology in determining its assignment of costs to the BCC. It has been using the same methodology for the last 23 years, considered the method still appropriate and did not propose to change.

Dr. Wilson was critical of the minimum distribution system of assigning costs, because it

assigned a significant portion of distribution plant and associated distribution cost on a flat per customer basis rather than on power demand or energy consumption. The distribution system costs are allocated among customer classes on the basis of numbers in each class. The result is that the small residential and small commercial customers, who use comparatively less energy, are assigned a higher percentage of distribution plant cost. The same applies to street lighting customers. Such assignments were unwarranted since the design of the system was based on the expected loads that it must support, not the number of customers it supplied. Dr. Wilson raised the question of whether or not a utility would favour a high BCC, not because of its high cost, but because it was a fixed charge not subject to competitive pressure, and would provide revenue stability for a utility.

Counsel for Irving Oil submitted that the Applicant's BCC was the highest in Canada because of its method of assignment of costs to the customer. Her recommendation was to "roll back" the BCC and recover the shortfall of revenue by having the Applicant increase the rate of the end block of energy utilizing marginal cost principles.

The Consumer Advocate contended that the Applicant enjoys an over-recovery of its costs through the basic customer charge having the "highest recovery of basic cost in Canada". This, in turn, places a completely unfair burden on low energy users. The Consumer Advocate recommended that a further study on marginal costs, and on cost allocation methodologies, be implemented.

The Consumer Advocate further recommended that "run out" blocks of energy for rate classes 2.3 and 2.4 be priced closer to marginal cost. The resultant increase would allow a corresponding reduction in BCC and the initial block of energy.

The Board will order that the methodology and the resultant cost of the BCC should be revisited and that the BCC not be increased for rate classes 1.1 and 2.1 until a subsequent review has been undertaken and presented to the Board for its consideration. The review should explore methodologies other than the "minimum distribution system" in assigning distribution costs.

The Board will approve a BCC for rate classes 2.2, 2.3 and 2.4 since there are compensating reductions which appear to treat users in these classes fairly. The resubmission of rates should retain the elimination of minimum demand, and the appropriate changes in demand and energy charge and minimum monthly charge, as can be accommodated within the limits of the redesign.

Reduction in the Alternate Energy Rate

The Applicant proposes to reduce the alternate energy rate in rate classes 2.2, 2.3 and 2.4 from 20.00/kWh to 140/kWh, plus the basic customer charge. The purpose of the alternate energy rate is to provide a limit to what low load factor customers pay. The proposed limit of 140/kWh will benefit customers with less than a 15% load factor.

Board Determination

The Board accepts the proposed model for reduction in the alternate energy rate in rate classes 2.2, 2.3 and 2.4 from 20.00/kWh to a lower rate, plus the basic customer charge. This lower rate must be resubmitted to the Board for its consideration.

Elimination of Minimum Billing Demand for Rates 2.2, 2.3 and 2.4

The Applicant proposes to eliminate the Minimum Billing Demand of 10 KW in rate class 2.2, 110 kVA in rate class 2.3 and 1000 kVA in rate class 2.4. The purpose of this change is to avoid the transitional problems which arise when a customer's demand temporarily exceeds the maximum demand level in that customer's rate class, which has the effect of moving the customer to a higher minimum billing demand, even though the customer's demand may be considerably less for most of the year. It is not fair that those customers who moved from rate class 2.2 pay a substantially higher demand rate while larger customers in rate class 2.3 are not affected by this minimum billing demand ratchet. A similar ratchet problem arises in the transition between rate classes 2.1 and 2.2. The transition problem from rate class 2.3 to 2.4 is mitigated by the availability clause in 2.4, whereby a customer must exceed 1,000 kVA four times in the previous twelve months before he goes on rate class 2.4. With the removal of the minimum billing demand of 1000 kVA from rate class 2.4, the availability requirement that a customer's demand exceed either 1000 kVA four times or 2500 kVA once in the previous twelve months, is no longer needed. The purpose of this condition was to ensure that customers who exceeded 1000 kVA on one occasion only would not be subjected to the minimum billing demand of 1000 kVA. The proposed change is linked with the introduction of basic customer charges for rate classes 2.2, 2.3 and 2.4. Once a customer's demand exceeds the demand threshold for either of rate class 2.2, 2.3 or 2.4, the customer will stay on that rate for twelve months, without being subject to a minimum billing demand associated with that rate class.

Board Determination

The Board accepts the elimination of minimum billing demand of 10 KW in rate class 2.2, 110 kVA in rate class 2.3 and 1000 kVA in rate class 2.4 and the modification of the availability clauses in rate classes 2.3 and 2.4. -

Elimination of Discount for Churches and Schools

The Board confirms that the elimination of the Discount for Churches and Schools conforms with the Board's previous Order No. P.U. I (1 990).

Curtable Rates

Curtable rates were approved by Board Order No. P.U. 4 (1994-95) dated October 4, 1994. In the 1995-96 winter season, nine customers had applied for the rate. It is available only to general service customers that had a demand of over 330 kVA, had standby or back up independent supply generators, could eliminate their load in sixty minutes and other conditions. Six months notice is required to terminate the agreement.

During the "winter season" 1995-96 (designated as December, January, Feb and March between the hours of 8:00 A.M. to 9:00 P.M.), eight customers availed of the rate (one failed). The total of credits earned was \$109,750.

The rate of the credit earned is based on a Loss of Load Probability (L.O.L.P.) Study carried out by Hydro and the price or value of curtailment is determined by a method attributed to National Economic Research Associates (NERA) by examining short run marginal costs in successive years. The resulting capacity costs are customer shortage costs, not the costs of adding capacity. The

Applicant proposes to allow a credit of \$29.00/kVA, the same as is now in place.

A new L.O.L.P. Study was completed by Hydro which would indicate the credit should be raised to \$67.00/kVA,

Mr. Connors noted that, considering the L.O.L.P.'s volatility, some other mechanism to determine the value for a curtailable credit should be sought. He testified that, any time the curtailable customers were asked to curtail, the system peak had not been reached, but with their alternate supply functioning it would theoretically improve system reliability. He also noted that at present the curtailable load was relatively so small that it was not included in either the Applicant's or Hydro's forecasting. Its value was to improve the system reliability. At times of largest demand, there still was a system reserve so that the availability of curtailable customers supply of their own power only improved their "comfort level".

The cost incurred for curtailable credits flows through to the Rate Stabilization Account (R.S.A.) and is borne by all customers.

The Board has not been provided with sufficient evidence to adequately evaluate curtailable rates. It is aware of the principles involved but it hasn't been demonstrated that their use has done anything but to improve "the comfort level" of a utility distributor.

The Board is concerned about the instability of the value placed on the curtailable rate, particularly since the estimate of its cost fluctuated from \$29.00/kVA in 1994 to \$12.00 in 1995 to \$67.00 in 1996.

The Board agrees that another method of establishing such value should be explored.

The Board is not prepared to deal with such rates on a long term basis in light of the lack of evidence, consequently it will order that the rate for curtailment -at \$29.00/kVA be approved on an interim basis for a maximum of two years of "winter seasons", i.e., until April 30,1998.

The Applicant will be ordered to continue the directions in Items (4) and (5) of Order No. P.U. 4 (1994-95) and provide the updated statistics, 30-days after each "winter season" for the Board's information and evaluation.

The Board will order that all future costs of curtailable rates shall not be charged to the RSA.

The Applicant should as well attempt to determine the value received by all other customers who will be paying the cost.

Time of Use

Much has been said about the introduction of innovative rates, such as Time of Use (T.O.U.) rates.

Mr. Bowman suggested that, by not having a number of rate options, the Applicant is missing an opportunity to respond to competition, to improve service and customer relations as well as to enhance its overall financial position. If its Power Purchase Agreement with Hydro was restructured to reflect both demand and energy charges, that vary by time of day and season, it would allow the Applicant to be flexible in its offering of rate options that would encourage the most efficient use

of electricity. It may also be a method of improving its load factor, which now stands at approximately 50%.

Dr. Wilson agreed with the principle of T.O.U. rates but suggested that they could only be offered after all the appropriate information was acquired to enable an accurate design of such rates. He agreed that such rates should be sought (after appropriate studies were completed) and that the rates should incorporate a retail design based on marginal cost and time of use design principles.

Mr. Brockman agreed that, before innovative rates (such as T.O.U.) were implemented appropriate research and studies should be undertaken. He cautioned that any study or research undertaken should be focused, so that specific concerns could and would be addressed, e.g., whether innovative rates be optimal or mandatory.

The Board agrees that the prospective use of alternative rates should be explored. The Board is also aware that there are a great many variations of such rates and variations within each rate.

Board Determination

Marginal cost and time of use design methods should be pursued and will direct the Applicant to pursue innovative approaches based on such methodology.

The Board also agrees with the advice that a study must first be undertaken, and that the study must be well focused and presented to the Board no later than July 1, 1997. The Board expects that the study will include an examination of the utility's load profile as well as its costs. The Board will allow an increase in revenue requirements of 5150,000 to cover the cost of the Applicant's initiative in this regard.

The Board will not direct the Applicant to any specific innovations (that will be the

Applicant's decision) which will be based on its recognized and/or projected problems, its knowledge of existing customer patterns, or its general knowledge of its industry.

The Applicant will be ordered to follow the direction given by the Board in its Report to the Minister of Mines and Energy dated April 13, 1992 (Recommendation 19), and reiterated in its Report to the Minister of Mines and Energy dated February 1993, p. 62, that it consult with Hydro and develop an acceptable rate form for review containing appropriate division of demand and energy costs.

Regulations

The Applicant has proposed several changes to its Rules and Regulations. These revisions are contained in Exhibit TAC - I 0 Revised. During final argument the Applicant further revised the Regulations to remove an inadvertent penalty contained under the street and area lighting clauses, Regulation 9(h)(ii). (transcript, August 15, 1996, p. 97-98)

The Board questioned several witnesses with respect to the proposed changes to the Rules and Regulations as well as to certain of the present Rules and Regulations. Few objections were raised to the Rules and Regulations as proposed during the course of the hearing. The exceptions to this included the penalty under the street and area lighting clause which has been modified by the Applicant, as well as the Late Payment Fee proposed by the Applicant.

Board Determination

With respect to metering, Regulation 7(e)(2), all references with respect to the first 700 kWh per month for each domestic unit are no longer necessary, given the Board's decision not

to introduce a surcharge in the domestic and general service rates.

With respect to increases in the charges for disconnection in Regulation 9(f), the Board is not convinced that an increase in these fees at this time would be warranted and hereby disallows the proposed change. Extension of this Regulation to situations where service has been disconnected for fraud and abuse is approved by the Board.

With respect to Regulation I O(c), the Applicant proposed a Late Payment Fee equal to the prime rate charged by chartered banks on the last day of the previous month plus I 0%. In support of this proposal the Applicant filed Exhibit TAC - 12. In this Schedule, it indicates that the Applicant's proposal is the fourth lowest Late Payment Charge of any Canadian utility charging such a rate. Certain intervenors believed that such an increase at this time would be unfair to those ratepayers who are not in a position to fully pay their bills.

The Board is not convinced that an increase in the Late Payment Fee is necessary at this time. Therefore, no change in Clause 10(c) is considered to be necessary.

The Rate Stabilization Clause has been modified by including under Section II.4 and II.5, the reference to street and area lighting and the curtailable service options. Section III has been modified to reflect the exemption to the Provincial Electricity Surcharge.

The Board orders the proposed Rate Stabilization Clause be approved with the exception of Section 11.5 which shall be deleted and Section III shall have removed the reference to the Provincial Electricity Surcharge in Rate 1.1 and Rate 2.1.

With the exceptions noted above, the Board accepts the changes proposed to the Rules and Regulations as contained under TAC - 10, Revised, as modified on August 15, 1996 for Regulation 9(h)(ii).

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9. COSTS

The Applicant will be ordered to pay the expenses of the Board arising out of the hearing as well as the expenses of the Consumer Advocate, as ordered by the Lieutenant-Governor in Council pursuant to section 117 of the Public Utilities Act, R.S.N. 1990. All other parties will bear their own costs.

PART III - ORDER

IT IS THEREFORE ORDERED THAT:

Test Year

1. The calendar year 1997 be used as the Test Year for the purpose of this application.

Rate Base

2. The Applicant's Audited Accounts for rate base for the years ending December 31, be and they are hereby Fixed at:

1991	\$435,007.000
1992	\$450,418,000
1993	\$459,561,000
1994	\$465,333,000
1995	\$469,676,000

and,

the forecast accounts for the years ending December 31, 1996 and December 31, 1997 be approved as adjusted in this Order.

Demand Side Management (DSM)

8. The DSM program shall remain one of managing demand side use of electricity in a manner that minimizes rates. Programs should be evaluated with respect to rate impact, as well as the total resource costs. The Applicant shall continue to file DSM progress reports annually, indicating the validity of individual programs and documenting their impact on conservation, valley filling, peak shifting, peak clipping and strategic load growth; their impact on minimizing customer rates; and their impact on next generation planning.
9. The Applicant's proposal to expense its DSM costs as incurred is accepted. The Board orders that this policy amend Order No. P.U. 6 (1995-96) and that all DSM expenditures for the period 1996 onward shall be expensed as incurred. Any expenditures capitalized before 1996 shall be amortized in accordance with the policy in place in the year incurred.

Advertising

10. The allowed regulatory expenses for advertising are to be limited to matters relating to conservation, safety and consumer information. The Board limits the allowable regulated advertising expenses for 1997 to a maximum of 5700,000. Advertising directed solely at image building is not a regulated expense. The Applicant shall file annually, by April 1st of each year, a report on its advertising and marketing programs, detailing its objectives for the year, along with qualitative measures of success and a description of its advertising and marketing efforts.

Charitable Expenditure

11. The Charitable Donations Policy set out in Order No. P.U. 47 (1982) is hereby clarified. Expenditures in the form of charitable donations, community and charitable advertisements, as well as grants, subsidies, scholarships, membership fees and dues to organizations whose purpose is not reasonably related to the provision of regulated utility services are not allowed as regulated expenses.

Productivity Allowance

12. Forecast operating expenses shall be reduced by 51,000,000 in 1997.

Inflation Index

13. Use of the GDP deflator for forecasting inflation for non-labour operating expenditures is accepted. The Applicant shall research whether a suitable inflation index can be found that measures Newfoundland industrial cost inflation, before the next rate hearing. Revenue requirement is reduced by 5282,220 and \$407,845 in 1996 and 1997, respectively, to-account for the overstatement of inflation.

Compensation

14. The Applicant shall review executive and management compensation in detail at the next rate hearing.

Monthly Meter Reading

15. The Applicant's proposal to return to monthly meter reading in 1997 is accepted. The Board also agrees this should be phased in at the same time as the optimization of meter reading routes.

Value Added Tax

16. 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.
17. A study of the tax benefits associated with the implementation of the Value Added Tax(VAT) system be undertaken, subject to the VAT being implemented. This study shall be conducted in early 1998 by the Board's Financial Consultant to cover the period related to VAT implementation, during the 1997-98 fiscal year. This study shall recommend whether an adjustment for indirect benefits is warranted, and shall confirm the actual direct tax benefits, including the direct savings to Hydro.

Capital Spending Estimates

18. Capital expenditure estimates for 1997 are reduced by 4% for rate setting purposes.

Inter-corporate Transactions

19. Inter-corporate quarterly transaction reports be filed with the Board within 60 days following the quarter end.
20. The acceptance of the recommendation of Deloitte Touche that, in allocating charges from Fortis Inc. to the Applicant for costs related to raising equity capital, equity, rather than net assets, shall be used as the basis of allocation.
21. The charges of Fortis Inc. for its Chairman's fees in 1996 be treated as nonregulated expenses. In order to be considered as a regulated expense, an future salary allocations must be supported by time records indicating the duty and time spent on the Applicant's business. The Applicant's executive and staff must record time spent on duties for the benefit of Fortis Inc. and its subsidiaries.
22. Executive salary transfers from Fortis Inc. are to be treated as non-regulated expenditures unless sufficient evidence can be provided to prove that the time spent was not a duplication of executive services expected to be provided by the Applicant's executives.
23. The guiding principles established in the Deloitte Touche Report are accepted. The Board orders that inter-corporate services obtained from a competitive market be valued at market. In acquiring a competitive service from an affiliate, the allowed regulated expense shall be the lowest cost bid or tariff. In cost allocations from affiliates and the parent, transactions must be supported by documentation. The mark-up on the cost must also be supported by reasonable documentation. A mark-up may include return on capital only where assets were used to deliver service or good. Inter-corporate loans involving the Applicant must be valued at their opportunity cost and documentation to support the rate shall be kept. Pole attachment charges to Unitel shall be valued at the same rates as offered to NewTel or CATV operators. Postage and courier charges must include labour and the standard overhead charge.

Heat Pumps Project

24. The \$96,000 heat pumps project shall not be deferred for regulatory purposes and therefore, the costs are not to be included in 1996 and 1997 regulated expenses. Pursuant to section 41 of the Act the amount in excess of the approved budgetary amount for Commercial Heat Pumps in 1995 is not allowed in the determination of 1995 regulated earnings.

25. The changes to the Applicant's cost of service methodology, as proposed, are accepted on a temporary basis until the next rate hearing. The Applicant shall provide detailed evidence on its cost of service methodology at that time.
26. The changes to the street and area lighting cost of service are-also accepted, on a temporary basis, along with its resultant rate design.
27. The proposed rate design model for the end block rates of rate classes 2.2 and 2.3 are accepted.
28. The proposed two-tier restructuring of rates for rate classes 1.1 and 2.1, whereby the rural subsidy is applied as a surcharge on the first 700 kWh/mo. is rejected.
29. The guidelines proposed by the Applicant for allocating rate increases, among customers and among rate classes, are accepted.
30. The proposed model for reduction in the alternate energy rate in rate classes 2.2, 2.3 and 2.4 from 20.00kWh to a lower rate is accepted.
31. The elimination of minimum billing demand of 10 kW in rate class 2.2, 110 kVA in rate class 2.3 and 1000 kVA in rate class 2.4 and the modification of the availability clauses in rate classes 2.3 and 2.4, are accepted.
32. The basic customer charge for rate classes 1.1 and 2.1 shall not be increased. The Board approves the principle of a basic charge for rate classes 2.2, 2.3 and 2.4, as proposed in the amended application.
33. The Applicant shall undertake a review of the basic customer charge for all rate classes.
34. The proposed changes in the energy and demand charges in rate classes 2.2., 2.3 and 2.4 are accepted in principle.
35. The Applicant shall investigate the benefits associated with curtailable rates, with a view to improving the reliability and accuracy of the credit value assigned to curtailable rate customers. The Board orders that the demand credit for curtailment continue at 529/kVA, on an interim basis, for a maximum of two winter seasons, until April 30, 1998. Beginning January 1, 1997, all future costs associated with curtailable rates shall be charged to the Applicant and not to the Rate Stabilization Account.

36. The Applicant shall follow the directions given in Items (4) and (5) of Order No. P.U. 4(1994-95) and provide the updated statistics, thirty days after each (winter season" for the Board's information and evaluation.

Rate study

37. A study shall be conducted by July 1, 1997, to evaluate rate designs based upon marginal cost, time-of-use design principles and other innovative rate options. The Board allows an increase in revenue requirements of 5150,000 to cover the cost of such a study.

Energy and Demand Charge from Hydro

38. The Applicant shall follow the direction given in the Board's Report to the Minister of Mines and Energy dated April 13,1992 (Recommendation 19), and reiterated on Page 62 of the Report to the Minister of Mines and Energy dated February, 1993, to the effect that the Applicant consult with Hydro and develop an acceptable rate form for review containing an appropriate division of demand and energy costs.

Rules and Regulations

39. The Applicant shall **file** revised Rules and Regulations which will comply with the Board's **findings** herein and which will become effective January 1, 1997.

Resubmission of Rates Directed

40. The Applicant shall submit a redesign of its rates to be effective January 1, 1997 with the surcharge removed, as well as incorporating the other directives of this Order.
41. The Applicant shall pay the expenses of the Board arising out of the hearing, including the expenses of the Consumer Advocate as ordered by the Lieutenant Governor in Council pursuant to section 117 of the Act. All other parties will bear their own costs.

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DATED at St. John's, Newfoundland this 22nd day of October, 1996.

D.A. Vardy

L.E. Galway

J.A.G MacDonald

APPENDIX I

LIST OF LETTERS OF OBJECTION/COMPLAINT SUBMITTED TO THE BOARD

- | | | | |
|-----|--|-----|--|
| 1. | Ms. Mabelia Whitten
Petty Harbour | 19 | Marian Frances White
St. John's, NF. |
| 2. | Mr. Cyril Galway
St. John's, NF | 20. | Mrs. Jan Spracklin
Area Commissioner
Girl Guides of Conception
Bay South
Topsail, NF |
| 3. | A. L. George
St. Andrew's, NF | 21. | Ms. K.M. Rodgers
St. John's, NF. |
| 4. | Mr. George Herritt
Consumer
(No address) | 22. | Mr. & Mrs. Randolph Noseworthy
Mount Pearl, NF |
| 5. | Mr. Ray Genge
Anchor Point, NF | 23. | Mr. Reuben A. Noseworthy
Garnish, NF |
| 6. | Mary S. & Randell Russell
Flatrock, NF | 24. | Bruce Little
St. John's, NF |
| 7. | Brian & Deborah White
Stephenville, NF | 25. | Mrs. J. Parsons
Clareville, NF |
| 8. | Town of Grand Falls-Windsor
Grand Falls-Windsor | 26. | Lillian Murphy
Parkers Cove, NF |
| 9. | Frances Williams
Corner Brook, NF | 27. | Charles Hutton
Portugal Cove, NF |
| 10. | G. Noel
St. John's, NF | 28. | Jean E. Sceviour
Corner Brook, NF |
| 11. | Richard Pittman
Pouch Cove | 29. | Jim Doyle
Goulds, NF |
| 12. | David & June Burden
Deer Lake, NF | 30. | Don Whelan, M.H.A.
Harbour Main - Whitbourne
House of Assembly
of the Province of Newfoundland
Government Members Office |
| 13. | Mayor Dianne Whelan
Town of Paradise
Paradise, NF | 31. | Mayor C. Ralph Dawe
The Town of Clark's Beach
Clarke's Beach, NF |
| 14. | Carolyn Keating
Stephenville, NF | 32. | Mr. Jim Tessier
Town Manager
Town of Grand Bank
Grand Bank, NF |
| 15. | Mayor Glenn Clarke
Chairman
Conception Bay North
Joint Councils Association
c/o Town of Victoria | 33. | Messrs Rex Cotter and Doug Meggison
for N.A.P.E. Local 5402
Carbonear, NF |
| 16. | Thomas St. Croix
Carbonear, NF | | |
| 17. | Herbert Badcock
Manuels, NF | | |
| 18. | Rita Farrell
Town Clerk
The Town of Flatrock | | |

34. Jim Burke, Betty Hogan
Mrs. Elizabeth Burke, Ken Burke
Betty Burke, Linda Squibb
Daniel Burke, Joan Burke
Matthew Burke, Tom Reynolds
Cathy Earle and thousands more if
they took the time to express their
opinion.
(No address)
35. Mr. Gerald Dolomount
Corner Brook, NF
36. Mrs. Margaret O'Brien
Manuels, NF
37. Ms. Donna Ryan
President
Loca]488
Canadian Union of Public Employees
Commerce Ct. Bldg
Corner Brook, NF
38. Mayor Boyd Noel
Office of the Mayor
Town of St. Anthony
St. Anthony, NF
39. Mayor Claude Elliott
Town of Gander
Gander, NF
40. Ms. Beth A. Ryan
St. John's, NF
41. Enid Dominey
Corner Brook, NF
42. Mr. Gary Holwell
St. John's, NF
43. Mrs. Mary Paimer
& Mr. Nelson Palmer
Heart's Delight, NF
44. Mr. Barry Coates
Town Clerk/Manager
The Town of Stephenville
Stephenville, NF
45. Mr. Douglas Dawe
Secretary
District Grand Lodge # 1
New Harbour, NF
46. Mr. Maurice Kelly
49. Mrs. Phyllis C. Wicks
Grand Falls-Windsor, NF
50. Mr. Derm Flynn, Mayor
Town of Appleton, NF.
51. His Worship Mayor
John J. Murphy, SBSTJ.
City of St. John's, NF.
52. Ms. Flora G. Thornhill
Grand Falls-Windsor,NF.
53. Mr. George F. Chafe
Grand Falls-Windsor, NF.
54. Ms. Bridget McGrath, Town Clerk
The Town of St. Anthony, NF
55. Mr. Jerry Kearley, Mayor (Town of
Milltown/Head Bay D'Espoir), Coast of
Bays Joint Town Councils Committee
Milltown, NF
56. Mr. Wilfred Mercer, Mayor
Town of Point Leamington, NF
57. Ms. Anne Hillier
Development Coordinator
Greater Lamaline Area
Development Association,Lamaline, NF
58. Ms. Loretta J. Peddle
Bloomrield, NF
59. Ms. Alice M. Swain
Calvert, NF
60. Mr. & Mrs. Harold Sullivan
Calvert, NF
61. Ms. Mary Roche
St. John's, NF
62. Ms. Catherine C. Sullivan
Calvert, NF
63. Ms. Gertrude M. Power
Trepassey, NF
64. Mr. & Mr. Brendan Murphy
Calvert, NF
65. Mr. & Mrs. Tom Sullivan
Calvert, NF
66. Mr. Edward Power
Trepassey, NF
67. Ms. Catherine M. Boland
Calvert, NF
68. Mr. & Mrs. Austin Ryan

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|-----|--|-----|--|
| 47. | Town Manager/Clerk
Town of Port au Choix, NF
Mr. Oscar House
Stephenville, NF | 69. | Calvert, NF
Ms. Bride (Drew)Finn
Calvert, NF |
| 48. | Mr. Martin Foley
(No Address) | 70. | Mr. Bertram Morris
St. George's, NF |
| | | 71. | Mr. William Munro
Wedgewood Park, NF |

APPENDIX II

Presentations

Mr. Dennis O'Keefe, Co-founder of Consumer Power, indicated that he represented 75,000 Newfoundlanders who had signed a petition objecting to the Applicant's rate application. Many reasons were given for the objection, they included:

- (1) The proposed rate increase and resultant rate structure is discriminatory in that the ones using the least amounts of electricity per month would be asked to pay the largest percentage increase;
- (2) The economic circumstances of the Province as a whole and its citizens would not be able to bear such an increase at this time; and
- (3) The Applicant has consistently enjoyed a large profit (\$27 million in 1995) and should not be given an increase in rates simply because its last rate adjustment was in 1991.

He recommended that:

- (a) The Applicant be ordered to coordinate the issuance of monthly bills with the time senior citizens would receive their pension incomes, i.e., the end of each month; and
- (b) The Applicant be assessed a penalty if it has violated any Board Order, and
- (c) The application be denied.

Mr. Nath Mullett, owner and manager of multiple apartment and housing units, indicated that he felt that:

- (1) The Applicant was unfair to its customers to seek an increase in these adverse economic times;

- (2) The Applicant was not justified in spending huge sums in an advertising campaign to convince home owners to switch to electric heat, particularly because he questioned the comparison of costs produced by the Applicant; and
- (3) The Applicant was requesting a rate of return on its equity that was unjustified.

He submitted a document showing comparative costs of heating two dwellings over a two year period - one by oil and one by electricity. According to Mr. Mullett, oil was the cheaper alternative.

Mr. Edward Besso, Kelligrews, presented petitions with approximately 50,000 - 60,000 names. This represented a major portion of the approximately 70,000 names he had collected. He also included approximately 150 personal letters and approximately 150 taxes addressed to him. These petitions, letters and taxes were from people all across the Province. All signatories were protesting the proposed increase in the application. Mr. Besso presented a breakdown on the increase in the basic customer charge from May, 1989 (\$10.35 per customer/month) to the proposed rate in 1996 (\$16.73 per customer/month).

The Newfoundland and Labrador Federation of Municipalities (FOM) stated its adamant opposition to the application for a rate increase as well as regarding some of the changes in the Rules and Regulations. It cited the following reasons for its opposition:

- (1) An increase in the cost of street lighting would probably force a reduction in municipalities' street lighting program. The change in the street lighting regulation as it related to a penalty period for reconnection would penalize all municipalities,

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but especially the ones forced to reduce or eliminate street lighting on a temporary basis as a cost containment measure. It would be a disincentive to a community to reinstate a street light unit.

- (2) An increase in the general service rates will place an additional burden on the municipalities, which would flow through to the taxpayers in the municipalities. This would also cause a reduction in municipal services if a recreational or cultural facility were forced to close.
- (3) They objected to the surcharge and its resultant lowering of the energy charges because it was a penalty to lower volume users. and a disincentive to conserve energy by high volume users.

The FOM, through its consultant showed details on a suggested alternative to expensive diesel generated power - a micro hydro-electrical plant.

In its conclusion, the FOM made recommendations which expressed its views on the rate application, the treatment of the provincial subsidy (or lack thereof and the suggested alternative for the supply of power to the isolated communities.

The Newfoundland and Labrador Pensioners and Senior Citizens Federation was represented by Mr. Don Holloway and Mrs. Olive Atfield.

The Federation was founded and promoted because of a program which the Federal Government instituted called New Horizons. The Federation is devoted to the welfare and best interests of the Province's elderly, and its objects and purposes are:

- (1) To promote establish and foster seniors' groups into centres or clubs through the province.
- (2) To provide education for persons in the retired or senior citizens age group and other individuals interested in aging as well as the status and well being of seniors.
- (3) To reach out to seniors that are lonely, isolated and at risk.
- (4) To provide programs that promote a healthy and active lifestyle, thus sustaining mental and physical health.
- (5) To assist in developing positive social attitudes about seniors and the aging process through promotion of educational experiences.
- (6) To disseminate information on the aging process and on any problems and benefits pertaining to the aged that is of interest to the Federation and its members.
- (7) To provide opportunities for all older adults to utilize their volunteer and leadership skills for the benefit of all persons.
- (8) To consult and cooperate with other private and public organizations which offer similar services in order to enhance programs for older adults,"

The meeting places or rooms used by the Federation are generally heated by electric heat. Because of the infrequency of use, the fact that they are considered commercial by the Applicant has caused the Federation's heating bills to seriously escalate in the last number of years.

The proposal to increase the charge for smaller users is, according to Mr. Holloway, unacceptable to the members of the Federation.

The Federation also felt that the rate of return to a public utility should reflect the economic

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status of its customer base so that, in a time when cut-backs are the general rule, a cutback in the rate of return should also occur.

Mr. Tom Osborne, M.H.A. for St. John's South, argued that the Applicant should not be granted an increase. His argument was on a compassionate basis, as well as the fact that, because the Applicant was presently realizing "enormous" profits, the request for an increase was morally unacceptable. He accused the Applicant of "defying government intention of ensuring corporations dip into their own profits to help bear the costs of public fiscal responsibilities" by "passing corporate income taxes onto its customers". He disagreed with "differential" rate increases, because it would penalize the poor. He felt there was no justification for an increase in rates in light of the amount of poverty in the province.

Mr. John C. Butt, President and C.E.O., Canadian Oil Heat Association (C.O.H.A.) indicated that his Association represented about two hundred oil companies plus a "few" equipment manufacturers. His intervention was being made on behalf of the customers of the Newfoundland members of the Association.

He gave a historical account of other events that, in effect, promoted the use of electric heat and influenced the consumer's choice of the appropriate type of space heating fuel, the most notable being "Canadian Oil Substitution Program" instituted by the Federal Government, and which was triggered by the fear of skyrocketing oil prices. As a result of this "Off Oil" program, small oil companies went out of business and electric utilities expanded their capability to supply electric power to enable them to accommodate the new requests for home heating needs.

As time progressed, the price of oil stabilized and returned to its mid-eighties price and the price of electricity increased because of expansion and other costs.

He attributed the application before the Board, with its two-tiered rate request, a result of the change in the relative price of oil vs. electricity and as a move designed to protect or increase the Applicant's penetration of the space heating market.

His Association concluded that the Applicant's proposed rate structure is discriminatory, flew in the face of conservation, is not environmentally friendly, is intended to be used as a marketing tool to retain their customers on an inefficient and expensive method of space heating, and was unfair and unacceptable to the public.

Ms. **Terri Gale**, speaking on behalf of her family, voiced her objection to the application for an increase in rates generally, and the restructuring of rates specifically. Since her home and water was heated by oil, she was in the group which would pay the highest rate of increase if the rate increase was granted.

Ms. Gale pointed out that the Province and its people are facing difficult economic times, with restricted employment opportunities, and increasing costs of living. It was her contention that the Applicant should show the same restraint forced on the population by accepting a lower rate of return. She considered the rate of return on equity that is proposed to be earned with the existing rates, i.e. 9.46%, to be fair.

Ms. Gale also pointed out that the cost of the increase in the General Service and Street and Area Lighting rates would flow back to the citizens through increased fees and taxes or a downgrading of service.

Mr. Sam Synard appeared in his capacity as Chairperson of the Advisory Council of Newfoundland Power. He described the Council as a group of volunteers(11) appointed by Newfoundland Power to act as a sounding board for the public and to relay the public's concerns to the Company. Individuals so appointed are usually those who have community involvement, and have a history of volunteer service in their community. Individually, they considered themselves as "community advocates to some degree". As a group, they do not receive remuneration in any form but are reimbursed for reasonable expenses when attending a meeting (travel to and from, meals taken during attendance), as well as for long distance telephone calls between meetings.

The Council decided that it would seek intervenor status at the hearing so that they could express its concerns.

Its first concern was the whole concept of the customers' ability to pay. The Council was aware of the Board's previous stance, but requested that the Board revisit its rationale in light of the adverse economic times in Newfoundland which have affected all its citizens.

Its second concern, and the basis for its intervention, was the Applicant's request for a rate of return on equity of 12%. It appeared to be excessive. In light of the Applicant operating in a monopoly situation, and not an open or free market situation, there should be better ways of determining a fair return, rather than compare it to competitive companies operating in areas outside Newfoundland.

The third concern was the Government's abdication from its responsibility to contribute to the Rural Rate subsidy, and its decision to legislate that it be borne only by the Applicant's customers only. Although the Council supported uniform rates across the Province, it disagreed with the targeting of one group to assume all the financial responsibility for another.

The fourth concern was the inefficiencies in having two utilities supply the one service: Hydro and the Applicant. It was the Council's view that the Applicant has made a genuine attempt to be efficient, but it was suspect of Hydro, in that Hydro did not appear to be trying to streamline their operations to the same degree.

The Council were concerned about the total cost of the present hearing given that the total cost would flow through to the ratepayers.

Mr. **Edward** Byrne, M.H.A., Kilbride, indicated that he appeared in three capacities: as an outraged ratepayer; as a person representing the electoral district of Kilbride, from which approximately 3,300 people had signed a petition protesting the request for a rate increase; and, lastly, as the Industry Critic for the Progressive Conservative Party.

As a ratepayer, he considered it inappropriate that a large corporation such as the Applicant should seek an increase, when the ratepayers, who would be the ones to pay for such an increase, are in such adverse economic restraints. As a group, the ratepayers are living with economic restraint, cutbacks and the resultant necessity for retrenchment. He believed that the proposed rate structure was discriminatory in that it penalized those who utilized fuels other than electricity for space heating. His belief was that the Board should revisit its dictum that "ability to pay cannot be considered" and take into consideration the general social and economic conditions in the Province. The Board should also consider that, if the P.S.T. and G.S.T. were harmonized, it would mean another 7 1/2 or 8% increase to the ratepayers.

As a political representative of his district, he was aware of many people with small and fixed incomes (the 2200 on social assistance, for example) who would have difficulty coping with any increase.

The Progressive Conservative Party's position was that it opposed the increase.

Mr. Jack Harris, M.H.A., Signal Hill - Quidi Vidi, Leader of the New Democratic Party gave his views both at the commencement and at the final argument stage of the hearing.

He thought that this particular hearing represented a turning point in the public's level of confidence in both the Board and the privately owned public utility as it related to the Board's ability to enforce its authority under the Act. He cited several sections of the Act which outlined responsibilities of the public utility and the Board's authority to enforce such responsibilities.

Mr. Harris gave several examples of instances in which he considered that the Board may have been remiss; for example, the apparent over-earning in 1992 and the sale or transfer of all the Applicant's common shares to Fortis Inc. without a public hearing.

He felt that there was cross-subsidization between Fortis and the Applicant and provided, as examples, bills or expenses incurred by Fortis executives and paid for by the Applicant. He questioned why the Newfoundland ratepayers should pay for membership in national organizations which have forums for national political issues, and felt that such expenditures should be disallowed.

Mr. Harris asked the Board to disallow the rule change that would permit the Applicant to collect interest at the rate of 10% over prime on late bills.

APPENDIX III

Written Submissions

Mr. Reg Gabriel, President of the Newfoundland Public Service Pensioners' Association, on behalf of its 3500 members, indicated a strong opposition to any rate increase.-
The reasons cited for the opposition were as follows.

- (1) Most pensioners' rate of pension was fixed in 1989 and, as a result, they are experiencing difficulty in maintaining a satisfactory lifestyle in the 1996 era;
- (2) Statistically, the average payment per pensioner is \$14,620 per annum, which dictates a spartan lifestyle;
- (3) Statistics Canada indicates that about 70% of Newfoundland citizens 65 years and older receive some portion of the Guaranteed Income Supplement, which places them economically below the poverty line;
- (4) In its proposed rate structure, the Applicant has indicated that those who use lesser amounts of electricity will bear a larger portion of the required increase, which will be punitive to "the poor", including those on fixed incomes; and
- (5) Most older people on fixed incomes tend to be frugal and conscientious in paying their obligations, and, hence, are going to be punished for their lifestyle.

Mr. Gabriel recognizes that a "for profit" agency must be profitable to survive, but it should also be expected to bear its share of the "hard times" and reduce its expectations as to the amount of return it is requesting for its shareholders.

The Association opposed any increase that would increase shareholders' profit, particularly if it were to be on the backs of the poor, the vulnerable and those who want to pay only their fair share.

Ms. **Gladys M. Costello**, President of the Western Division of the Retired Teachers Association of Newfoundland and Labrador, on behalf of its approximately six hundred and fifty (650) members, submitted that the Applicant's request for an overall rate increase should be denied. Its reasons for this request were that:

- (1) A 12% return to shareholders was unrealistic, especially when banks are paying one quarter of one percent on deposited funds;
- (2) It is not in keeping with general economic restraints imposed on the population as a whole by the current economic time;
- (3) Many citizens, including their Association members, are living on fixed incomes, and are unable to cope with an increase in a basic expense; and
- (4) The Applicant's proposed rate structure is punitive to those who do not utilize electricity for heating purposes, or are generally low volume users.

The Fisheries Association of Newfoundland and Labrador (FANL) suggested that the Applicant's application for an increase should be either denied, or at least reduced, and that the Board should consider changing the proposed rate structure.

It offered the following as a rationale for their conclusions:

- (1) The Applicant's parent (Fortis Inc.) is apparently earning at a higher rate than the

shares of the average company listed in the "TSE 300";

- (2) The shares of Fortis Inc. are consistently trading higher than their book value;
- (3) Because the economy of the Province is reflective of the decline in the fishery, the Applicant's customers' ability to pay has also been reduced. and.-
- (4) Because its membership's demand for electricity is mainly in the summer time, and is generally "off-peak", some consideration for lower off-peak demand charges should be reflected in the Applicant's pricing policy.

The City of Corner Brook submitted that the increase requested by the Applicant was more than the average consumer can afford if the difficult economic times are to be taken into consideration. It also pointed out that the average ratepayer would be indirectly expected to pick up its share of increases to others, e.g.. the increase charged to the City would flow back to the residents in the form of higher taxes. The City considered that it had few avenues that would allow a reduction in electricity usage since the majority, of electricity purchased was used to operate basic services, e.g., street lighting and traffic signals.

The City submitted that the rate application should be refused and that -the Applicant should absorb its increased expenses.