

1 **Q. In P.U. 32 (2007) the Board ordered NP (see p. 36) to file a fair market value**
2 **determination for insurance services provided by NP to its Fortis affiliates with an**
3 **appropriate charge out rate to be recommended. Please file a copy of the said filing**
4 **and indicate how the amount billed to Fortis affiliates has changed since NP assigned**
5 **a fair market value to such services.**

6
7 A. Attachment A is a copy of the report titled *Determination of a Charge-out Rate for*
8 *Insurance Services* filed with the Board in accordance with Order No. P.U. 32 (2007).
9

10 The charge-out rate recommended by the report was \$108 per hour. The Company
11 implemented the revised charge-out rate for the billing of insurance services to Fortis Inc.
12 and its affiliate companies on April 1, 2008. Prior to that date, insurance services were
13 billed on a cost recovery basis (i.e., base salary rate plus a 54% loading factor for
14 employee benefits, vacation and pension costs). The rate based on a cost recovery basis
15 ranged from \$72 to \$79 in the two years prior to April 1, 2008.
16

17 Inter-company billings for insurance services have increased by approximately \$50,000
18 annually as a result of the increase in the charge-out rate.

**Determination of a Charge-out Rate
for Insurance Services**

March 2008

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Rate for Insurance Services**

March 31, 2008

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1.0 Background

In Order No. P.U. 32 (2007) (“the Order”), the Board of Commissioners of Public Utilities (the “Board”) ordered, amongst other things, that Newfoundland Power Inc. (“Newfoundland Power” or the “Company”) file with the Board a fair market value determination for insurance services provided by the Company to its affiliates (the “Affiliates”), including an appropriate charge-out rate.

This report is filed in compliance with the Order.

2.0 Administration of a Group Insurance Program

Much of the day-to-day administration of the insurance function of each of the Affiliates is carried out by their own staff. This work consists of processing claims, coordinating property inspections, gathering underwriting data for policy renewals, arranging for insurance coverage and providing general risk management information as a result of inquiries from both internal and external parties (e.g., contractors).

Establishing and maintaining appropriate insurance coverages also requires insured entities to engage brokerage services and to obtain professional risk management advice and guidance from insurance professionals. These services are provided for the Fortis companies by Aon Reed Stenhouse Inc. (“Aon”), an insurance broker.

Although Fortis Inc. has grown through the acquisition or creation of other affiliates, overall coordination of the group insurance program has continued to be provided by Newfoundland Power. Currently, coordination of the program is provided by Newfoundland Power’s Director, Risk Management (the “Director”), who also acts as a liaison between the staff of the individual Affiliates and Aon.

Corporate responsibility for management of the insurance function rests with the Chief Financial Officers of the individual Affiliates.

3.0 Benefits of the Group Insurance Program

The group insurance program reduces costs and provides demonstrable benefits for Newfoundland Power’s customers through the cost effective capture of the economies of scale in the insurance procurement process. Savings are realized by each participant in the group insurance program.

The Report on Inter-Corporate Charges filed with the Board on March 31, 2004, indicated that the Company saved approximately \$400,000 annually in insurance related costs by participating in the group insurance program instead of maintaining a stand-alone insurance program. These savings were principally attributable to reduced insurance premiums and reduced broker service fees.

Benefits for Newfoundland Power's customers related to the group insurance program generally increase as the number of Affiliates participating in the plan increases. An update of the 2004 insurance cost comparison provided by Aon for the Company's 2008 general rate proceeding indicated that Newfoundland Power is currently saving over \$600,000 annually, in reduced premiums alone, as a result of its participation in the group insurance program.¹

4.0 Pricing of Inter-Corporate Insurance Services

Newfoundland Power's pricing for insurance services provided to Affiliates is based on the following guiding principles established by the Board in Order No. P.U. 19 (2003):

- (i) all inter-corporate transactions between a utility and its affiliates shall be fully transparent and are subject to scrutiny by the Board;
- (ii) a utility shall have the right to manage its affairs but it must demonstrate to the satisfaction of the Board that all affiliate transactions are prudent;
- (iii) a utility shall ensure that inter-corporate transactions will not disadvantage the interests of ratepayers and furthermore that ratepayers and the utility will derive some demonstrable benefit from such transactions; and
- (iv) the onus is on the utility to show that it is in compliance with the guidelines and principles with respect to inter-corporate transactions.

In accordance with the Company's policy for inter-corporate transactions, the charge-out rate for the Director is based on a shared services approach. This approach is employed when pooling of resources results in goods or services being acquired at a lower cost per Affiliate than if each Affiliate negotiated prices separately with suppliers. Consistent with other shared services arrangements among the Affiliates, such as the Microsoft Enterprises Agreement and the group transformer purchasing arrangement, insurance services provided by Newfoundland Power to Affiliates are charged based on a fully distributed cost methodology.²

Determined on this basis, the 2008 charge-out rate for the Director is \$78.97 per hour.³ This is equivalent to 1.54 times base salary.⁴

¹ Request for Information CA-NP-170 (1st Revision), Newfoundland Power 2008 General Rate Application.

² The fully distributed charge-out rate includes the employee's base hourly salary including general payroll overheads (EI, CPP, taxes) and other employee benefits overheads (health and life insurance, vacation, pension costs.). Staff charges related to the insurance function are charged to Affiliates on the basis of detailed time records. These transactions are summarized and reported to the Board through the Quarterly Inter-Company Transactions report.

³ Calculated as \$100,000 (base salary) plus \$54,000 (payroll and employee overheads) equals \$154,000. \$154,000 divided by 1,950 hours (7.5 hours per day) equals \$78.97 per hour.

⁴ Approximately 80% of the costs related to the Director, Risk Management position at Newfoundland Power are charged to affiliated companies on an annual basis.

5.0 Charge-Out Practices for Insurance Services of Canadian Regulated Utilities

The Company completed a review of the practices for charging out insurance services to affiliates for a sample of regulated utilities across Canada. The results of the review are shown in Table 1.

Table 1
Pricing of Insurance Service in Canadian Regulated Utilities

Utility	Regulator	Charge-Out Basis
Newfoundland Power ⁵	Board of Commissioners of Public Utilities of Newfoundland and Labrador	Cost Recovery
Newfoundland Hydro	Board of Commissioners of Public Utilities of Newfoundland and Labrador	Cost Recovery
Nova Scotia Power	Nova Scotia Utility and Review Board	Cost Recovery
Ontario Power Generation	Ontario Energy Board	Cost Recovery
Manitoba Hydro	The Public Utilities Board of Manitoba	Cost Recovery
Epcor Utilities Inc.	Alberta Utilities Commission	Cost Recovery
BC Hydro	British Columbia Utilities Commission	Cost Recovery

The results show that, for all regulated utilities reviewed, the charge-out rate for insurance services provided to affiliates was based on a full cost-recovery methodology. This is consistent with Newfoundland Power's practice.

6.0 Determination of a Charge-Out Rate

In its discussion, in the Order, of the charge-out rate for insurance services, the Board observed that the allocation of fully distributed costs among Affiliates is not necessarily indicative of the intrinsic value of the service to each Affiliate. The Board further stated that it saw "little distinction between establishing a market rate for these insurance services when compared to other technical and professional services supplied by Newfoundland Power and charged at market."⁶

Newfoundland Power's charge-out rates for technical and professional services are based on an observable professional market.⁷ There is no observable professional market for the services provided to Affiliates by the Director.

To determine a proxy market rate for insurance services for the specific services provided by the Director in the absence of an observable market, the Company obtained fee information from its

⁵ Other Fortis affiliates have been excluded from Table 1 because administration of the group insurance program is provided by Newfoundland Power.

⁶ Order No. P.U. 32 (2007), pp. 35 - 36.

⁷ Professional Engineers & Geoscientists of Newfoundland and Labrador ("PEGNL") recommended hourly rates.

insurance broker Aon, and from three Canadian risk management consulting firms.⁸ The hourly rates quoted for these insurance professionals ranged from \$150 to \$200, based on an average of 1,400 billable hours per year.

The services provided by insurance consultants and brokers consist of professional advice and guidance based on specialized expertise, professional qualifications, and industry knowledge. Brokers and consultants also undertake and maintain professional responsibility for the advice provided.

The services provided by the Director, on the other hand, principally consist of administrative coordination, and liaison among the Affiliates and with external advisers such as Aon.

To account for the difference in the nature of the services provided by the Director and the professional services on which the quoted rates are based, the low end of the range of hourly rates quoted was used to determine a proxy market rate for the Director.

The calculation is as follows:

A.	Hourly Rate for External Consultants.....	\$150
B.	Annual Billable Hours (Consultant)	1,400
C.	Value of Annual Insurance Services (A times B).....	\$210,000
D.	Annual Working Hours (Corporate)	1,950 ⁹
E.	Proxy Market Rate (C divided by D).....	\$108 per hour

7.0 Conclusions

A review of affiliate pricing for insurance services for Canadian regulated utilities indicates that charge-out rates are based on fully distributed costs. This is consistent with the approach currently used to charge for insurance services provided by Newfoundland Power to the Affiliates.

In compliance with the Order, and in consideration of the observations of the Board contained therein, the Company has derived a proxy market rate for the Director of \$108 per hour.

⁸ For reasons of confidentiality, the three risk management consulting firms contacted for this review are not identified. Two of the three are national consulting firms; the third is a Newfoundland-based risk management consulting firm.

⁹ Based on a 7.5 hour work day *times* 260 working days in a year.