Q. **(page 96, lines 1-4) Please provide a copy of the report, "Report on Inter-Corporate Charges" filed on March 31, 2004 in compliance with Order No. P.U. 19 (2003).**

A. Attachment A is a copy of the *Report on Inter-Corporate Charges* filed with the Public Utilities Board on March 31, 2004.

Report on Inter-Corporate Charges

March 31, 2004

Report on Inter-Corporate Charges

March 31, 2004

(filed in compliance with Order No. P.U. 19 (2003))

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1.0 Overview

1.1 Introduction

In Order No. P.U. 19 (2003) (the "2003 Order"), following the Newfoundland Power Inc. ("Newfoundland Power" or "the Company") 2003 General Rate Application ("GRA"), the Board of Commissioners of Public Utilities ("the Board") directed that Newfoundland Power review and report on specific matters relative to inter-corporate transactions on or before March 31st, 2004.

This report presents the results of Newfoundland Power's review of those matters, and is submitted in compliance with the 2003 Order.

1.2 Background

Business transactions with related parties are unique due to their non-arm's length nature. When one of the parties is a regulated entity, such transactions are typically recorded and monitored to ensure they are transparent and subject to regulatory scrutiny.

It is generally accepted that a fair price for such transactions is the price that would result if the parties were dealing at arm's length, in other words, a fair market price. Where no observable market exists, other mechanisms must be used to ensure a fair price. It is generally accepted in utility regulation that, in the absence of a market, price may be based on the full economic cost.[1]

The matter of inter-corporate transactions between Newfoundland Power and its shareholder, Fortis Inc. and other Fortis subsidiaries ("Related Companies") has been considered by the Board in several rate proceedings.

1.3 Regulatory History

In Order No. P.U. 6 (1991), following Newfoundland Power's 1991 GRA, the Board directed that the Company institute a quarterly reporting mechanism for inter-corporate transactions. The Board also ordered that the Company modify its code of accounts to facilitate the identification of all such transactions, and that it conduct a study of Canadian regulated utility policies on mark-up percentages on inter-corporate charges.[2]

The Board again considered the matter of inter-corporate transactions during the hearing of Newfoundland Power's 1996 GRA. At that time, Newfoundland Power filed a study of Canadian regulatory policy on inter-corporate transactions (the "Deloitte & Touche Report"). The Deloitte & Touche Report included a review of generally accepted principles relative to inter-corporate charging practices, and a review of regulatory practice among Canadian utilities.[3] The *Electrical Power Control Act, 1994* requires that the Board, in implementing the power

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[1] Deloitte & Touche, Newfoundland Light & Power Co. Limited Report on Inter-corporate Charges, March 18, 1996.
[2] Order No. P.U. 6 (1991), p. 37.
[3] Deloitte & Touche, *op. cit.*

policy of the province, apply tests that are consistent with generally accepted sound public utility practice.[4]

The Deloitte & Touche Report summarized the relevant generally accepted principles relating to inter-corporate transactions and made recommendations as to specific matters relating to transactions between Newfoundland Power and the Related Companies. Following the 1996 GRA, the Board issued Order No. P.U. 7 (1996-97), which, among other things, contained specific direction, based on the principles summarized in the Deloitte & Touche Report, as to the practices to be followed in relation to inter-corporate transactions between Newfoundland Power and Related Companies.[5]

Since 1996, Newfoundland Power has administered its inter-corporate relationships with Related Companies in accordance with the directives of the Board in Order No. P.U. 7 (1996-97), and consistent with generally accepted sound public utility practice. All inter-corporate charges have been reported to the Board on a quarterly basis. Annual financial reviews conducted on the Board's behalf have confirmed the Company's ongoing compliance with the Board's orders in this regard.[6]

In Order No. P.U. 36 (1998-99), following the Company's 1998 GRA, the Board noted that the annual financial reviews had confirmed Newfoundland Power's compliance with Board orders relative to inter-corporate transactions, and found that the directives contained in Order No. P.U. 7 (1996-97) continued to be appropriate. [7]

During the hearing of Newfoundland Power's 2003 GRA, the Board again considered the matter of the Company's relationships with Related Companies and the administration of inter-corporate charges.

2.0 Order No. P.U. 19 (2003)

2.1 General

Following the 2003 GRA, the Board issued the 2003 Order. Commencing at page 55, the 2003 Order presents the Board's consideration of the evidence in respect of the inter-corporate relationships of Newfoundland Power, and specific directives in relation thereto. A review of the various matters considered, and directions made, by the Board in the 2003 Order follows.

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[4] *Electrical Power Control Act, 1994*, SN 1994, c. E-5.1, s. 4.
[5] Order No. P.U. 7(1996-97), pp. 75-82.
[6] Doane Raymond, *Board of Commissioners of Public Utilities 1997 Annual Financial Review of Newfoundland Light & Power Co. Limited*; Grant Thornton, *Board of Commissioners of Public Utilities 1998 Annual Financial Review of Newfoundland Power Inc.*; *Board of Commissioners of Public Utilities 1999 Annual Financial Review of Newfoundland Power Inc.*; *Board of Commissioners of Public Utilities 2000 Annual Financial Review of Newfoundland Power Inc.*; *Board of Commissioners of Public Utilities 2001 Annual Financial Review of Newfoundland Power Inc.*; *Board of Commissioners of Public Utilities Financial Consultants Report Newfoundland Power Inc – 2003 General Rate Application Hearing.*
[7] Order No. P.U. 36, (1998-99), p. 97.

2.2 Governing Principles for Inter-Corporate Transactions

In Order No. P.U. 7 (1996-97), the Board had accepted the basic guidelines summarized in the Deloitte & Touche Report in relation to inter-corporate charges between Newfoundland Power and Related Companies. In the Company's 1998 GRA, the Board found that these principles continued to be appropriate. In the 2003 Order, however, the Board observed that the relationship between Newfoundland Power and the Related Companies had become "much more complex and integrated since 1998."

The Board noted that inter-corporate transactions present unique challenges because of their non-arm's length nature, and put the onus on the utility to establish that such transactions are prudent. The Board observed that the guidelines adopted in 1996 had generally proven to be adequate. However, the Board was of the view that, in light of the corporate growth of the Related Companies, more explicit regulatory direction was required in relation to Newfoundland Power's inter-corporate transactions. The Board stated the overriding principle to be that all inter-corporate transactions between affiliates should be fully transparent and subject to scrutiny by the Board. In that regard, the Board ordered that, in addition to the existing guidelines, Newfoundland Power would henceforth be required to observe certain principles in all of its inter-corporate transactions. The Board ordered as follows:

> **NP will be required to observe the following principles in all inter-corporate transactions:**
>
> > **(i) All inter-corporate transactions between a utility and its affiliates shall be fully transparent and are subject to scrutiny by the Board.**
> > **(ii) A utility shall have the right to manage its affairs but it must demonstrate to the satisfaction of the Board that all affiliate transactions are prudent.**
> > **(iii) A utility shall ensure that inter-corporate transactions will not disadvantage the interests of ratepayers and furthermore that ratepayers and the utility will derive some demonstrable benefit from such transactions.**
> > **(iv) The onus is on the utility to show that it is in compliance with the guidelines and principles with respect to inter-corporate transactions.**
>
> **These principles may be amended by the Board from time to time. Given the implications of these principles on both NP and its affiliates, NP will be required to undertake a review and update of its operating practices and procedures relating to any and all inter-corporate transactions to ensure that the principles as set out above are reflected. The results of such a review shall be reported to the Board no later than March 31, 2004.**

In compliance with the Board's direction, Newfoundland Power has reviewed and updated its practices and procedures in relation to inter-corporate transactions, and has developed a formal policy to reflect the principles set out in the 2003 Order.

The pricing and regulatory treatment of certain transactions between Newfoundland Power and the Related Companies continue to be governed by specific directives contained in Order No.

P.U. 7 (1996-97).[8] Transactions not governed by specific directives are valued on the basis of fair market value, where a market is ascertainable.[9] Where no market is ascertainable, charges to Related Companies are based on Newfoundland Power's fully distributed cost.

In the 2003 Order, the Board directed that transactions between Newfoundland Power and Related Companies should not disadvantage the interests of ratepayers and that ratepayers and the utility will derive some demonstrable benefit from such transactions. The Company's formal policy explicitly recognizes this principle, and contains pricing policies to ensure that ratepayers benefit from all inter-corporate transactions. Where transactions do not provide benefits to ratepayers, they are charged as non-regulated costs.

Schedule 1 contains the Company's policy and pricing guidelines related to inter-corporate transactions which include revisions such as those proposed for charges for Executive and Management time (see: Section 2.4 below).

2.3. Centralized Insurance Administration

Newfoundland Power participates in a group insurance program with Related Companies. Participation in the group program is more cost-effective than purchasing insurance on a stand-alone basis, and is therefore of benefit to customers.

Newfoundland Power has historically administered its insurance program in-house. As the group insurance program evolved, Newfoundland Power continued to maintain insurance expertise, and has continued to administer the insurance program for the Related Companies.

In the 2003 Order, the Board considered the Company's participation in the group insurance program in the context of the principles governing inter-corporate transactions. The Board observed that it was unusual for a subsidiary company to perform a centralized function such as insurance administration. The Board was satisfied that the costs associated with the program were tracked and billed to Related Companies as required; but expressed the view that it was difficult to determine whether the Company's participation in the program benefited ratepayers. To assist it in making this determination, the Board ordered the Company to review and report on the matter as follows:

> **NP will be directed to prepare a report which should compare and quantify the benefits to NP and ratepayers of its administration of and participation in a centralized insurance program for the Fortis Group of Companies, rather than be insured on a standalone basis. This report should be filed with the Board no later than March 31, 2004.**

A report analyzing the quantitative benefits of Newfoundland Power's participation in and administration of a centralized insurance program is provided in Schedule 2.

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[8] Order No. P.U. 7 (1996-97), pp. 75-82.

[9] Newfoundland Power's policy on inter-corporate transactions provides for a number of methods for determining fair market value. Such methods include competitive tendering, competitive quotes, benchmarking studies, catalogue pricing, replacement cost comparisons and recent market transactions.

The Board also directed the Company to modify its quarterly reports on inter-corporate transactions as follows:

> **NP will be required to modify its quarterly reports on inter-corporate charges to show separately associated labour and other staff and expense charges billed in relation to NP's insurance administration on behalf of Fortis and related companies.**

Newfoundland Power implemented the required modifications in the 2nd quarter of 2003.

2.4 Inter-Corporate Charges for Executive and Management Time

Newfoundland Power employees, including members of the executive, occasionally devote working time to Related Companies. Costs are recovered on the basis of detailed time records. Where no market rate is ascertainable, charges are based on the employee's pay rate plus benefit costs.

During the 2003 GRA, the Board reviewed the Company's practices in relation to the charging out of staff time. The Board concluded that Newfoundland Power employees' time was generally being recorded and charged out appropriately. However, the Board concluded that a method other than the "cost plus overhead" method should be implemented for charging out the time of Executives and Managers. To ensure appropriate recognition of the value of the services being provided by Newfoundland Power's senior management, the Board ordered as follows:

> **As part of the review of operating practices and procedures relating to intercorporate transactions NP will be required to investigate the utilization of market rates for executive and management time charges. In lieu of market rates, NP shall propose an appropriate markup on its cost-based rates as a proxy for market in the event that utilization of market rates is not practical.**

There is no observable market in Canada for executive and management time and, consequently, no economic basis for the derivation of a markup rate. It has been accepted practice among Canadian utilities in such circumstances to base inter-corporate charges on cost.[10] Consistent with this practice, the time of Newfoundland Power's Executives and Managers has been charged out on the basis of the individual's salary plus benefits.

A review of methods being utilized by Canadian utilities for charging out senior management time is contained in Schedule 3.

Newfoundland Power's review of the practices of other Canadian utilities has not disclosed any instance of a rate purporting to be a market rate being charged to related parties for executive and management time. This would appear, to confirm that no such market exists.

In the absence of the existence of a market or an established regulatory practice of charges other than cost, the question of what is an appropriate proxy for a market rate is necessarily a matter of

[10] Deloitte & Touche, op. cit., pp. 13-14.

impression. In Newfoundland and Labrador at present, the principal concern appears to be the regulatory transparency and acceptability of inter-corporate charges.

As a result of its review, Newfoundland Power proposes to implement, as a proxy for market, an inter-corporate charge-out rate for the time of Executives and Managers that includes a markup of 20% on the individual Executive's or Manager's salary and benefits.

2.5 Billing and Collection Practices

During the hearing of Newfoundland Power's 2003 GRA, the Board reviewed the issue of the Company's billing practices for transactions with Related Companies; in particular, the timing of billings and interest charges on overdue accounts. To ensure that billings to Related Companies are issued on the same terms and conditions as billings to unrelated parties, the Board ordered as follows:

> **NP will be required to apply billing and collection practices with respect to intercorporate transactions which are consistent with those applied to unrelated parties.**
>
> **Billings to Fortis and related companies should also be undertaken within 30 days of the service and/or expenses being charged for recovery.**

It is Newfoundland Power's current practice to issue bills for services provided to, and expenses incurred on behalf of, Related Companies on a monthly basis. Payment is due within 30 days of the invoice being issued. Interest is charged on overdue accounts at a rate of prime plus 5 per cent, which is the same as the rate charged to customers on overdue accounts pursuant to Regulation 10 (c) of the *Newfoundland Power Inc. Schedule of Rates, Rules & Regulations*.

Newfoundland Power has never experienced any material difficulty in collecting receivables from Related Companies. Practically, any credit risk associated with the provision of non-utility services to Related Companies is borne by Fortis Inc. as the equity shareholder in Newfoundland Power.

The provision of utility services to Related Companies is carried out in accordance with the *Newfoundland Power Inc. Schedule of Rates, Rules & Regulations*.

Schedule 1

Policy and Pricing Guidelines for Inter-Corporate Charges

March 31, 2004

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Appendix C: Internal Guidelines for Pricing Inter-Corporate Transactions

1.0 Overview

1.1 Purpose of Report

In Order No. P.U. 19 (2003), the Board of Commissioners of Public Utilities (the "Board") ordered, amongst other things, that Newfoundland Power Inc. ("Newfoundland Power" or the "Company") undertake a review and update of its operating practices and procedures relating to inter-corporate transactions. The purpose of the review is to ensure that all inter-corporate transactions involving Newfoundland Power comply with the principles established by the Board in Order No. P.U. 19 (2003) and prior orders of the Board. The Board also ordered that the Company report the results of its review to the Board no later than March 31, 2004.

This report contains Newfoundland Power's policy (the "Policy") and pricing guidelines (the "Guidelines") relative to inter-corporate transactions. The Policy and Guidelines meet the requirements set out in Order No. P.U. 19 (2003).

1.2 Inter-Corporate Charges - Background

Inter-corporate charges are comprised of charges to and from Newfoundland Power's common equity shareholder, Fortis Inc., and its subsidiaries (the "Related Companies").

Charges from Related Companies are split between regulated and non-regulated charges. Regulated charges to Newfoundland Power relate to costs incurred on behalf of Newfoundland Power that are required for the provision of electrical service to the customers of Newfoundland Power. Regulated costs are included in determining test year revenue requirement for the purpose of setting electricity rates and are subject to review in general rate applications.

Inter-corporate charges that do not meet the test of being required to serve the customers of Newfoundland Power are treated as non-regulated, and are excluded from the determination of revenue requirements used in establishing electricity rates. This ensures that costs that are not necessary to the provision of electrical service are not borne by ratepayers.

Newfoundland Power files quarterly reports to the Board providing a summary of the inter-corporate charges to and from affiliates by cost category and for each Related Company.

Appendix A provides additional detail on the nature of the charges included in each of the major categories.

2.0 Policy and Pricing Guidelines

The Policy for determining inter-corporate charges is provided as Appendix B. The internal guidelines for pricing inter-corporate transactions, attached as Appendix C, provide the administrative details related to the pricing of inter-corporate charges.

The Policy and the Guidelines reflect current Company practice and, taken together, comply with the Board directives on inter-corporate transactions and are consistent with practices employed by other Canadian utilities in administering inter-corporate transactions.

3.0 Compliance With Board Guidelines

In Order No. P.U. 19 (2003), the Board ordered the Company to undertake a review and update of its operating practices and procedures relating to inter-corporate transactions, and to report the results of the review to the Board. Newfoundland Power has completed its review and has documented its operating practices and procedures, which are presented in the appendices.

Newfoundland Power's practices and procedures relative to inter-corporate transactions have been developed in compliance with Board orders to reflect the regulatory objectives of fair pricing and transparency.

The formal inter-corporate transactions policy and pricing guidelines reflect current Company practice, and comply with the Board's guidelines on inter-corporate transactions.

Summary of Inter-Corporate Charges

Inter-corporate Charges are comprised of charges to and from Related Companies.

1.0 Charges to Related Companies

The major categories of charges to Related Companies are as follows:

Staff Charges:	Staff charges are applied when employees of Newfoundland Power do work for Related Companies. Staff charges include both labour cost and travel cost. The Staff Charges category does not include staff charges that are specific to Insurance, Information Services (IS), Postage, Printing and Stationary. They are instead included in the specific category.
Insurance Charges:	Newfoundland Power administers the insurance program for the Fortis groups of companies. Insurance charges reflect costs of this administration.[1]
Pole Installations:	These costs are directly related to the removal and installation of non-joint use poles owned by Fortis Inc. These costs primarily relate to the labour and material costs of pole contractors.
IS Charges:	These charges primarily relate to software licenses.
Postage:	These charges relate to the activity of providing mail and courier services to Related Companies.
Printing and Stationary:	These charges relate to the provision of printing services to Related Companies. Costs to be recovered include labour, material and equipment costs.
Miscellaneous:	Miscellaneous charges are charges to Related Companies that do not fit in any of the other categories.

1 Prior to March 31 2003, insurance premiums were paid by Newfoundland Power and then recovered from the Related Companies. This practice was discontinued in the second quarter of 2003. Related Companies now pay their own insurance premiums directly.

2.0 Charges from Related Companies

Charges from Related Companies include both regulated and non-regulated charges. Non-regulated charges are charges that are not properly recoverable through customer rates. The most significant examples are charges from Fortis Inc. for directors' fees and annual report expenses.

Newfoundland Power has its own Board of Directors and produces its own annual report, the costs of which are borne by the ratepayers. The cost allocated to Newfoundland Power by Fortis Inc. related to such duplicate items is not borne by ratepayers.

Newfoundland Power pays charges related to the listing of Fortis Inc. shares on the Toronto Stock Exchange and charges related to the administration of share purchase plans. These are costs that would have to be incurred by Newfoundland Power even if Fortis did not exist. The Board approved the treatment of these costs as regulated expenses. The Board also approved that shareholder equity be the basis of allocation for determining the amount to be charged to Newfoundland Power.[2]

The major categories of regulated charges from Related Companies are as follows:

Listing & Filing Fees:	These include charges from Fortis Inc., a portion of which is allocated to Newfoundland Power, for being listed on the Toronto Stock Exchange.
Trustee Fees:	These include charges from Fortis Inc., a portion of which is allocated to Newfoundland Power, for service fees associated with share administration.
ESPP/DRIP/CSPP Costs:	These include charges from Fortis Inc., a portion of which is allocated to Newfoundland Power, for share administration costs that are specific to the Employee Share Purchase Plan, Dividend Reinvestment Plan and the Consumer Share Purchase Plan.
Hotel/Banquet Facilities:	These include charges from Fortis Properties for the use of facilities for meetings or training purposes.
Staff Charges:	These include charges for time spent by staff of Related Companies to provide service to customers of Newfoundland Power.
Miscellaneous:	Miscellaneous charges are charges from Related Companies, incurred to provide service to customers of Newfoundland Power, that do not fit in any of the other categories.

[2] Order No. P.U. 7 (1996-97), page 78

Policy on Inter-Corporate Transactions

1.0 Purpose and Scope

The purpose of this Policy is to set out standards and conditions for inter-corporate charges between Newfoundland Power and its Related Companies. These standards and conditions apply in determining charges from Related Companies and charges to Related Companies.

The Policy protects the interests of ratepayers through the establishment of parameters for the sharing of services and resources, while allowing the achievement of economies of scale and operating efficiencies through transactions with Related Companies.

2.0 Definitions

Board means the Board of Commissioners of Public Utilities of Newfoundland and Labrador.

Demonstrable Benefits occur when inter-corporate transactions with Related Companies provide benefits to the ratepayers of Newfoundland Power that exceed the incremental costs to be borne by ratepayers of Newfoundland Power.

Fair Market Value means a price equivalent to the price reached in an open and unrestricted market between informed and prudent parties, acting at arms length and under no compulsion to act.

Fully Distributed Cost means the full cost, both direct and indirect, of providing a service including a fair return on assets, where appropriate.

Incremental Cost is a cost incurred as a result of a transaction that is over and above the cost that would be incurred in any event if the transaction did not take place.

Non-Regulated Costs are costs that are not included in the determination of the revenue requirements of Newfoundland Power used to establish electricity rates.

Policy means this Newfoundland Power Inc. Policy on Inter-Corporate Transactions.

Related Company means Fortis Inc. or any of its subsidiary companies.

Shared Service means any service, other than a Utility Service, in which the service is administered by a single company for Related Companies.

Utility means a public utility within the meaning of the *Public Utilities Act* RSN 1990 Chapter P-47, or as defined under similar legislation in another jurisdiction.

Utility Service means a service that is regulated by the Board for which the terms and conditions of service, including the schedule of rates, tolls and charges, is approved by the Board.

Non-Utility Service means a service that is not a Utility Service.

3.0 Underlying Principles

Newfoundland Power shall ensure:

(i) that all transactions with Related Companies are prudent, fully transparent and subject to the scrutiny of the Board; and
(ii) that ratepayers will derive a Demonstrable Benefit from all Non-Utility Service transactions with Related Companies.

All charges from Related Companies to Newfoundland Power must meet the following criteria:

(i) the proposed charges must be prudently incurred for the provision of a service required by the ratepayers of Newfoundland Power;
(ii) the proposed charges must be supported by the principles of cost causality; and
(iii) the benefits to the ratepayers of Newfoundland Power must equal or exceed the costs.

Charges that do not meet these criteria will be treated as Non-Regulated Costs.

4.0 Pricing

Inter-corporate charges for Non-Utility Services will be based on Fair Market Value. If market cannot be established, the charges should be based on cost. Where cost is used, it will be based on Fully Distributed Cost including a fair return on assets, where appropriate.

Where a service is subject to a regulated tariff, the regulated tariff rate will be treated as the market price.

5.0 Determination of Fair Market Value

Newfoundland Power may utilize any reasonable method to determine Fair Market Value that is appropriate in the circumstances. Appropriate methods include competitive tendering, competitive quotes, bench-marking studies, catalogue pricing, replacement cost comparisons, or recent market transactions.

Opportunity cost will be the basis for evaluating inter-corporate loans.[3] In order to reflect the opportunity cost of the transaction, the interest rate on any loan between Newfoundland Power and a Related Company shall be set at a rate that is the average of the lowest available market

[3] Order No. P.U. 7 (1996-97), page 82

rate for borrowings and the highest available market rate for deposits at the time the transaction takes place.

6.0 Determination of Fully Distributed Cost

Fully Distributed Cost with respect to:

i) the use of personnel, means the full cost of such personnel for the duration of their service to the Related Company, including salary and benefits;

iv) the use of equipment, means an allocated share of capital costs (cost of capital and depreciation) and operating costs appropriate for the time period utilized by the Related Company;

v) the use of products or services, means the total cost of providing the product or service to the Related Company, allocated as appropriate to the circumstances; and

vi) the transfer of equipment, plant, inventory, spare parts or similar assets between Related Companies, such as may occur in the provision of Emergency Services, means the net book value of the transferred assets plus any related handling charges.

7.0 Cost Allocation Among Related Companies

The charges to each Related Company for Shared Service will reflect all of the costs incurred in providing the service.

Cost will be allocated on a basis that reflects causality. Where a causal relationship cannot be established, the costs will be allocated on the basis of benefits.

8.0 Billing and Collection

Bills for charges to Related Companies, other than for Utility Service, will be issued monthly. Interest charges will apply if the bill is not paid in full within 30 days. The interest rate is set equal to that charged to ratepayers for outstanding charges as set forth in Regulation 10(c) of the *Newfoundland Power Inc. Schedule of Rates, Rules & Regulations*.

Billing for Utility Service will be in accordance with the *Newfoundland Power Inc. Schedule of Rates, Rules & Regulations*.

9.0 Regulatory Reporting

Newfoundland Power will maintain a record of supporting documentation for all inter-corporate transactions.

Newfoundland Power will submit a quarterly report to the Board, within 45 days from the end of the quarter, to assist the Board in monitoring inter-corporate charges to and from Related Companies. The report shall identify inter-corporate charges by major cost category and for each Related Company. The report will also include copies of any formal agreements signed during the quarter with a Related Company.

Inter-corporate charges for expense account items such as room or meal costs at a Fortis hotel charged on an employee visa or expense account shall not be included in the report on inter-corporate transactions due to the administrative cost of monitoring these low cost items.

10.0 Compliance

Newfoundland Power will communicate to relevant employees their responsibilities relative to inter-corporate transactions. Information will be provided on the application of the Policy to employees that are involved in inter-corporate transactions. Newfoundland Power will make the Policy available on its intranet.

Newfoundland Power will monitor compliance with the Policy through annual compliance reviews.

The Chief Financial Officer is responsible for ensuring compliance with the Policy.

Internal Guidelines for Pricing Inter-Corporate Transactions

1.0 Administration of Inter-Corporate Charges

The administration of inter-corporate charges is the responsibility of the Manager, Finance, who shall report directly thereon to the Chief Financial Officer. The determination of prices to be charged will be made in accordance with the Newfoundland Power Policy on Inter-Corporate Transactions.

Prior to any employee entering an agreement for the provision of Non-Utility Service to or from a Related Company, the methodology to be used in determining the charges is to be established and approved by the Manager, Finance (or a designated employee).

The Manager, Finance is responsible for ensuring that the appropriate price is applied and has been accepted by the Related Company prior to the transaction taking place.

2.0 Guidelines for Determining the Price

The following guidelines are provided on the application of the Policy:

How do you establish market?
A review of the market, where possible, is required to determine the market rate. Methodology options for determining market are set forth in the Policy. The market review must be documented and provided to the Manager, Finance (or a designated employee).

Where appropriate and supportable, market value may be approximated by a mark-up on cost. The definition of cost will be determined on a basis that is consistent with what is expected to be covered by the mark-up.

Below are examples where inter-corporate charges will be based on market.

Executive and Managers
Executive and Managers staff time will be charged based on a proxy for market price. Fair Market Value will be based on a market proxy rate set to equal 1.2 times the Fully Distributed Cost.

Engineering Services
Staff time to provide engineering services will be charged based on Fair Market Value. Fair Market Value will be based on a review of the market.

Equipment and Materials
Assets sold by Newfoundland Power to a Related Company or purchased from a Related Company by Newfoundland Power shall be at Fair Market Value, except in the case of Emergency Services.

Incremental Expenses
Incremental expenses such as travel expenses will be directly charged to the Related Company.

How do you establish cost?
Fully Distributed Cost is determined in accordance with Section 6 of the Policy.

Overtime will be charged out at two times the hourly rate plus loadings. Loadings are not doubled as overtime does not attract additional benefits.

The following are examples where inter-corporate charges will be based on cost:

Insurance Administration
Staff time for the administration of the group insurance program is charged based on the recovery of Fully Distributed Cost.

Information Systems Services
The Information Services Department acquires computer software license agreements to serve Related Companies. The cost is allocated based on the number of users per Related Company.

Staff time charged for contract renegotiation is based on the recovery of Fully Distributed Cost.

Trustee, Listing and Filing Fees
These are charges from Fortis. The full cost is allocated based the relative percentage of total shareholder equity for each Related Company.

Share Purchase Plan Costs
These are charges from Fortis. The full cost is allocated based the relative percentage of total shareholder equity for each Related Company.

Employee Exchange
When an employee exchange occurs, that is temporary in nature, between Related Companies, staff time is charged based on the recovery of the Fully Distributed Cost.

Emergency Services
Where assistance is provided to a Utility to deal with an emergency situation, the charges will recover the Fully Distributed Cost.

3.0 Determining Fully Distributed Cost – Staff Charges

Time spent on work for Related Companies will be supported by daily timesheets submitted on a bi-weekly basis. The Related Company will be identified on the timesheet in accordance with the Company's Code of Accounts.

The hourly labour rate will be loaded for benefits as a percentage of cost. Benefits are defined to include vacation (including statutory holidays), Canada Pension Plan, Employment Insurance, workers' compensation, health and post-secondary education tax, health insurance, and pension costs.

Benefits of a Centralized Insurance Program

March 31, 2004

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Appendix A: Correspondence from AON Reed Stenhouse Inc. dated January 14, 2004

1.0 Overview

1.1 Purpose of Report

In Order No. P.U. 19 (2003) ("the Order"), the Board of Commissioners of Public Utilities (the "Board") ordered, amongst other things, that Newfoundland Power Inc. ("Newfoundland Power" or the "Company") compare and quantify the benefits of the Company's administration of and participation in a centralized insurance program rather than being insured on a stand-alone basis.

This report compares and quantifies the benefit derived by Newfoundland Power from participation in a centralized insurance program as opposed to being insured on a stand-alone basis, and the benefit of administering the centralized insurance program as opposed to having the program administered by Fortis Inc.

Quantified analysis of these benefits is contained in Section 2.4.

1.2 Newfoundland Power's Insurance Program

To afford some perspective on Newfoundland Power's insurance program, a brief overview of the primary forms of insurance coverage maintained by Newfoundland Power is provided below.

Property Insurance	insures against all risks of direct physical loss or damage to both real and personal property;
Boiler & Machinery Insurance	insures against loss or damage to electrical equipment and machinery resulting from internal fault or mechanical breakdown;
Commercial General Liability Insurance	covers legal liability for bodily injury, personal injury and/or property damage to a third party (limit $1.0 million per occurrence);
Automobile Insurance	covers legal liability for bodily injury and/or property damage to a third party arising from the operation of an automobile (limit $2.0 million);
Non-owned Aviation Insurance	covers legal liability for bodily injury and/or property damage to a third party arising from the operation of a leased or rented aircraft (limit $10.0 million);
Umbrella Liability Insurance	covers legal liability for bodily injury, personal injury and/or property damage to a third party over and above the specified limits contained in the Commercial General Liability, Automobile and Non-owned Aviation insurance polices (to a limit of $50.0 million);

Directors & Officers Insurance	covers personal legal liability of the Company's directors and officers in the event of a wrongful act committed by a director or officer in the performance of their duties;
Employee Dishonesty Insurance	covers loss of money, securities and other property resulting from fraudulent or dishonest acts committed by an employee of the Company;
Professional Liability Insurance	provides coverage for legal liabilities arising out of the provision of professional engineering services to third parties; and
Travel Accident Insurance	provides coverage to all employees for accidental death, dismemberment or personal injury that may occur while traveling at the request of the Company.

1.3 Administration of Insurance Program

Prior to the creation of Fortis Inc. as the parent company of Newfoundland Power in 1987, Newfoundland Power administered its own insurance program. Because Newfoundland Power had expertise in the administration of the insurance function and because Newfoundland Power was the single largest subsidiary of Fortis Inc., it evolved that Newfoundland Power continued to administer this function. Although Fortis Inc. has grown with the acquisition and/or creation of other subsidiaries, Newfoundland Power has retained its role as administrator of the centralized insurance program.

Staff charges related to the insurance function are charged to Fortis Inc. and participating subsidiaries (the "Related Companies") on the basis of detailed time records. These transactions are recorded and reported to the Board through the quarterly Inter-Company Transactions Report. Common insurance premiums are apportioned among the Related Companies by several methods, depending on the nature of the coverage.[1]

2.0 Group Program Versus Stand-Alone Program

2.1 General

There are three primary advantages to Newfoundland Power participating in the centralized insurance program. These are (1) pooling of risk, (2) access to the markets specializing in utility risks, and (3) reduced insurance costs.

[1] For example, property insurance premiums are apportioned among the program participants based on the value of insured property; liability insurance premiums are apportioned based on revenues, and adjusted for relative risk; automobile insurance premiums are apportioned directly on the basis of the number and type of vehicles covered for each participant. Prior to March 31, 2003, insurance premiums were paid by Newfoundland Power and then recovered from the Related Companies. This practice was discontinued in the second quarter of 2003. Related Companies now pay their own insurance premiums directly.

2.2 Pooling of Risk

"Pooling of risk" refers to the grouping together of individuals or organizations with the objective of acquiring insurance coverage. Pooling allows groups of individuals or organizations to bring their risks together for insurance purposes, thereby balancing the consequences of the realization of individual risks. At the same time, participants in the pool share the total costs of insurance coverage.[2]

By spreading its exposure over different types of operations and over different geographic locations, an insurance provider reduces their proportionate exposure to individual losses. The resulting reduction in loss expectancy allows the insurer to charge, and the group's participants to benefit from, lower insurance premiums.

In addition, when a greater number of risks of a similar type are grouped together, the law of averages or the law of large numbers comes into play. According to this principle, the greater the number of exposures, the more predictable the probability of loss. This, too, enables insurers to lower insurance premiums, since the safety margin included in the premium can be smaller.[3]

2.3 Access to Specialized Utility Markets

The unique risks inherent in the operation of electrical utilities can only be properly insured by a select and limited number of specialty insurers. Many of these are global insurance providers that tend to focus on larger accounts. These insurance companies are not typically attracted to electric utilities of the size of Newfoundland Power with a small premium base. In fact, one of Newfoundland Power's current general liability insurers has advised that they would not continue to provide insurance to the Company on a stand-alone basis.

By combining the insurable risks of Newfoundland Power with those of other Related Companies, the premium base is substantially increased. This in turn gives the centralized insurance program access to a broader range of insurers and allows the program to actively compete with larger utilities in the specialized utility insurance market.[4]

2.4 Reduced Insurance Costs

The most tangible advantage of Newfoundland Power's participation in the centralized insurance program is a reduction in insurance costs. Costs that are reduced as a result of participation are: (1) insurance premiums, (2) broker fees, and (3) the day-to-day cost of administering the insurance function for the Company.

2.4.1 Insurance Premiums

For the purpose of this analysis, Newfoundland Power asked its insurance broker, AON Reed Stenhouse Inc., to approach the current markets for the existing insurance program to solicit pricing indications based on insuring Newfoundland Power on a stand-alone basis. Table 1 is a

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[2] *Topic Brief: Risk Pooling*, prepared by Georgia's State Planning Grant for the uninsured, September 30, 2002.
[3] *Insurance on Property*, Insurance Institute of Canada, Study Nine.
[4] Correspondence from AON Reed Stenhouse, September 28, 1999.

summary of the results of AON's survey. Table 1 compares the cost of coverage under the current centralized program to the estimated cost for Newfoundland Power if it were insured on a stand-alone basis.

Table 1
Comparison of Insurance Premium Costs[1]
(Centralized Insurance Program versus Stand-alone Program)

Type of Insurance	Centralized Program	Stand-alone Program	Difference	Per Cent
Property	$ 520,760	$ 574,938[2]	$54,178	10.4 %
Boiler & Machinery	198,127	304,290	106,163	53.6 %
General Liability	224,937	275,931	50,994	22.7 %
Automobile	218,646	218,646	nil	nil
Non-owned Aviation	6,878	6,878	nil	nil
Umbrella Liability	177,608	233,260	55,652	31.3 %
Directors & Officers	42,703	115,000	72,297	169.3 %
Employee Dishonesty	4,579	12,650	8,071	176.3 %
Professional Liability	11,079	11,079	nil	nil
Travel Accident	1,920	1,920	nil	nil
Total Cost	**$1,407,237**	**$1,754,592**	**$ 347,355**	**24.7 %**

[1] All insurance premium costs except for Travel Accident include a non-refundable 15% provincial insurance tax.
[2] Excludes coverage for transmission and distribution line coverage, which is currently covered under the centralized program, but which would not likely be available to Newfoundland Power on a stand-alone basis (see Appendix A).

As indicated in Table 1, insurance premium costs for most types of insurance would be higher on a stand-alone basis than that incurred under the centralized insurance program. For the remaining types of insurance, the premiums are the same on a stand-alone basis as they are for the centralized insurance program. In no circumstance could Newfoundland Power obtain a lower insurance policy premium on a stand-alone basis. In fact, the Company would pay an estimated $347,355 ($302,048 premium plus 15% provincial insurance tax) for the July 1, 2003 to July 1, 2004 period if insured on a stand-alone basis.

Appendix A is a letter from AON Reed Stenhouse Inc. dated January 14, 2004 containing detailed information on the rationale behind the increases in insurance premiums for specific types of insurance, as well as the reasons why the insurance premiums for specific types of insurance (automobile, aviation, professional liability and travel accident) remain unchanged.

2.4.2 Broker Fees

Another aspect of insurance costs is the annual fee charged by the insurance broker for its services. Newfoundland Power and all other participating Related Companies are allocated a portion of the total annual broker service fee on the basis of their percentage of total insurance premiums. Currently, Newfoundland Power's portion amounts to $49,382. On a stand-alone basis, the Company's insurance broker has advised that the fee would be $80,000, an increase of $30,618. The higher fee reflects the minimum fee that the broker would charge based on the size, risk portfolio and complexities associated with marketing and administering an electric utility insurance program. The broker's cost to administer a single group program is less, due to economies of scale, than the cost to administer numerous individual insurance programs.

2.4.3 Program Administration Costs

Participation in the centralized program lowers the day-to-day costs associated with the internal administration of the insurance function. The insurance administration function primarily involves processing claims, coordinating property inspections, preparing for policy renewals, arranging for insurance coverage and providing general risk management information to both internal and external parties (e.g., contractors).

For the year ending December 31, 2003, Newfoundland Power had two employees involved in the day-to-day administration of the centralized insurance program for the Related Companies. A review of the detailed timesheets for these employees reveals that approximately 1,450 hours (representing approximately 0.74 full-time equivalent employees (FTEs)) were charged to Newfoundland Power for the risk management function. This time was primarily related to claims processing, property inspections and responding to general inquiries related to risk management. Based on the salaries plus benefits of the employees completing the work, the cost of the risk management function was $68,966 in 2003.

If Newfoundland Power were insured on a stand-alone basis, additional time would be required to administer the Company's insurance program. In addition to time noted above for claims processing, property inspections and responding to general inquiries, time and expense would be incurred in the annual insurance renewal process, as well as for participation in risk management training sessions and industry conferences. Currently, all time related to these tasks is charged directly to Fortis Inc. (as it benefits all of the Related Companies) and is not included in Newfoundland Power's revenue requirements. With the inclusion of this additional time, and taking into consideration vacation time and statutory holidays, the Company conservatively estimates that at least one full-time employee would be required to administer the full risk management function for Newfoundland Power if it were insured on a stand-alone basis.

The cost of one FTE position for the risk management function has been estimated to be $84,000 (includes base salary and benefits). As noted above, Newfoundland Power's share of the staff costs related to administering the centralized insurance program in 2003 was approximately $68,966. Thus, the Company realized annual labour savings of $15,034 as a result of being able to leverage the administration costs of the insurance function over all the Related Companies.

3.0 Administration of Group Insurance Program

In Order No. P.U. 19 (2003), the Board also directed Newfoundland Power to compare and quantify the benefits accruing to Newfoundland Power from its administration of the centralized program, as opposed to having the program administered by the parent company.

The qualitative benefit derived by Newfoundland Power from its administration of the centralized insurance program is the retention by the Company of expertise in all aspects of the insurance function and direct control over the components of its own insurance coverage. Should administration of the centralized insurance program reside at the parent organization level, then this expertise would be transferred to Fortis Inc. and decisions on insurance coverage would be made by the parent organization with input from Newfoundland Power. It is acknowledged that the benefit of retaining insurance expertise and direct control is an intangible benefit, which is difficult to quantify.

As noted above, there are currently two employees involved in the day-to-day administration of the centralized insurance program. The total cost of salary and benefits for these two employees in 2003 was $154,505 (base salary and benefits). A total amount of $85,539 was charged to Related Companies for insurance related matters, leaving $68,966 to be borne by Newfoundland Power. If these employees were transferred to Fortis Inc., and were to charge their time spent on Newfoundland Power insurance matters back to Newfoundland Power, then the cost of that time would not be materially different.

4.0 Conclusions

In response to the directive contained in Order No. P.U. 19 (2003), Newfoundland Power has analyzed the benefits related to (1) participation in a centralized insurance program versus being insured on a stand-alone basis, and (2) administering the centralized program versus having the program administered by Fortis Inc.

Appendix A provides AON Reed Stenhouse Inc.'s opinion that Newfoundland Power achieves the greatest cost efficiency and broadest coverage by remaining insured under the centralized insurance program.

After reviewing all the costs related to the insurance function (premium costs, broker service fees and general administration costs), it is clear that Newfoundland Power derives a substantial direct benefit from participation in the centralized insurance program. Table 2 provides a summary of the difference in insurance costs for a stand-alone insurance program versus participation in the centralized program.

Table 2
Summary of Annual Insurance Costs

	Centralized Program	Stand-Alone Program	Difference
Premiums	$ 1,407,237	$ 1,754,592	$ 347,355
Broker Fees	49,382	80,000	30,618
Administration	68,966	84,000	15,034
Total	**$ 1,525,585**	**$ 1,918,592**	**$ 393,007**

In total, Newfoundland Power saves almost $400,000 annually as a result of its participation in the centralized insurance program.

Newfoundland Power's analysis does not disclose any material difference in cost between having the centralized insurance program administered by Fortis Inc. and having the program administered by Newfoundland Power.

Appendix A

Correspondence from AON ReedStenhouse Inc.
dated
January 14, 2004

Insurance Brokers
Risk Consultants

Jan. 14, 2004

Mr. Alex Knight
Risk Manager
Fortis Inc.
P. O. Box 8910
St. John's, NL
A1B 3P6

Re: Insurance Quotation - Newfoundland Power Inc.

Further to your request we have approached current markets of the Fortis Inc. Insurance Program to solicit quotations to insure Newfoundland Power Inc. on a stand alone basis. We understand the purpose of your request was to seek confirmation as to whether it is more cost effective for Newfoundland Power Inc. to remain under the Fortis Program or to obtain insurance as a separate entity.

Quotations were requested based on current terms, conditions, limits and deductibles. Current markets have been approached as these markets were selected based on a recent complete remarket of the Fortis Inc. Insurance Program. The successful markets were chosen based on the scope of coverage offered, premium rates and market stability.

Based on the response from Insurers, as outlined in Appendices A and B attached, it is evident that Newfoundland Power Inc. benefits greatly from participation in the Fortis Inc. Insurance Program. You will note in Appendix B that additional costs of $302,048 would be incurred by Newfoundland Power Inc. to purchase coverage on a stand alone basis for the current term. Policy by policy Insurers have cited various reasons for either requiring higher rates to insure Newfoundland Power Inc. on a stand alone basis or quoting rates as per the current allocation under the Fortis Inc. Insurance Program. An overview of the quotations provided for each policy is included in Appendix A.

Insurers have cautioned that the quotations provided are based solely on the underwriting information currently on file, including claims statistics relative to Newfoundland Power Inc. Some markets have also cautioned that coverage wordings for Newfoundland Power Inc. on a stand alone basis may not be as broad as those provided under the Fortis Inc. Insurance Program. In some policies broader coverage may be available at additional cost and, in some cases, not at all. In this exercise we have also encountered markets that require a minimum premium to write certain classes of risks, regardless of the exposure and loss statistics and, additionally, we have been advised by one current market that they would not be interested in insuring Newfoundland Power Inc. on a stand alone basis.

Insurers follow the principle that the larger the number of exposures considered the greater the accuracy that can be achieved in determining the true probability of loss. It is this statistical expectation of loss, which determines premium rates. On this basis and based on the quotations received from current Insurers, we are of the opinion that Newfoundland Power Inc. will achieve the greatest cost efficiency and the broadest coverage by remaining insured under the Fortis Inc. Insurance Program.

Trusting all information has been presented to your satisfaction, however, should you require further information or wish to discuss any of the information contained in this correspondence, please do not hesitate to contact the undersigned.

Yours truly,

M. Leonard

MARILYN LEONARD, AIIC, CCIB
SENIOR ACCOUNT MANAGER

APPENDIX A

Utility Property Insurance

FM Global would require a rate increase of approximately 10% to insure Newfoundland Power Inc. on a stand alone basis. The lower rate currently applicable to the Fortis Inc. Insurance Program is a reflection of the Insurer's ability to underwrite larger risks at lower rates and still maintain profitability and spread of risk. It is common for Insurers to allow rate and coverage concessions to their larger clients.

This quotation would also exclude all Transmission and Distribution line (T&D) coverage. Currently, Fortis Inc. has coverage for T&D lines, subject to an annual limit of $500,000. Most utilities in Canada do not have T&D coverage, utilities that have the coverage tend to be the larger companies with sufficient market influence to obtain this coverage, such as Fortis Inc. The importance of T&D coverage, albeit with a low limit, was evidenced during lightning storms of Sept., 2002, when Newfoundland Power Inc. sustained significant lightning damage to its T&D system, resulting in $368,000 of insured damage. The fact that Newfoundland Power Inc. had coverage, as part of the Fortis Inc. Insurance Program, whereas, Newfoundland Power Inc. on a stand alone basis would not, illustrates the value of being part of a larger program.

Boiler & Machinery Insurance

BI &I, current Boiler & Machinery Insurers of the Fortis Inc. Insurance Program, would require a rate increase of approximately 53% to insure Newfoundland Power Inc. on a stand alone basis. Insurers have made this rate determination based on the exposures at risk and the historical loss experience of Newfoundland Power Inc. The Boiler & Machinery Policy rating provides another example of the large premium savings afforded Newfoundland Power Inc. due to their participation in the Fortis Inc. Insurance Program.

Commercial General Liability Insurance

The quotation provided by American Home Assurance Company for a stand alone policy for Newfoundland Power Inc. would result in a premium increase of approximately 23% over existing premium. The rating provided takes into account the exposures to risk of Newfoundland Power Inc., only, without the policy rating credits allocated to the Fortis Inc. Insurance Program due to volume and diversity of risks covered by the Program. Insurers require minimum rates for certain classes of risk, such as utilities. These minimum rates are usually elevated based on the condition of the risk, the potential exposure to loss and claims history, among other factors.

Umbrella Liability Insurance

The rating for the Umbrella Liability Policy would increase by less than 10% for a stand alone policy for Newfoundland Power Inc. Statistically, rating calculations for this type of policy are similar to the General Liability Policy, except the overall rating basis is lower to acknowledge that coverage provided by underlying policies would have to be exhausted before the Umbrella Policy would be called upon to pay claims.

First Excess Umbrella Liability Insurance

AXA Corporate Solutions Assurance, as the current Insurer of the First Excess Umbrella Liability Policy, have provided a stand alone quotation for Newfoundland Power Inc. However, AXA has further advised that their corporate mission is to serve large, international accounts such as the Fortis Inc. account. In compliance with their corporate mission, AXA would not be willing to insure Newfoundland Power Inc. on a stand alone basis. As a result, should Newfoundland Power Inc. elect to purchase stand alone insurance, this coverage would have to be remarketed in the general market place.

Second Excess Umbrella Liability Insurance

Current Insurer, Elliott Special Risks Ltd., would require additional premium of approximately 47% to insure Newfoundland Power Inc. on a stand alone basis. Insurers would consider the premium charge quoted as the minimum premium at which they would participate based on the policy limits required, the class of business and types of exposures.

Automobile Insurance

The Automobile Policy is currently rated on a per company basis, subject to submission of an annual automobile fleet inventory. Consequently, there would be no change in premium to insure Newfoundland Power Inc. on a stand alone basis. If, however, a decision is made to insure the Newfoundland Power fleet on a separate policy, all future claims will be charged directly against the Newfoundland Power Policy, instead of spreading the losses over the larger Fortis Inc. Automobile Policy. Potentially, the foregoing circumstances will result in higher premiums for Newfoundland Power Inc. should future claims experience warrant.

Directors & Officers Insurance

Current Insurers of the Fortis Inc. Directors & Officers Policy have quoted an additional premium of $62,867 to provide cover for Newfoundland Power Inc. on a stand alone basis. The premium quoted represents an increase of approximately 170% over the current allocation for Newfoundland Power under the Fortis Program. Insurers have advised that the premium quoted for Newfoundland Power Inc. is the minimum premium for which current limits can be written on a stand alone basis. Newfoundland Power Inc. benefits from a lower allocation by participation in the Fortis Inc. Directors & Officers Policy. In addition, there are administrative efficiencies inherent to a consolidated program that further reduce costs.

Crime Insurance

The Guarantee Company of North America have quoted an additional premium of $7,018 to provide coverage for Newfoundland Power Inc. on a stand alone basis. This quotation would result in an premium increase of approximately 175% over the current allocation. In explanation of the large premium difference, Insurers have advised that in the rating of a Crime Policy the pricing per additional employee reduces as the total employee count increases and the reverse occurs when the total number of employees decreases. Consequently, by insuring Newfoundland Power Inc. separately, based on a reduced employee count, the per employee rate will increase substantially.

Professional Liability Insurance

The current policy through Econ Insurance provides professional liability coverage for fee based engineering services performed for Third Parties. Within the Fortis Group of Companies, only Newfoundland Power Inc. and Maritime Electric Company Ltd. provide such services to outside parties. As this policy is rated based on the annual fee amounts for such services generated by each company, there would be no premium difference to insure Newfoundland Power Inc. on a stand alone basis.

Non-Owned Aircraft Insurance

The Non-Owned Aviation Policy is currently rated at a minimum premium for this type of coverage, as a result, there would be no premium saving to insure Newfoundland Power Inc. on separate basis.

Travel Accident Insurance

The current Travel Accident Policy is rated on a per company basis taking into account the number of employees and travel days per company. Therefore, the rate assessed to Newfoundland Power Inc. would not change on a stand alone basis.

APPENDIX B

Comparative Analysis of Stand-alone versus Group Insurance Program for Newfoundland Power

Insurance Type	Group Premium	NF Power (Group-share)	NF Power (Stand alone)	Difference	Per Cent
Utility Property	$1,425,724	$ 452,835	$ 499,946	$ 47,111	10.5%
Boiler & Machinery	508,038	172,284	264,600	92,316	53.0%
Commercial General Liability	445,034	195,597	239,940	44,343	23.0%
Primary - Umbrella Coverage	180,000	73,641	80,000	6,359	8.5%
1st Excess - Umbrella Coverage	97,500	39,889	62,835	22,946	55.0%
2nd Excess - Umbrella Coverage	100,000	40,912	60,000	19,088	47.0%
Automobile	345,273	190,127	190,127	nil	nil
Director's & Officers	183,000	37,133	100,000	62,867	170.0%
Comprehensive Crime	18,610	3,982	11,000	7,018	175.0%
Professional Liability (E&O)	13,647	9,634	9,634	nil	nil
Non-owned Aircraft	7,975	5,981	5,981	nil	nil
Travel Accident	5,140	1,920	1,920	nil	nil
Total	$3,329,941	$ 1,223,935	$ 1,525,983	$ 302,048	

Comparative Analysis of Stand-alone versus Group Insurance Program for Newfoundland Power

Type of Service Fee	Group Service Fee	NF Power (Group-share)	NF Power (Stand alone)	Difference	Per Cent
Broker Service Agreement	$150,000	$49,382	$80,000	$30,618	62%
Commission Basis	na	na			

Senior Management Time Charges
March 31, 2004

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1.0 Purpose of Report

In Order No. P.U. 7 (1996-97), following the Newfoundland Power 1996 General Rate Proceeding, the Board of Commissioners of Public Utilities (the "Board") ordered 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 executive". Since 1997, there have been no material executive salary transfers from Fortis Inc. to Newfoundland Power.

In recent years, there has been an increase in the level of services provided to Fortis Inc. and its subsidiaries (the "Related Companies") by Executives of Newfoundland Power. Because there is no observable market from which to derive an appropriate charge-out rate, charges to Related Companies for Executives' time have been based on fully distributed cost (hourly rate plus benefits).

In Order No. P.U. 19 (2003) (the "2003 Order"), the Board found that the "cost plus overhead" rate did not sufficiently recognize the value of the service provided by Newfoundland Power's senior management. The Board ordered that the Company investigate the utilization of market rates or, in lieu of market rates, propose a suitable mark-up as a proxy for market rates for executive and management time.

2.0 Practices in Other Canadian Jurisdictions

2.1 Overview

A review of Canadian regulatory jurisdictions reveals that executive charges to affiliated corporations typically involve charges to a regulated subsidiary from a parent company. This typically occurs where the provision of corporate services for parent and subsidiary companies is integrated or centralized. For example, there may be a single executive group, a single Human Resources department and a single Accounting department serving more than one company.

Examples of regulated utilities where the parent company shares resources with subsidiaries on an ongoing basis include: Nova Scotia Power Inc., Maritime Electric Company, Limited, FortisOntario Inc., Hydro One Inc., Terasen Gas Inc. (formerly BC Gas), Pacific Northern Gas Ltd., Newfoundland & Labrador Hydro, TransCanada Pipelines Limited and Aquila Networks Canada (British Columbia) Ltd.

Regulators require that such shared costs be allocated among the affiliates to ensure that only appropriate amounts are reflected in rates. Such shared costs are allocated on the basis of causality, which is determined according to the circumstances. For example, human resources costs may be allocated based on the number of employees in each company; information services costs may be allocated on a user per entity basis. Executive costs may be allocated in a number of different ways, or based on a timesheet allocation. These shared corporate services costs tend to be fairly consistent from year to year, and the allocations among subsidiaries are calculated and charged on a regular basis.

Newfoundland Power's sharing of the services of Executives and Managers with Related Companies is somewhat different. Newfoundland Power operates on a stand-alone basis, and Newfoundland Power and Fortis Inc. have separate and distinct executive groups, and separate and distinct functional departments. Regulated charges from Fortis Inc. to Newfoundland Power are not a material issue.

Accordingly, the issue for Newfoundland Power is one of establishing fair value for services performed for Related Companies by Executives and Managers of Newfoundland Power as opposed to one of apportioning the costs of sharing of Executives and Managers between regulated and unregulated businesses.

For Newfoundland Power, the sharing of Executives' and Managers' services with Related Companies typically occurs on an as required or project basis. This would not normally reduce the individual's executive and management responsibilities to Newfoundland Power.

2.2 Research Results

2.2.1 Current Survey

Table 1 summarizes the methodologies used by a number of Canadian utilities to determine the charges to affiliated companies for executive and manager time supplied on a project basis.

Table 1
Survey of Canadian Utilities
Senior Management Time Charges

Utility	Regulator	Basis for Executive Charges	Mark-ups
Nova Scotia Power	Nova Scotia Utility and Review Board	Cost Recovery[1]	No
Maritime Electric	Island Regulatory and Appeals Commission	Cost Recovery	No
FortisOntario	Ontario Energy Board	Cost Recovery	No
Hydro One	Ontario Energy Board	Cost Recovery	No
Newfoundland Power	Board of Commissioners of Public Utilities of Newfoundland and Labrador	Cost Recovery	No
Newfoundland & Labrador Hydro	Board of Commissioners of Public Utilities of Newfoundland and Labrador	Cost Recovery	No
Aquila Alberta	Alberta Energy and Utilities Board	Cost Recovery	No
TransCanada Pipelines	National Energy Board	Cost Recovery	No
Pacific Northern Gas	British Columbia Utilities Commission	Cost Recovery	No
Terasen Gas	British Columbia Utilities Commission	Cost Recovery plus mark-up	Yes
Aquila BC	British Columbia Utilities Commission	Cost Recovery plus mark-up	Yes

[1] The reference to cost recovery refers to salary, benefits and administrative overheads where appropriate.

2.2.2 The CRTC Experience

In its 1996 report on inter-corporate charges, Deloitte & Touche described the CRTC approach to the issue of mark-ups.[2]

As part of the restructuring of the telecommunications industry that took place in the late 1980s, the Canadian Radio-television and Telecommunications Commission (CRTC) conducted a review of the issue of inter-corporate charges for senior management time. At that time, the CRTC ruled that the use of accounting costs alone did not capture the full costs involved in temporary employee transfers. The CRTC required a mark-up of 25% to be applied to salaries plus benefits[3].

As a result of further regulatory changes in the telecommunications industry, the 25% mark-up is no longer in effect. In May 2002, the CRTC ruled that telecommunications utilities would no longer be required to file inter-corporate transaction reports.[4]

3.0 The Application of a Mark-up on Costs

3.1 Current Canadian Regulated Industry Practice

A survey of the charge-out rates for senior management of other utilities revealed that most utilities base charges on cost recovery.[5] There were two exceptions among the available respondents.

Terasen Gas applies an availability charge of 20% to the cost based rate for management time provided on an as required basis. This availability charge is waived, however, if the utility reserves the right to immediately recall their employee.[6]

Aquila BC charges a mark-up of 10% on the total invoiced cost to reflect profit margin.[7]

3.2 The 2003 Order

In the 2003 Order, the Board ordered that Newfoundland Power propose an appropriate mark-up on its cost-based rates as a proxy for market in the event that the utilization of market rates is not practical.

The Company's review of current Canadian utility practices disclosed no observable market for executive and senior managers' time. Further, Newfoundland Power's review of the practices of other Canadian utilities has not disclosed any instance of a rate purporting to be a market rate being charged to related parties for executive and management time.

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2 Deloitte & Touche, Newfoundland Light & Power Co. Limited Report on Inter-corporate Charges, March 18, 1996, pp. 24-26.

3 CRTC; Telecom Decision CRTC 88-4; March 17, 1988.

4 CRTC, Telecom Decision CRTC 2002-34; paragraph 998.

5 This includes salaries plus benefits and administrative overheads where applicable.

6 Terasen Gas Inc., Transfer Pricing Policy .

7 Aquila Networks Canada (British Columbia) Ltd., Schedule 1, Code of Conduct (internal company policy).

3.3 Proposed Market Rate Proxy

In the absence of the existence of a market or an established regulatory practice of charges other than cost, the question of what is an appropriate proxy for a market rate is necessarily a matter of impression. In the 2003 Order, the principal concern appears to be the regulatory transparency and acceptability of inter-corporate charges.

To address this concern, Newfoundland Power proposes to add a mark-up of 20% on the salary and benefits of individual Executives and Managers who perform work for Related Companies. This mark-up is equivalent to the highest mark-up revealed in the Company's review of current Canadian regulated industry practice.

The 20% mark-up will serve as a proxy for market in valuing the services of Newfoundland Power's Executives and Managers provided to Related Companies.

The mark-up is proposed to be effective at the commencement of the 2nd quarter of 2004.