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M A N I T O B A	**)**	**Order No. 79/07**
	)	
THE PUBLIC UTILITIES BOARD ACT	**)**	**June 8, 2007**

BEFORE: Graham Lane, C.A., Chairman
Susan Proven, P.H.Ec., Member

STITTCO UTILITIES MAN LTD.
REGULATORY OVERSIGHT AND PROPANE RATES

Table of Contents

1.0 EXECUTIVE SUMMARY

The Public Utilities Board (Board) held a public hearing in Thompson, Manitoba on March 14, 2007 with respect to Stittco Utilities Man Ltd.’s (Stittco) concurrent applications for a reduction in regulatory oversight and increased rates. In the event that the Board did not agree to reduced regulation, Stittco asked the Board to consider revised rates.

By this Order, the Board first rejects Stittco’s proposal for reduced regulatory oversight, which if accepted, would have left rate setting to Stittco, possibly subject to a complaint-based or a Board-directed review process. The Board does not find that Stittco and its services are, or will be, subject to competition sufficient to protect the public interest. The Board finds its current regulatory oversight both desired by Stittco’s customers and of continuing public benefit. That said, in this Order the Board will provide for changes to the current approach.

Given the Board’s decision to remain the final determiner of rates, the Board will also move towards amending Stittco’s propane rates. However, before setting new rates, the Board requires additional information.

Herein, the Board directs Stittco to file, on or before June 22, 2007, an amended rate proposal based in part on the application it brought before the Board at the March hearing. The amended rate proposal is to reflect the following changes to Stittco's proposed across-the-board rate increases of 6.1%:

a) a reduction in revenue requirement to reflect an allowable rate of return on rate base and shareholder's equity of 10%, reduced from the current 10.83%; the Board will continue to allow Stittco's 100% equity-based capital structure; and
b) a reduction, for regulatory rate setting purposes, in revenue requirement to account for a provision for income tax expense consistent with the allocation to Stittco of one-third of the annual allowable maximum small business tax deduction, to a maximum of Stittco's prospective taxable income.

Following the receipt of the information required as set out herein, the Board intends to establish revised interim rates as of July 1, 2007. Such rates will be subject to further amendment and finalization, possibly as of August 1, 2007, following the Board's review of further additional information to be required of Stittco, as set out below.

The further additional information which is to be provided to the Board, and with the exception of specified information to be received by the Board on a confidential basis, will be shared with the Consumers Association of Canada/Manitoba Society of Seniors (CAC/MSOS). CAC/MSOS was an Intervener to the proceeding, and will be provided an opportunity to provide comments subsequent to it receiving the additional information.

Stittco is required to file additional information with the Board, as outlined in 5.0 Board Findings, and ordered in the directives section.

With the assistance of this further information, the Board intends to:

a) closely examine the relationship and arrangements between Stittco and its parent, to assure itself of the reasonableness of such;
b) establish a process for the regular review of rates in future; and
c) set finalized rates as of August 1, 2007.

Stittco's Purchased Propane Variance Accounts (PPVA) are to continue to accrue differences between actual propane supply and transportation costs and those reflected in rates; these balances may result in rate adjustments as early as August 1, 2007.

2.0 BACKGROUND

Incorporated in Manitoba, Stittco distributes propane brought in by railcar and then delivered through pipeline distribution to approximately 1,039 customers in Thompson, Flin Flon and Snow Lake. About sixty-five percent of Stittco's propane volume is consumed by its commercial customers including restaurants, other businesses and large institutions such as the Thompson and Flin Flon Hospitals; the remainder is consumed by residential customers.

Over the past 15 years the number of commercial customers has increased by 24 (146 to 170), with six commercial customers added in fiscal 2005/06. Since 1991, Stittco reported having lost in aggregate only three customers, with the gains in commercial accounts offset by losses of residential customers. On a weather-normalized basis, the volume of propane sales projected for 2005/06 was lower than that of the early 1990s.

Stittco has provided regulated propane services to customers in Northern Manitoba since 1963. The initial term of Stittco's Thompson franchise agreement began in 1967. Following a 2012 expiry of the current ten-year franchise extension, it is the Board's understanding that either a further ten-year extension will be granted or the City of Thompson will exercise its option to purchase the system.

Stittco and its sister company, Stittco Utilities NWT Ltd (Stittco NWT), are wholly-owned subsidiaries of Stittco Energy

Limited (Stittco Energy). Stittco Energy sells propane in bottled form to various industrial and other customers in Thompson, Flin Flon and Snow Lake, as well as in other locations in northern Manitoba.

Currently, Stittco Energy purchases propane from the market and resells it to Stittco. Stittco also engages in three other significant related party transactions with its parent, these being:

- contract services provided by Stittco to its parent;
- contract services provided by the parent to Stittco; and
- administrative services provided by the parent to Stittco.

For the eight years 1997/98 to 2005/06, Stittco reported receiving about $460,000 for contract services provided to its parent, and paid Stittco Energy about $1.5 million ($1.16 M for administrative services and $380,000 for contract services). As well, for the four fiscal years 2001/02 through 2004/05, the parent received almost $1 million in dividends from Stittco.

Stittco Energy is unregulated, and the Board has yet to receive or review the financial statements and results of Stittco Energy. Herein, the Board reiterates its requests through the proceeding and directs Stittco to file, in confidence, the latest audited statements for Stittco Energy.

On January 30, 2006, Stittco filed two applications with the Board. The first, for deregulation, if approved would make the second moot. The second requested across-the-board rate increases of 6.1% to be effective April 1, 2006.

At that time, the Board deferred addressing the requests, as commodity prices were then falling. Subsequently, Stittco renewed its applications on August 9, 2006, and again in late September 2006.

With commodity prices still well below the levels forecast by Stittco in its application, by Order 138/06, dated October 2, 2006, the Board denied Stittco’s rate request and deferred further consideration of both the regulatory approach and rate increase applications to a then-scheduled December 2006 public hearing. The December 2006 hearing was subsequently postponed at the request of Stittco and rescheduled to March 2007. This Order results from that hearing and related proceeding.

Leaving aside the regulatory process matter for now, the two major contributing factors driving Stittco’s rate application were projections for the wholesale cost of propane and increased non-commodity operating costs. As well, the provision for income taxes reflected in Stittco’s cost projections took no account of any allocation of the small business tax deduction and remained based on an allowable return on shareholder’s equity of 10.83% per annum.

A comparison of existing interim rates, as set by Order 133/05, and the rates sought by Stittco in its recent application are set out below:

	Rate per cubic meter	
Cubic meters	**Proposed**	**Existing Order 133/05**
Domestic Service		
First 50	$2.4526	$2.3121
Over 50	$2.0283	$1.9121
Commercial, Industrial and Large Volume Service		
First 1,000	$2.2722	$2.1421
Next 3,000	$2.1343	$2.0121
Over 4,000	$1.8904	$1.7821

Industrial and large volume rates may be set through negotiation, subject to negotiated rates not exceeding the rates specified above and being filed and accepted by the Board. At the time of the release of this Order, Stittco had two customers with negotiated rates, the hospitals in Thompson and Flin Flon.

A summary of rates charged and proposed to be charged to domestic (residential) customers since 1997 follows:

Year	**Order #**	**First 50 m^3**	**% Inc.**	**Over 50 m^3**	**% Inc.**
1997	91/97	1.2930	n.a.	1.0660	n.a.
1998	115/98	1.2930	nil	1.0660	nil
1998	158/98	1.2930	nil	1.0660	nil
1999	182/99	1.4160	9.50	1.1890	11.50
1999	187/99	1.4160	nil	1.8890	nil
2000	120/00	1.6020	13.1	1.3750	12.20
2001	4/01	2.0361	27.1	1.8091	31.60
2001	124/01	1.9131	(6.0)	1.6861	(6.8)
2002	28/02	1.7271	(9.7)	1.5001	(21.6)
2002	172/02	1.6500	(4.5)	1.2500	(16.7)
2003	20/03	2.0162	22.2	1.6162	29.30
2005	50/05	2.0162	nil	1.6162	Nil
2005	133/05	2.2178	10.0	1.7778	10.00
2006	133/05	2.3121	4.3	1.9121	7.60
2007	Proposed	2.4526	6.1	2.0283	6.10

Generally, rate changes have been symmetrical, either as to the rate of change or as to the absolute monetary change applied to each customer class.

Stittco’s propane supply and transportation expenses, to Stittco’s franchise area, are reflected in customer rates without markup. Fluctuations in these costs, upwards or downwards, are captured in Stittco’s PPVA balances. Stittco has repeatedly advised Board proceedings that it is unable to borrow on its own credit-worthiness and requires the support of its parent. At the recent hearing, Stittco advised that it is unable to purchase and transport propane, and that Stittco Energy buys and transports Stittco’s propane to Manitoba, with Stittco paying no mark-up to its parent.

Stittco’s application advised that its parent’s current propane supply contract with Keyera Energy arose out of a tender issued to thirteen companies; four bids resulted. The contract provides for propane to be purchased half on a variable basis and half by fixed price. At the time of the hearing, the fixed price portion was priced at $352.64 per cubic meter F.O.B. Thompson (prior contract, $330.70).

Stittco’s rate application assumed an overall commodity product cost of $360 per cubic meter including transportation to Thompson for fiscal 2006/07, consistent with the Company’s January 2006 estimate of $359.14 per cubic meter. On a cost per litre basis, commodity costs have increased from 2002’s level of $0.185 to $0.2738 for the year ended July 31, 2005, and to $0.359 for the year ended July 31, 2006.

Stittco’s application projected that higher propane commodity prices will be sustained, though market conditions and price fluctuations will occur.

Propane prices have fluctuated over the past few years. Prices rose sharply in 2005, then fell, more or less, through the winter, spring and summer of 2006, only to climb again in the fall before retreating somewhat ahead of the March hearing. Prices have since increased again.

Wholesale propane prices (Shell Canada- Edmonton prices), which were set in early August, 2006 at $313.00 per cubic meter, were, as of recent dates, approximately $308.00 per cubic meter. These prices exclude transportation. As previously indicated, Stittco’s commodity costs reflect not only the purchase price for the commodity but also railcar transportation to Thompson; thus changes in market wholesale prices only partially reflect Stittco’s landed cost experience.

Rates are established based on forecast commodity prices and costs; thus differences arise between the forecasts and the actual experience. Variations between actual and forecast commodity costs are recorded within Stittco’s Board-approved domestic and commercial PPVA’s, for later reflection in rates.

As at December 31, 2006, PPVA’s had balances owing to customers of $19,796.00 and $125,859.00, for residential and commercial customers respectively. By Order 4/07 of January 2007, refunds of then-credit balances to customers were directed.

The rebates were provided based upon the amount of propane consumed since November 1, 2005. With respect to customers that moved during the period, Stittco advised it took steps to ensure that all rebates owed to customers were refunded. Residential customers received modest rebates, but some commercial customers received large rebates.

Stittco indicated that a typical domestic customer, consuming 4,000 litres of propane over the 14-month period, received a rebate of approximately $25.00; a commercial customer having consumed 16,000 litres received $287.00. Some commercial rebates were in the thousands of dollars. For customers on the equal monthly payment plan, Stittco applied the rebates to their accounts, with the required monthly payment to remain unchanged until the next amendment date.

3.0 HEARING

The hearing took place in Thompson, Manitoba on March 14, 2007, at which representatives of Stittco and its customer base, both residential and commercial, attended. While CAC/MSOS was the sole intervener, its first involvement with Stittco proceedings, several customers provided presentations, providing support for continued Board regulation of Stittco.

Ahead of the proceeding and following Stittco’s application, CAC/MSOS and the Board filed interrogatories with Stittco, and Stittco responded. A transcript of the hearing was prepared at

Stittco's direction and cost, with copies provided to Stittco, the Board and CAC/MSOS.

At the hearing, Stittco's witness panel of Mr. Stitt and Mr. Mullback were cross-examined and undertakings committed to by Stittco. Following the hearing, additional questions were asked of Stittco. Stittco filed undertakings and responses to the final round of questions with the Board and CAC/MSOS.

Subsequently, Stittco provided written final argument supporting its application and CAC/MSOS filed its closing comments. Stittco then responded to CAC/MSOS, completing the evidentiary file for the proceeding to-date. The Board panel then considered the evidence and concluded on its findings.

3.1 Deregulation of Rates or Complaint Based Regulation

In the first instance, Stittco applied to the Board for an Order either deregulating its rates or, in the alternative, authorizing regulation of rates on a complaint basis.

To support deregulation, Stittco proposed that the Board:

a) make a finding pursuant to Section 74.1 (1) of *The Public Utilities Board Act of Manitoba* (Act) that Stittco is and will be subject to competition sufficient to protect the public interest;
b) on the basis of its finding in respect of competition, make a determination pursuant to Section 74.1(1) of the Act to

refrain from exercising its power under the Act to regulate the rates of Stittco; and

c) issue an Order providing authorization to Stittco to charge such rates as competition may allow.

In the alternative, Stittco proposed complaint based regulation, whereby the Board would provide Stittco with authorization to charge rates with the filing of those rates with the Board, subject to review only if unresolved complaints are received by the Board from Stittco's customers.

Stittco is a small public utility suffering significant competitive disadvantages vis-à-vis electricity, where, according to Stittco and confirmed by the evidence:

> *"…on a cost of heating per million BTU's … the selling price of propane is over 38% more than … (electricity)…" .*

As well, Stittco provided evidence of tank-based propane and fuel oil as competition to its pipeline-distributed propane service to commercial and institutional customers, this with respect to primarily non-space heating requirements. During the hearing, it was reported that Stittco's tank-based competition in Thompson, Flin Flon and Snow Lake has withdrawn, due to a cited inability to earn a satisfactory return at then-market prices.

Stittco provided evidence of on-going residential customer number and volume losses, as well as significant savings to be obtained through the use of electricity rather than propane for space heating.

The following calculation of the net present value (NPV) of converting to electricity heating for a small volume Stittco customer was cited as outlining the operating cost advantage of electricity, which has led to new residential construction not installing propane space-heating.

Customer No.	**Propane Effic.**	**Annual Savings per Foster ($)**	**NPV of Savings over 20 years, 5% discount rate ($)**	**NPV of Savings over 20 years, 10% discount rate ($)**
1	62%	685	8,537	5,832
1	82%	517	6,443	4,401
1	90%	449	5,596	3,823

In discussing this table, Stittco opined that (from the perspective of a prudent consumer) for the cost of conversion “to make economic sense for this consumer, the net present value of the saving must exceed the up front conversion costs”.

Given the significant operating cost advantages for space-heating customers provided by electricity, Stittco reported that its future viability was inextricably linked to its ability to reduce costs and charge competitive rates, and that reducing costs depended on, in part, reduced regulatory costs.

With respect to the costs of regulation, Stittco reported:

a) costs of $65,000 for a 1991 General Rate Application hearing process cost (Stittco noted that following that proceeding it was granted “least cost regulation”, so as to avoid the high costs associated with the 1991 hearing);

b) that while the Board’s levies were relatively modest, they still represented an additional cost load affecting customer rates; and

c) Stittco’s reportedly significant internal costs associated with regulatory oversight and review, representing another cost burden affecting customer rates.

Stittco stated:

> *“… costs have increased in the past 15 years while (the Company’s) market share and customers have declined, so now even the expense of the least cost regulatory process is a burden on customers*.”

Stittco noted the annual fixed regulatory fee levy of $10,460, and opined:

> *“ .. the size of operation(s) does not warrant the time and expense of the Board and its staff, particularly when it is competition that is controlling chargeable rates*.”

Overall, Stittco opined that the benefits from regulation for consumers are outweighed by the costs and lengthy processes involved, the effects of which are reflected in rates. Stittco suggested its customers have little interest in the Board’s regulation of Stittco’s rates.

In short, Stittco suggested competition will protect the public interest without the Board’s regulatory oversight over rates being maintained, and that reduced regulation could be expected to bring down costs – not only Board-related costs, but also overhead costs incurred directly by Stittco.

In further support of its application for reduced Board oversight, Stittco cited regulatory precedent in the approach taken by the National Energy Board (NEB) and the Public Utilities Board of the North West Territories, citing:

> *“…for the maximization of regulatory efficiency and minimization of cost through the utilization of a system of regulation on a complaint basis.”*

Stittco noted that NEB employs complaint-based regulation in its oversight of small pipeline operations. Pipelines regulated under this model are required to make information available to interested parties. Stittco indicated that in the absence of a complaint, NEB normally does not undertake a review of rates.

Stittco also cited the regulatory approach of the Public Utilities Board of the North West Territories, which applies complaint-based oversight to Stittco’s affiliate Stittco NWT.

On the other hand, residential and business customers presenting to the Board at the hearing indicated their concerns with the effects of high propane prices, the financial difficulties associated with potential conversion to electricity, and their opposition to the Board reducing its regulatory oversight.

3.2 Rates

As previously indicated, in the event that the Board rejected Stittco's bid for forbearance of direct rate setting regulation, Stittco applied for across-the-board rate increases of 6.1%.

If approved, the increases would bring the accumulated increase since 2005 for residential customers to 24.9%, the increase primarily attributable to commodity price and cost increases. Most of the proposed 6.1% increase relates to increased non-commodity costs.

At the hearing Stittco commented on Foster's 1991 report, which indicated that Stittco's rate schedule favoured residential customers and recommended adjustments to improve rate design fairness, including the imposition of a minimum bill; Stittco reported that the consultant was preparing an updated report.

A draft of that updated report:

a) confirmed the consultant's 1991 view that the rate schedule favours residential customers at the expense of commercial customers;
b) recommended changes to the rate schedule to improve the "fairness" of rates between residential and commercial customers; and
c) proposed the imposition of a fixed charge for low-volume months.

Reflected in Stittco’s proposed rates were projected 2006/07 commodity and non-commodity expenses, a tax provision, and an allowable rate of return on shareholder’s equity. The tax provision did not reflect any attribution to Stittco of the allowable small business tax deduction, reported by Stittco to have been fully taken by the parent. Stittco’s approach to establishing the tax provision has been in place since at least 1991, and its exclusion from rate setting consideration was approved by the Board in 1998.

With respect to the actual annual rate of return achieved on shareholder’s equity achieved, returns vary year to year as a result of weather and whether volumes are lower than those forecast at the time rates were set. As well, there may be other factors that result in lower achieved rates of return compared to the allowable rate of return.

Over its last twenty-three fiscal years (including the forecast for 2005/06), Stittco experienced:

a) five years of returns on rate base in excess of 10%, the last such year being the year ended July 31, 2001 (the highest rate of return, 15.4%, was achieved in the fiscal year ended July 31, 1989; since July 31, 1990, Stittco has exceeded a 10% actual return in only two years, those ending July 31, 1996 and 2003);
b) fourteen years of returns between 5% and 9.99%, the last being the year ended July 31, 2004;
c) three years of returns between 1% and 4.99%, the last being the year ended July 31, 2005; and

d) one year of an actual rate of return below 1%, that being a loss incurred for the year ended July 31, 2006.

Stittco reported that “during the period between 1983/84 and 2004/05, which excludes Stittco’s negative actual return in 2005/06, the actual return earned was 8.56%. The simple average of the allowable rate of return for the period was 12.20%.”

Stittco attributed the shortfall to:

a) competitive conditions leading to decreasing annual volumes of propane sold; and
b) delays between the incurring of non-commodity cost increases and the reflection of such cost increases in rates. For example, non-commodity costs reflected in current rates are based on the 2002 test year, five years ago.

Stittco opined that its sales volumes would have decreased even further except for:

> *“(Stittco) continuously charge(ing) customer rates … insufficient to recover a fair rate of return.”*

This approach by Stittco recently led to the actual loss incurred in 2005/06, a year of exceptionally warm winter weather.

Though the application reflected a return on equity of 10.83%, Stittco held that the allowable rate should be 11.37%. In its supporting material for the application, Stittco reviewed the history of the Board’s approach to establishing a rate of return on rate base for Stittco, citing in particular a 1998 study by its consultant, Emerald Regulatory Services (Emerald).

Emerald then-opined that a fair rate of return on Stittco’s equity would not be less than 12.75% per annum, and as Stittco could not secure long term debt financing on its own credit, the appropriate capital structure was 100% equity with no provision for debt. The importance of this for ratepayers is that debt is generally associated with rates of interest which are well-below rates anticipated for equity investments. Current long-term Canada bonds yield in the range of 4%, and, generally speaking, debt components of 60% are expected for private utilities. In short, funding by equity alone means higher rates for ratepayers. That is and has been the experience for Canadian private utilities.

Notwithstanding Emerald’s opinion on an appropriate rate of return for equity, Stittco applied for and received a return on rate base of 10.89%, a rate subsequently revised to 10.83% prior to this Order.

Contending Emerald’s recommendation was still appropriate, Stittco cited:

a) Alberta Energy and Utilities Board Order U2005-140; and
b) a published National Energy Board opinion with respect to risk premiums in declining interest rate environments.

Extrapolating from Emerald’s study, Stittco opined that Emerald’s study would support a rate of return on equity of 11.37%. Stittco opined that competition was such that even an 11.37% rate of return on equity would be considered low given the extant competition risks.

To further support its argument for a capital structure absent of a debt component, Stittco previously filed a copy of a letter from its bank that denied access to a long-term loan, citing the following reasons:

a) fixed assets, with minimal value from a lending perspective, being unlikely to provide a realization value on a sale equal to the values reported on Stittco’s balance sheet or, according to Stittco’s bank, values insufficient to support the granting of credit; and
b) a competitive business environment challenging assurance of annual cash flow.

Stittco’s bank then-required a guarantee from Stittco’s parent company before considering granting long-term credit, and Stittco advised of an unwillingness to seek a loan guarantee from its parent (and an unwillingness of the parent to provide such a guarantee).

As it was unable to secure long-term debt on its own strength, Stittco concluded that a capital structure comprised totally of shareholder’s equity was appropriate. In further support, Stittco advised:

a) an inability to secure propane supplies on its own credit, requiring the parent company to enter into supply and transportation contracts on Stittco’s behalf, and billing the cost without mark-up to Stittco; and
b) Stittco $770,000 debt to the parent, this due to losses incurred and propane supply costs, credit extended at no interest.

In response to Board questioning of an apparent contradiction between the Stittco view that higher rates would likely further customer conversions from propane to electricity and its view that higher rates had to be implemented, Stittco stated that its parent could not subsidize Stittco’s regulated operations any further.

Stittco advised that the rate increases were required to allow for full recovery of costs and a return on equity. Such rates would also allow sufficient funds to pay-off the non-interest-bearing loan to the parent.

With respect to the full allocation of the allowable annual small business tax deduction to the parent company, Stittco strongly asserted that it is the parent company’s right to make such allocation as it determined to be in its best interest. Stittco further advised that by Order 158/98 the Board accepted that no allocation of the small business deduction would be made to Stittco.

With respect to inter-company charges of Stittco Energy, Stittco advised that the approach had been reviewed and accepted as appropriate and fair by its consultant and the Board, in previous decisions. The approach involves a levy for administrative and executive services of 12% of Stittco's direct costs, with increases corresponding to increases in annual direct costs.

As well, the parent bills Stittco for "contract services"; these services relate to costs incurred in Manitoba by the parent for the benefit of Stittco, and recently increased as a result of Stittco's new Flin Flon hospital customer.

Towards assuring itself of the fairness of the inter-company charges and of the reported pass-through without mark-up of commodity and transportation costs by the parent to Stittco, the Board requested the financial statements of Stittco's parent. Stittco has refused to-date, indicating that Stittco Energy was outside of the jurisdiction of the Board.

All information filed within the proceeding is available for public examination at the Board's Winnipeg office.

4.0 Presenters and CAC/MSOS Recommendations

4.1 *Presenters*

Business community members from the City of Thompson presenting at the hearing took exception to Stittco's suggestion that it was facing competition from other propane suppliers; as well they indicated particular reasons for reliance on Stittco's pipeline-delivered propane.

Manfred Boehm, proprietor of the Thompson Inn and Burntwood Hotel and also representing the Restaurant and Hotel Association, suggested that there was no current competition to Stittco. He held this view based on the perspective it had proven uneconomic for an above-ground (propane tank) supplier to compete in Thompson where pipelines have been in place for 48 years.

Mr. Boehm's stated:

> "First, there is currently no other providers available for propane in Thompson, so hence there is absolutely zero competition. In 13 years that I have resided in Thompson only one other propane provider has tried and that was Superior and economically (it) could not compete (using) above ground tanks, which is what they had to come into Thompson with."

Mr. Boehm's perspective was supported by other business owners, including Mr. Brown (operator of the Thompson McDonald restaurant) and Mr. Oberdorfer (operator of the Thompson A&W restaurant). They indicated that they had actively sought out an alternative above ground supplier of propane in 2004.

Mr. Brown noted that Superior Propane had provided propane to McDonalds from December 2004 until September 2005, but cancelled service provision on the basis of economics.

> "Unfortunately in September I get a call saying that we are going to pull out because it wasn't economical for them to set up a depot and all that."

While the business presenters indicated that Manitoba Hydro's (MH) electricity service provided some opportunity for commercial propane customers to mitigate their reliance on Stittco, they also indicated that the cost of conversion was quite high and there were business factors requiring propane rather than electricity.

Mr. Boehm noted that he had attempted to diversity to electricity even though conversion was very expensive.

> "Yes, we may have a little more financial resources than the residential person if you want to look at it in terms of just a furnace, but there is a lot more cost in terms of switching your property over from gas to electric. I have done that. I have done that in both my hotels. I ran boilers for years… They were gas-fired and we have made those conversions in our bedrooms and I can tell you it's in the tens of thousands of dollars, so it's not a cheap fix. You know? We have done it for two reasons: One, to offset the constant increase in terms of the raw material, the gas that keeps costing us more and more and more, and, Two, to become, hopefully, a little more self reliant."

Mr. Boehm noted that for certain equipment, electricity was not a viable option to propane. He noted:

> ". . . the underlying problem that we have in the hospitality industry is we have no choices as it pertains to some of our equipment requirements . . . "

In particular, Mr. Boehm identified makeup air units, char broilers, deep fryers and commercial high volume pizza ovens as equipment for which electricity was not a realistic competitive option.

- **makeup air units – "**I dare anybody to stick that electric makeup air unit in Thompson, Manitoba, in January when it is minus 55 below outside and tell me that that unit is running efficiently; it has the ability and the capacity to recoup what it needs to recoup."

- **char broilers** – "You've got to have a flame if you are going to char broil a burger. Pretty basic."

- **deep fryers** - "In a high volume situation, electric deep fryers I have not ever found one that can keep up and recoup again in terms of capacity and maintain a consistent heat. It just can't recover to the same degree as a gas piece of equipment can."

- **pizza ovens** – "As to Commercial high volume pizza ovens. Again, you just can't do it. You can't do it with an electric unit."

Similarly, Mr. Brown, the owner of the local McDonalds, opined that as to restaurant equipment he had to rely on propane, as electricity would not provide the type of energy required.

> "And so it is a real concern that if the regulation is not there, if they become deregulated, that where is the end. There is no end. We've got no safety net. Every piece of equipment in my restaurant is gas, so I depend on Stittco to operate the restaurant. If I've got no gas, I can't open up. I don't have electric vats and fryers and grills and all that stuff."

A residential customer presented a perspective on the difficulty associated with a residential customer converting from propane to electricity. Regarding the cost of conversion, one residential customer noted that the cost of upgrading the amperage and installing an electrical furnace would be approximately $8,000.

> "If I could, honestly, everybody here, if I could afford it, $6,000 off the top of my head, I would have gone to Manitoba Hydro, but with the $6,000 for the electrician to do it and that was bare minimum, he said, if you run into any problems like the price of the furnace, no, like that's $8,000 plus."

Speaking to the issue of the potential deregulation of Stittco's rates, Mr. Boehm opined, representative of other comments made by other presenters at the hearing:

> "Deregulation of rates can only be contemplated with true competition exists and as long as Stittco has the monopoly on the underground pipeline, I do not foresee a competitor coming forth with the ability with which to compete on a level playing field."

4.2 CAC/MSOS Recommendations

CAC/MSOS recognized what it portrayed as the unique dilemma of the Board's responsibilities with respect to regulating a small utility with high commodity costs, a unique capital structure, a complicated relationship with its parent and, from CAC/MSOS's perspective, "a somewhat cavalier attitude to cost control in recent years".

For CAC/MSOS, requiring the utility to undergo the same intensity of scrutiny as a Crown corporation (such as MH) would be both unfair and unproductive. That said, CAC/MSOS indicated cause for concern in terms of whether Stittco's current operations are prudent. Further, CAC/MSOS noted an underlying issue brought forward by the Foster study of whether commercial customers are subsidizing residential rates.

For CAC/MSOS, Stittco has no true competition, and thus CAC/MSOS opposes the Board withdrawing/forebearing from regulating Stittco. In fact, given CAC/MSOS portrayal of the effects of the Board's relatively light-handed regulation of Stittco over the past few years (that being uncontrolled cost growth), the intervener holds that increased examination of Stittco, at least for the short-term, is now required. CAC/MSOS suggested that a period of intense examination could be "… followed by a transition to a system that allows for a less frequent but more intensive regulatory review".

CAC/MSOS suggested that in the longer-term, an approach using multi-year applications would assist Stittco in achieving greater efficiencies even with an ongoing regulatory burden.

Through closing argument, CAC/MSOS recommended that the Board:

1. find that Stittco is not subject to competition sufficient to protect the public interest without Board rate regulation;
2. find that Stittco failed to demonstrate prudent and reasonable cost control (2003/04 through 2005/06, and as projected for 2006/07);
3. reconsider the Board's 1998 decision with respect to the applicability of the small business tax deduction;

4. review the tax rate and allowable provision for income taxes for regulatory purposes;
5. consider annual rate filings to ensure that only reasonable propane costs are recovered in commodity rates;
6. request additional documentation regarding the reasonableness of affiliate transactions, including propane purchases;
7. request an external examination of Stittco's forecasting, weather normalization methodology and cost control;
8. significantly reduce the 6.1% rate increase sought in the rate increase decision;
9. implement performance based regulation (PBR) with respect to operating, maintenance and administration expenses, for the period 2008-2010;
10. adjust the PBR yearly to account for changes in forecasts, with subsequent "true-ups";
11. unbundle the propane charge, billing customers on the basis of separate commodity and non-commodity charges;
12. consider implementing a heating season fixed-variable rate design incorporating a fixed charge, with only a volumetric charge to apply through the non-heating season;
13. not accept Foster's 2006 preliminary findings with respect to customer class rate subsidization, deferring consideration of the issue until a future proceeding; and
14. request Stittco's position with respect to Foster's draft finding that commercial customers are subsidizing residential customers with the current rate schedule.

In part, CAC/MSOS supported its recommendations with the following observations. Firstly, CAC/MSOS considered the record of the proceeding to have been established by three critical realities:

- "the market in Thompson is not truly competitive. There is no current competitor in the market for above ground propane and electricity cannot meet all the needs of commercial businesses. Meanwhile, the competition supplied by heating fuel appears to be meaningful only for large customers who can afford the expense of dual heating capacity. While electricity is an option for some residential customers, the costs of conversion are daunting for some and not economic for others."

- "Stittco has not established that the direct or indirect costs of regulation are astronomical. It concedes that the direct costs of the PUBM levy are small and it is unable to substantiate its own costs. While Stittco Man faces undeniable pressures and challenges these do not appear to be a function of the regulatory process. Some of these pressures appear related to the internal management approach of the company."

- "Stittco consumers, both business and residential, appear strongly opposed to rate deregulation."

CAC/MSOS noted discussion of various forms of regulatory alternatives, and opined there were only four alternatives to the present approach worthy of consideration:

i) complaints based regulation;

ii) least cost regulation;

iii) multi-year cost of service applications; and

iv) multi-year targeted PBR.

CAC/MSOS noted that the decision of the Public Utilities Board of the North West Territories, in its Decision 9-94, which was to regulate Stittco NWT through a complaints based regulatory approach. CAC/MSOS opined that the complaints based approach was the approach sought by Stittco NWT when it entered into its Hay River agreement.

CAC/MSOS opined that complaints based regulation is based on the presumption that the utility involved operates in the public interest. CAC/MSOS held that this places the onus on the utility’s customers to persuade the regulator that it should either hold an inquiry or hearing, or take other action, when rates appear unfair to the customers.

CAC/MSOS suggested a deficiency of the approach was that there was not assurance, even if a complaint is made, that an inquiry would be held. As well, CAC/MSOS observed that complaints based regulation is not the approach favoured by either Thompson’s business community or residents, as presented at the hearing.

In its final submission to the Board, CAC/MSOS quoted Mr. Wilson, a representative of Thompson’s Restaurant and Hotel Association, as follows:

> “To deal with the second issue on complaint based regulation, I feel it would resemble a bureaucratic nightmare. And, as in the past, with two local business owners, I feel people may become intimidated by the monopoly that exists today and that the steps one would need to take, in my opinion, would be enough to dissuade people from the effort. And I believe that's another thing that Brian Wilson had alluded to earlier in his presentation. In Thompson we still experience difficulties in getting people out on a Monday night for our local mayor and council meetings, so the more that we throw roadblocks and procedures in place to people, it seems the less they want to take that effort and run with it.”

CAC/MSOS concurred with the views of the presenters and concluded against complaint based regulation. In short, given the nature of Stittco's market, CAC/MSOS were of the view that it would be inappropriate to start with the presumption that rates set by the utility, presumably in light of market condition, were correct. CAC/MSOS held that a presumption that the company is right risks undermining confidence in the impartiality of the regulator.

CAC/MSOS preferred least cost regulation, though it offered criticism of the procedure as employed to date. CAC/MSOS expressed discomfort with Stittco's cost control and forecasting. CAC/MSOS suggested that a more intensive examination of Stittco through hearing proceedings would provide Stittco increased motivation to improve cost control.

CAC/MSOS suggested that an appropriate regulatory change would be for Stittco to be obliged to bring forward future applications for delivery rates (non-commodity costs), projecting two or three forward test years with proposed rates. CAC/MSOS suggested a multi-year filing would lower regulatory costs as compared to annual filings, while allowing for more detailed examinations at the hearings as held. CAC/MSOS suggested the Board would require minimum filing requirements for the approach to be efficacious.

Under the approach, CAC/MSOS suggested delivery rates (non-commodity costs) for the first year (base year) would be set on a cost of service basis. For the following few years (years two through four), non-commodity cost components of the delivery rates to be set would be adjusted through an arithmetic process that would, among other matters, reflect general inflation, though offset to reflect expectations for productivity gains and customer growth.

CAC/MSOS further suggested that the allowable rate of return on rate base could be adjusted in each year of the multi-year rate setting to reflect changes in Canada long bond rates and these changes could then be reflected in delivery rates.

CAC/MSOS noted Stittco’s criticism of multi-year approaches, a criticism reportedly based on the premise the approach would not adequately address the goal of regulatory cost minimization. However, for CAC/MSOS, Stittco has not adequately controlled costs, evidenced in CAC/MSOS’ view by actual and projected increases in operating expenses.

In brief and in summary, CAC/MSOS held that greater regulatory scrutiny was required, at least in the short term, to ensure operating cost control and adequate forecasting.

CAC/MSOS noted Foster’s concerns about commercial customer subsidization of residential customers, present since at least 1991. CAC/MSOS opined that the question requires further examination and discussion, and until the issue has been appropriately tested, no conclusion should be reached.

5.0 **BOARD FINDINGS**

5.1 Preamble

As Stittco claimed in its closing argument: “the public interest would not be served by the departure of Stittco from Thompson and would not be served by the elimination of pipeline propane from the Thompson energy mix”.

The Board reiterates this core view because it takes seriously Stittco’s claims to be a utility facing difficult circumstances. With propane at a significant “value” disadvantage to electricity for space heating due to rate differences, it is difficult to forecast anything other than gradual future decreases in the use of propane for space heating in Stittco’s operating area.

The Board confirms that Stittco has not earned its allowable rate of return over the past twenty-some years and, in the most recent year, has experienced a negative return. The Board also accepts that Stittco has not recovered through rates incurred increases in non-commodity costs since 2002/03.

No private utility can be expected to operate through subsidization by its parent company. That said, the Board is not satisfied that it fully understands the economic relationship between Stittco and Stittco Energy, its parent, and will seek additional information on this matter.

Yet, as Stittco also noted, the Board has and does confirm its long-held generally accepted principle that the public interest includes not only the reasonable interests of utility customers in setting fair and equitable rates but also the reasonable interests of utilities.

That said, the Board is not yet in a position to conclude on the current status of the balance of interests between customers and the utility. The Board lacks information related to affiliate transactions and is cautious as to how to proceed with respect to the alleged subsidization of residential customers by commercial customers.

Through the directions of this Order, the Board intends to complete its understanding of the situation as quickly as possible and then proceed to establish revised rates that will represent a fair balance between and amongst the interests of the utility’s ratepayers and its owner.

In both its application and final argument, Stittco held out the possibility of it being unable to continue in operation if it was unable to fully recover its costs and earn a reasonable return for its shareholder. While the Board expects to relieve these concerns, once it has reviewed the additional information it requires, bringing to a conclusion immediate concerns over the potential of Stittco closing, it assures Stittco’s customers that in any event Stittco cannot simply choose to close.

Pursuant to provisions of *The Public Utilities Board Act*, Stittco is required to provide the Board with twelve-month notice of an intention to either close or sell its regulated operation. Neither action can take place without the Board's approval.

CAC/MSOS made several claims in its closing argument concerning Stittco's cost control management, and suggested the Board needs to explore Stittco's cost experience in more depth.

On the other hand, Stittco noted that from 2002/03 through to the present day, cost increases as reported in Stittco's accounts have not been passed through to its customers (through rates) and "(as) a result, Stittco had every incentive to ensure that (the) costs were closely monitored, since every additional dollar spent on operating and maintenance charges resulted in a direct and equivalent reduction in Stittco's actual return".

As to the Board being required to make a more thorough investigation of Stittco's costs, the utility stated "… the cost of service regulatory model starts with a presumption that the utility's costs are reasonable and prudent… No regulator starts with a blank sheet and attempts to build-up costs and rates of a utility on its own."

This concept has been referred to as the presumption of 'managerial good faith'… In *Re Newfoundland (Board of Commissions of Public Utilities)…* Green J.A., writing for the majority, found the regulator had a wide discretion to disallow or adjust the components of both rate and expense, but noted:

> *(T)here will normally be a presumption of managerial good faith and a certain latitude given to management in their decisions with respect to expenditures. In the United States, the test for disallowance is usually “abuse of discretion” showing “inefficiency or improvidence” or “extravagant or unnecessary costs.”*

The Board notes the comments of Mr. Doi, the operator of Thompson’s Boston Pizza restaurant, which provide support for Stittco’s contention that it operates in a satisfactory manner:

> “And I do want to comment that (Stittco) is a good company .. (the local manager) runs a very good operation. We have never had – like everyone else has said – we have never had any issues with service or maintenance or those kinds of things. (Stittco) does a very good job on those things.”

While the Board generally accepts Stittco’s advice as to a presumption of “managerial good faith”, it does intend to continue testing the utility’s cost control efforts, though the Board has no intention to “.. tell the utility what it can or cannot choose to spend money on.” The Board is cognizant of its ability to “… determine whether or not the costs incurred were reasonable and prudent” in the Board’s decisions with respect to accepting costs into the rate base.

Further, the Board does intend to put itself in a position to better understand the utility’s economic relationships and transactions with its parent and affiliate companies. Stittco Energy controls Stittco and has a clear conflict of interest in its dealing with Stittco; while that does not mean that the transactions between the two companies are improper or not in the public interest, it does mean that this Board must understand and test these matters.

5.2 Regulatory Model

As earlier stated, the Board agrees with Stittco; the evidence is clear that the propane distributor is in trouble. Evidence of this includes:

a) Assuming inter-company transactions are accepted by the Board, current non-commodity revenue to be derived from rates is inadequate, contributing to a certainty of lower than allowable rates of return rate and, if rate increases are not granted with respect to non-commodity cost increases, certainty of actual losses.
b) Further rate increases are likely to lead more customers to convert to electricity for space heating, further pressuring required rates for the remaining customer base.
c) The large electricity price advantage over propane, space heating by electricity can at 50% of the costs of heating by propane, provides virtual certainty that residential customers will move to electricity. The restraint is the cost of conversion, which the Board understands could be as high as $8,000 for a household.
d) Recently announced and new MH incentives for propane users promoting energy efficiency will not counter the incentives for new home construction to utilize electricity for space

heating. The major price advantage to electricity has virtually eliminated the opportunity to secure new propane space heating customers through new home starts.

e) The major price advantage to electricity means Stittco's ability to expand pipeline propane for space heating to other Manitoba communities served by the electricity grid is, in the Board's considered opinion, virtually nil.

f) Foster's 1991 and more recent reports make a clear case that residential customers are favoured by the current rate structure, and in receipt of a cross-subsidy from commercial customers. It would appear that the cross-subsidy damages the competitive position of propane for commercial users, meaning only customers requiring the particular energy advantages of propane are likely to remain on the propane system. As the cross-subsidy is reduced, the economic case for residential customers to convert to electricity for space heating will increase.

g) If rate schedules are amended to reduce the cross-subsidization of residential customers by commercial customers, residential rates will rise. And, even a 15% drop in commercial rates, would still leave commercial customers paying a large price for staying on propane compared to electricity.

h) All customers may be increasingly inclined to seek ways to enhance energy efficiency -- 25% of Stittco residential customers have low-efficiency furnaces, 5% mid-efficiency, reportedly resulting in the wastage of 50% and 10% respectively of propane litres. While the extension of MH Power Smart programming with respect to free insulation to propane customers will assist, for those with low or mid-efficiency propane furnaces, only an upgrade to high efficiency will prove effective. For some customers, when faced with an economic need to upgrade to a high efficiency furnace, a switch to electricity may also be considered. Further, energy efficient usage of propane poses risks to present volumes of propane sold.

Propane customers are highly disadvantaged relative to electricity consumers.

a) Electricity's pricing in the north benefits from both the legislated uniform rate policy and the attribution of MH's net export revenues to reduce Manitoba rates through the rate setting methodology; and
b) While MH subsidies are available to electricity and natural gas customers to upgrade furnaces, no subsidies are provided for upgrades of propane furnaces.

Based on the evidence, the Board agrees with Stittco. Propane by pipeline service to residential customers faces the risk of steady decline as customers gradually convert to electricity for space heating. The only reason evident for not converting is the high bills associated with conversion, funds many households may lack. Even the expenditure of $8,000 for a conversion may be justified from an economic perspective; the judgment depends on the discount rate one applies.

For Stittco’s commercial and institutional customers, who rely on propane for reasons beyond space heating, the decline in customer base is likely to be more gradual.

This situation represents a major business risk for which the Board has no suggestions as to how to meaningfully mitigate. Short of a major change in electricity pricing in Manitoba, propane users will remain at a major disadvantage and as customers convert to electricity, those left behind will be faced with increased rate pressures further widening the gap between electricity and propane space heat service.

The Board will monitor the electricity-propane situation closely, as time and events progress and occur.

Leaving aside rates, Stittco seeks:

a) full deregulation; or
b) complaint based regulation.

Stittco’s application for regulatory oversight change is driven by:

a) major competitive cost advantages to electricity, particularly with respect to space-heating;
b) propane tank competition with respect to commercial customers;
c) fuel oil competition with respect to industrial customers (as evidenced by reference to Stittco’s two major clients, the Thompson and Flin Flon hospitals);
d) erosion of the customer base and forecasts of further losses (including residential customers – estimated numbers range

from 10 to 100 - at risk of switching to electricity as a result of the Board directing Stittco to relocate lines under abandoned buildings on the customers' sites and resistance from many of those customers); and

e) reportedly high internal regulatory costs incurred by Stittco, due to regulatory reporting requirements.

5.3 Rates

As to rates, and in the absence of a favourable regulatory finding by the Board, Stittco sought 6.1% across-the-board rate increases, citing:

a) subsidization of Stittco by Stittco's parent (cites $770,000 interest free loan, low rates of return earned on shareholder's equity, the handling costs for propane purchasing at no mark-up due to lack of credit-worthiness of Stittco);
b) non-commodity cost increases not reflected in rates since 2002, accounting for 60% of the 6.1% increase sought;
c) being "on the verge of shutting the doors and going out of business", and "... only through the intervention of the parent does the utility have access to propane supplies. Suppliers refuse to deal with the utility because of the state of its balance sheet…";
d) recent losses due to lower than forecast volumes and the lack of recognition in rates of non-commodity cost increases; and

e) 10.83% rate of return on equity and full reliance on equity supportable by the state of company’s situation and competitive conditions.

In response to a suggestion by the Board that it may consider deeming a debt component to Stittco’s capital structure, Stittco claimed “…deeming debt into a utility that cannot obtain debt on its own would be patently unfair and would violate the regulatory principle that a utility should be regulated on a stand-alone basis”.

5.4 Conclusions

Considering the situation and Stittco’s prospects given a very difficult environment for the company, and a particularly costly environment for its space-heating customers, the Board concludes:

1. It will continue with Board oversight; Stittco’s application for no rate regulation or complaint-based regulation will be denied.

   While there are alternate energy sources in the Stittco service territories, the Board finds, as a question of fact, that Stittco and its services, are not subject to competition sufficient to protect the public interest.

   The Board concludes the retention of public confidence currently requires continuation of its oversight. No customer writing the Board ahead of the hearing or attending and presenting at the hearing supported Stittco’s regulatory oversight proposals. As well, the Board notes evident cross-subsidy issues along with other matters that need further consideration and possible resolution prior to any further consideration of reduced Board oversight.

2. Stittco’s propane pipeline service in Manitoba is in distress, and further customer losses probable.

   For the reasons cited, the Board concludes that Stittco’s general situation needs careful consideration and planning, as further customer losses are probable and such losses will further jeopardize the economics of the operation. The transition to stability, if it can be achieved, will require considerable time.

3. Changes to rate schedule, to reduce the relative advantage to residential customers as compared to Stittco’s commercial and institutional customers, are required.

   The Board accepts the preliminary findings of Stittco’s consultant, the Foster Group. The preliminary findings are consistent with Foster’s 1991 report, and the support for the findings as contained within Foster’s recent draft of its update report are credible. While CAC/MSOS is correct in its comment that Foster’s findings need to be more thoroughly tested, the Board, being of the view that the findings are consistent and compelling, feel some move towards remedying the situation is required.

It is an accepted regulatory principle that rates be fair for the various customer classes; currently, this is not the situation for Stittco's commercial customers. That said, the remedy for the situation could exacerbate Stittco's residential customer retention problems, and place increased pressure on rates over the short, mid and long term.

4. The Board finds Stittco to be at risk of a "death spiral".

   Currently, the Board is not aware of any means to arrest and/or reverse the present circumstances and forecast. The cost advantage to electricity is so great that major conversion costs could become economic for ratepayers. That said, the Board suspects that Stittco's pipeline-based service provides advantages to its parent's tank-based service to the same and close-by communities in Manitoba, and this factor may provide Stittco with more time to find and implement remedial steps to sustainability.

5. The Board finds the source of Stittco's problematic situation to be electricity rates.

   Specifically, the combination of the legislated adoption of uniform Manitoba grid electricity prices and the current practice of reflecting MH's net export earnings in customer electricity rates, accounts for the present cost advantage to electricity over Stittco's propane service. Propane supply for space heat is uneconomic on a comparative base.

6. The Board finds that the residential customer rate schedule is subsidized by commercial rates.

   The Board will direct Stittco to propose a transition plan to end the cross-subsidy over five years, and that the plan be based on rate schedules prepared on a cost of service methodology. While Stittco's consultant has not filed a final report with Stittco on the matter, the Board finds the evidence sufficiently compelling to conclude that current rates unfairly favour residential over commercial customers.

7. Stittco has been unable to reach its allowable rate of return because of reduced volume of propane sales and failure to increase rates to reflect non-commodity cost increases.

   The Board will direct Stittco to file proposals to implement quarterly rate amendments for commodity cost changes and annual rate amendments for non-commodity cost rate elements.

8. Stittco will be directed to file its rates and the support for the rates for its large volume customers, the hospitals of Flin Flon and Thompson.

   While Stittco is authorized to negotiate rates for its largest customers, it is also obligated to file the rates with the Board. The Company has indicated to the Board that the rates provided to the hospitals are adequate to recover all costs and provide a reasonable contribution to common overheads, the provisions for taxes and a return on equity. The Board seeks assurance of the accuracy of this report.

9. Stittco’s accounting practices for its audited accounts do not reflect PPVA balances due to Stittco as accounts receivable; this affects annual Net Income and creates differences between Net Income for regulatory purposes and Net Income per audited accounts.

   The Board, though it disagrees with Stittco’s interpretation for audited statement purposes of balances owing from customers, will not take issue with the approach. However, the approach does underline the ability for Stittco to maintain regulatory accounts that are different from its tax and audited statement accounts.

10. Stittco’s provision for income taxes and customer rates should reflect at least a notional if not actual sharing of the small business tax deduction with its parent company.

   It is the Board’s understanding that a Canadian Controlled Private Corporation (CCPC) is allowed tax savings through the small business tax deduction. When one or more qualifying CCPCs are associated in a taxation year, the annual business limit must be allocated among them. As CAC/MSOS indicated during the proceeding, at different times the Board has directed that for rate setting purposes:

- the entire small business tax deduction be allocated to Stittco;
- only one half of the small business tax deduction be allocated to Stittco; and
- no small business tax deduction be allocated to Stittco.

In 1998, the Board revisited its 1991 direction, which directed the allocation of 50% of the small business tax deduction to Stittco. In 1998, it reluctantly accepted that Stittco not be accorded any share of the deduction. On re-examination of the issue, the Board determines that is was right in 1991 and wrong in 1998.

It is not fair that Stittco's customers gain no advantage from a tax benefit now reserved through Stittco Energy's unilateral decision in favour of Stittco Energy and Stittco NWT. The Board will require that for rate setting purposes a one-third sharing of the annual allowable small business tax deduction, to a maximum of Stittco's prospective taxable income, be reflected in Stittco's revenue requirement and rates.

11. The Board is concerned with the 30% of space heating customers still utilizing low or mid-range efficiency furnaces.

    The Board will seek from Stittco an action plan to address this situation, which leads to the wastage of thousands of litres of propane each year, to the detriment of the economy and the environment. The Board will seek Stittco’s view on the economics of conversion and strategies to bring these about.

That said, there is a problem. With the magnitude of the advantage electricity rates provide electricity space heating over propane space heating, the issue is whether or not conversion to a high efficiency propane furnace would be in the public and consumer interest. Economic and environmental issues suggest that, for some residential customers, conversion to an electric furnace may be the selection.

12. The Board does not have a sufficient understanding of Stittco’s arrangements and transactions with its affiliates, and intends to undertake a more thorough review of those transactions. To that end, the Board will direct Stittco to file additional information with the Board.

    If Stittco does not comply, the Board may be obliged to disallow for rate-setting purposes certain costs now included in the prospective rate base.

    The Board requires Stittco Energy’s financial statements to support not only the charges but also confirm propane commodity costs are being passed through at no mark-up.

    As well, to support the charges and arrangements, the Board needs to understand the apparent differences between Stittco Energy’s management charges against its North West Territory operation as compared to charges levied against Stittco. Currently, it appears that the management charges levied against Stittco are almost twice on a per litre level as the charges against Stittco NWT's operation. *The Public Utilities Board Act* provides for the Board approving inter-company arrangements.

13. Non-commodity cost increases suggest the rate for the non-commodity cost component must increase, and immediately.

    This said, adjustments are required for a reduction to the allowable rate of return and to provide Stittco's customers a fair share of the benefits arising out of the small business tax deduction. As well, the Board must first satisfy itself as to the appropriateness of the inter-company charges.

14. Stittco's customer rates should be split into two distinct components, commodity supply and non-commodity costs, so as to allow for a different and more transparent rate setting process for each of the two components.

15. The Board will establish quarterly rate changes for the commodity cost component, similar to the arithmetically driven and regulatory cost effective quarterly approach for Centra Gas Manitoba Inc.'s primary gas rates.

    This approach will provide more transparency for Stittco's customers with respect to price changes in the commodity and transportation markets, and such transparency is important to help motivate energy efficiency measures.

16. The Board will establish a five-year cycle for annual non-commodity rate changes, and will provide Stittco with limited discretionary authority to implement rate changes up to the rate of annual increase in the Manitoba Consumer Price Index.

    The discretionary authority will be subject to of the following to-be-established conditions:
    a) agreement on a revised Rate Setting Methodology; and
    b) a finalized plan to eliminate the cross-subsidy to residential customers over a five or ten-year period.

    At that point, the non-commodity rate component of overall rates may be amended annually by Stittco, with Board approval on an interim ex parte basis for four of each five-year cycle. This process should reduce regulatory costs, while providing reasonable customer protection.

17. The Board will establish on or before January 1, 2008 minimum filing requirements to support both the amendment of commodity-related and non-commodity rates, quarterly and annually, this in an effort to reduce future regulatory costs.

18. Regular General Rate Application oral hearing proceedings should occur at a minimum every five years. Other hearing proceedings, as may be required, may be paper-based, and may

be initiated through the Board's receipt of customer complaints.

19. While the Board's oversight, including that of safety-related matters, shall continue, the Board, in addition to the regulatory changes indicated above, will recommend to government that the annual levy by regulation on Stittco be reduced to $2,000. In addition, the Board will bill Stittco for out-of-pocket costs and applicable per diem costs for Board staff and members.

20. The Board accepts the equity based capital structure as being satisfactory for the present circumstances, given Stittco's difficult situation and operational prospects.

    The Board will review this decision at its discretion, but at least every five years.

To summarize, the Board first rejects Stittco's proposal for reduced regulatory oversight, which, if accepted, would have left rate setting and terms and conditions to Stittco. While the Board finds its current regulatory oversight of continuing public benefit, it will direct changes to the current approach towards both improving price transparency and restraining regulatory costs.

As the Board will remain the final determiner of rates and terms, the Board will direct Stittco to file an amended rate proposal to reflect the following changes to its application:

a) the first phase of a transition plan to reduce the revenue recovery gap between residential and commercial rates. The change is to be accomplished on an overall revenue neutral basis over a period not to exceed five years.

b) the allowable rate of return on rate base and shareholder's equity to be reflected in rates is to be 10% rather than 10.83% (the Board is not prepared to deem a different capital structure at this time, but will reconsider this issue at a future proceeding).

   The Board concludes a 10% rate of return on equity is adequate, given the dramatic decrease in long-term bond rates that has occurred since the Emerald study. As well, the 10% rate takes into account the Board's decision to allow Stittco to develop rates on the basis of a capital structure comprised entirely of equity. The modest decline of 0.83% in the allowable rate is more than compensated for by the Board's decision not to deem a capital structure that involves a debt component.

c) the provision for income tax expense reflected in the rate proposal is to be reduced, consistent with a one-third sharing of the small business tax deduction with Stittco – to a maximum of Stittco's prospective taxable income (this requirement is only for regulatory rate setting purposes).

The Board intends to establish revised interim rates as of July 1, 2007, and in that setting to utilize as much information as available. The Board appreciates Stittco’s position that it should be allowed to recover its allowable costs as well as the opportunity for a reasonable return on investment.

Final rates will not be set until the Board is comfortable with the revenue requirement established for commercial customers as opposed to residential customers, and has an acceptable understanding of inter-company arrangements between Stittco and its parent.

Accordingly, the Board will require Stittco to file additional information, and, following the Board’s review of additional information, as set out below, the Board will work towards revised and finalized rates and rate schedules, hopefully to take effect August 1, 2007.

The Board will require Stittco to file with the Board the following additional information:

a) on or before June 22, 2007, existing rates and contracts with the Flin Flon and Thompson hospitals;
b) on or before July 1, 2007, and on a confidential basis, the most recent audited financial statements of its parent company, Stittco Energy, together with a description of the allocation methodology used for inter-company financial arrangements between Stittco Energy and Stittco, by category; this is to be accompanied by an independent auditor’s

attestation as to the accuracy and reasonableness of the methodology.

c) on or before July 1, 2007, and also on a confidential basis, all agreements between Stittco Energy and Stittco;

d) on or before July 15, 2007, the then-current version of Foster Group’s review of Stittco’s rate schedules, including an analysis of the appropriateness of the imposition of a minimum charge, with recommendations;

e) on or before July 15, 2007, an amended rate proposal intended to take effect August 1, 2007, and on a revenue neutral basis, reflecting the first year of an intended five-year transition to a rate schedule providing for residential and commercial rates both within a range of 90%-105% revenue to cost ratio;

f) on or before July 15, 2007, a proposal for a different rate structure, providing separate rates, by customer class, for commodity costs (reflected in rates without mark-up on actual incurred costs) and for non-commodity costs;

g) on or before July 15, 2007, a proposal for a process by which commodity rates will be amended quarterly, on August 1, November 1, February 1 and May 1 of each year, to reflect actual and prospective commodity price and cost changes;

h) on or before September 30, 2007, a proposal for a process by which non-commodity costs will be amended annually, on May 1 of each year;

i) on or before September 30, 2007, a proposal to assist the approximately 30% of residential propane customers, who currently rely on mid or low-efficiency propane furnaces, to upgrade to high-efficiency furnaces; and

j) on or before September 30, 2007, an analysis of the advantages and implications to arise from the imposition of minimum charges for customers.

Subsequent to receiving the additional information, the Board will establish a process through which amended and finalized rates and rate schedules and processes will be set.

Finally, the Board directs Stittco to continue with the established procedure maintaining Purchased Propane Variance Accounts (PPVA), these to accrue differences between actual and estimated costs, as reflected in rates, for possible rate adjustments as at August 1, 2007.

5.0 IT IS THEREFORE ORDERED THAT

1. Stittco Utilities Man Ltd.'s proposal for regulatory oversight changes is denied.

2. Stittco Utilities Man Ltd. file with the Board on or before June 22, 2007 an amended rate proposal reflecting the following changes to its proposals:
   a) a reduction in the allowable rate of return on rate base and shareholder's equity to 10%; and
   b) reflect a one-third sharing, to the maximum of Stittco's prospective taxable income, of the small business tax deduction with Stittco Utilities Man Ltd., for regulatory rate setting purposes.

3. Stittco Utilities Man Ltd. file with the Board on or before June 22, 2007 existing rates, terms and contracts for the Flin Flon and Thompson hospitals.

4. Stittco Utilities Man Ltd. file with the Board on or before July 1, 2007, and on a confidential basis, the most recent audited financial statements of Stittco Energy, together with a description of the allocation methodology used for inter-company financial arrangements between Stittco Energy and Stittco, by category; this is to be accompanied by an audit attestation as to the accuracy and reasonableness of the methodology.

5. Stittco Utilities Man Ltd. file with the Board, on or before July 15, 2007:
    a) on a revenue neutral basis, a five-year transition plan to bring residential and commercial rates within a 90%-105% range of revenue to cost ratio acceptability by customer class;
    b) the final or then-current version of Foster Group’s review of Stittco’s rate schedules;
    c) a proposal for a different rate structure, providing separate rates for each customer class for “commodity costs” (reflected in rates without mark-up on actual incurred costs) and for non-commodity costs;
    d) a proposal to establish a process by which commodity rates will be amended quarterly, on August 1, November 1, February 1 and May 1 of each year, to reflect actual and prospective commodity price and cost changes; and
    e) a proposal for a process by which non-commodity costs will be amended annually, on May 1 of each year.

6. On or before September 1, 2007, Stittco Utilities Man Ltd. file a proposal to assist the residential propane customers that currently rely on mid or low-efficiency propane furnaces in upgrading to a high-efficiency furnace, and a review of the potential for the imposition of minimum charges.

7. Stittco Utilities Man Ltd. continue to track, in its Purchased Propane Variance Accounts differences between actual propane costs and the estimated propane costs embedded in rates, and continue to provide monthly reports to the Board.

The Public Utilities Board will, by separate Order, assess costs against Stittco Utilities Man Ltd. to meet the Board's disbursements related to Stittco proceedings.

THE PUBLIC UTILITIES BOARD

"GRAHAM LANE, C.A."
Chairman

"Gerry Gaudreau, C.M.A."
Secretary

Certified a true copy of Order No. 79/07 issued by The Public Utilities Board

Secretary