

M A N I T O B A) Order No. 152/07
)
THE PUBLIC UTILITIES BOARD ACT) November 29, 2007

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

STITTCO UTILITIES MAN LTD.
APPLICATION FOR REVIEW AND VARIANCE OF
BOARD ORDERS 79/07 AND 84/07

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1.0 EXECUTIVE SUMMARY

By this Order, the Public Utilities Board (Board) responds to Stittco Utilities Man Ltd.'s (Stittco) application for review and variance of Board Orders 79/07 and 84/07.

Orders 79/07 and 84/07 remain in force, excepting as amended to provide for an audit attestation rather than receipt of the audited financial statements of Stittco's parent company. As well, the Board extends the time allowed Stittco to file the remaining information sought of Stittco by the Board.

Accordingly, the interim propane rates established by Order 84/07 remain in effect until such time as may be amended by a future Board Order.

Stittco's most recent application asked the Board to set aside certain directives of Orders 79/07 and 84/07 and approve, as previously applied for by Stittco, a reduced regulatory oversight role for the Board on the basis that competition is sufficient in itself to protect the public interest. The Board will maintain its regulatory oversight of Stittco as Stittco and its services are not subject to competition sufficient to protect the public interest.

2.0 BACKGROUND

Incorporated in Manitoba, Stittco distributes propane, brought in by railcar and then distributed through pipelines, to approximately 1,100 customers in Thompson, Flin Flon and Snow Lake. About 65% of Stittco's propane sales volume is consumed by its commercial customers; these include restaurants, other businesses and large institutions such as the Thompson and Flin Flon Hospitals; the remaining sales volumes are consumed by residential customers.

On January 30, 2006, Stittco filed two applications with the Board. The first application sought deregulation. If it had been approved, the second application would have been moot. The second application requested across-the-board rate increases of 6.1%. At that time, the Board deferred addressing the requests, citing that commodity prices were then decreasing.

Subsequently, Stittco renewed its applications. But, with commodity prices still 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 public hearing.

Subsequently and still prior to the hearing that was held in March 2007, in Thompson, Manitoba, by Board Order 4/07 the Board approved lump sum refunds of Purchased Propane Variance Account (PPVA) balances to Stittco's customers.

Stittco's propane supply and transportation expenses, to Stittco's franchise area, are to be reflected in customer rates without markup. Fluctuations in these costs, upwards or downwards, are to be captured in Stittco's Purchased Propane Variance Accounts (PPVA) balances, and be taken into account when rates are next revised. Stittco's application projected that then-higher propane commodity prices would be sustained, though market price fluctuations could be expected.

Board Order 79/07 resulted from the March 2007 hearing. The Board:

- a) rejected Stittco's bid for forbearance of direct rate setting regulation; and
- b) required Stittco file additional information prior to the Board addressing Stittco's application for across-the-board rate increases of 6.1%.

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, an allowance reported by Stittco to have been fully taken up by its parent corporation. And, with respect to the actual annual rate of return allowed on shareholder's equity, the Board established a 10% allowable return rather than the then-applicable 10.83%.

Stittco filed the information required by the Board prior to an interim rate setting as of July 1, 2007, and its filing included an amended rate application reflecting the directions of the Board in Order 79/07. Accordingly, the Board accepted the revised rate proposal effective July 1, 2007, though on an interim basis. The interim rate increases represented an average increase of 4.5%, rather than the 6.1% sought by Stittco.

However, in setting interim and higher rates, the Board also indicated that if the remaining information sought by the Board was not provided by September 15, 2007, and the Board had not extended the timelines set for the receipt of the information before then, the interim rates would expire as of September 30, 2007, and the interim rates established by Order 133/05 would be returned to effect. (On October 2, 2007, following assurances by Stittco that it would fully respond to questions posed by the Board by close of business October 5, 2007, the Board extended the rates until consideration of the request to review and vary Orders 79/07 and 84/07 had been completed.)

The Board indicated to Stittco that the information it required by virtue of extant Orders was required to allow the Board to conclude on the fairness of current rates, and as to the balance of interests between customers and Stittco.

The Board reiterated that it lacked sufficient information related to affiliate transactions, and that it intended to put itself in a position to better understand the utility's economic

relationships and transactions with its parent and other affiliated companies.

At the time of the Thompson hearing, and since, it was and remained the Board's understanding that Stittco Energy controlled Stittco, and was its parent company. The Board was aware of transactions between Stittco and Stittco Energy that represented the vast majority of Stittco's costs, and that loans extended to Stittco by Stittco Energy were outstanding.

The Board then indicated that there was a clear issue of potential conflict of interest, and cross-subsidization issues, in the dealings between Stittco and its parent and that while that finding did not mean that the Board found the transactions between the two companies improper, it did insist on understanding and accepting the arrangements before finalizing rates.

As well, the Board then indicated that it remained uncertain as to how to proceed with respect to an alleged subsidization of residential customers by commercial customers, and required additional information and an opinion from Stittco. The Board also indicated that it would consider amending future rate setting processes to separate the setting of commodity and non-commodity based rates, to allow for more frequent amendments to commodity based rates.

The Board indicated to Stittco that upon receipt of the information still outstanding from Stittco and required by the Board, it would complete its understanding of the situation and then would finalize revised rates.

Finally, the Board then-directed that Stittco continue with the established procedure maintaining the PPVA's, these to accrue differences between actual and estimated costs, as reflected in rates.

3.0 STITTCO'S REVIEW AND VARY APPLICATION

By Orders 79/07 and 84/07 (collectively "the Orders"), the Board responded to applications by Stittco for regulatory forbearance and revised propane rates, by rejecting forbearance and establishing interim revised propane rates effective July 1, 2007.

In response to the Orders, Stittco applied to the Board, on July 6, 2007, for review and variance of the Orders, on the basis that the Board:

- a) erred in law and fact in finding that Stittco and its services are not subject to competition sufficient to protect the public interest;
- b) erred in law and exceeded its jurisdiction by ordering Stittco to file with the Board the most recent audited financial statements of Stittco's parent company, Stittco Energy Limited (Stittco Energy);
- c) erred in fact in concluding that the audited statements of Stittco Energy would assist the Board in testing the reasonableness of the allocation methodology used for

inter-company financial arrangements between Stittco Energy and Stittco; and

- d) erred in fact and law and exceeded its jurisdiction in directing that Stittco's rates reflect a one-third sharing, to the maximum of Stittco's prospective taxable income, of the small business tax deduction of corporations that are associated with Stittco.

Stittco asked the Board to:

- b) review and vary its finding that Stittco and its services are not subject to competition sufficient to protect the public interest to make a finding pursuant to section 74.1 of *The Public Utilities Board Act* (Act); Stittco suggested that, based on the evidence presented, Stittco is and will be subject to competition in both the residential and commercial/industrial sectors sufficient to protect the public interest;
- c) rescind the provisions of the Orders requiring that Stittco file with the Board the most recent audited financial statements of Stittco Energy;
- d) make a finding that the audited financial statements of Stittco Energy are not relevant or useful in testing the reasonableness of the allocation methodology used for

inter-company financial arrangements between Stittco Energy and Stittco; and

- e) rescind the Board's direction that a one-third sharing of the small business deduction be reflected in the rates of Stittco.

And, on the basis of the Board varying its finding in respect of competition, Stittco asked the Board to:

- a) 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 issue an order that provides written authorization to Stittco to charge such rates as competition may allow; or, in the alternative,
- b) implement complaint based regulation and issue an order that provides authorization to Stittco to allow it to charge the rates that it files with the Board, subject to complaints that may be received from Stittco's customers.

Orders 79/07 and 84/07 may be obtained through the Board's offices, or viewed on the Board's web site, www.pub.gov.mb.ca. An understanding of these Orders is required for full comprehension of the Board's findings as set out below.

4.0 STITTCO'S ARGUMENT

In support of its application, Stittco cited the following facts that were, generally, noted by the Board in Order 79/07:

1. Stittco is a small public utility distributing propane by pipeline to customers in Thompson, Flin Flon, and Snow Lake, Manitoba with the majority of its approximately 1,100 customers being residential and located in Thompson.
2. The Board has been regulating Stittco and its predecessor company since 1963.
3. Order 133/05 approved interim rates and directed Stittco to file a General Rate Application (GRA), and in response Stittco filed an application on January 30, 2006.
4. That GRA application sought deregulation of Stittco's rates, or, in the alternative, regulation on a complaints basis, or, in the further alternative, approval of a 6.1% rate increase.
5. Order 79/07 rejected Stittco's request for reduced regulatory oversight finding Stittco not to be subject to competition sufficient to protect the public interest.
6. Order 79/07 provided further directions, and indicated that the Board would, upon certain information to be filed June 22, 2007, establish interim rates as of July 1, 2007, and

proposed to amend and finalize rates after receiving the remaining information then-sought from Stittco.

7. Following an information filing of June 22, 2007, by Order 84/07 the Board set a) interim rates as of July 1, 2007 reflecting a one-third sharing, to the maximum of Stittco's prospective taxable income, of the small business tax deduction for regulatory rate setting purposes, and b) an allowable rate of return on rate base and shareholder's equity of 10%.
8. By Order 79/07, the Board directed that Stittco file with the Board, on a confidential basis, the most recent audited financial statements of Stittco Energy, Stittco's parent company, and a description of the allocation methodology used for inter-company financial arrangements between Stittco and Stittco Energy, with an audit attestation as to the accuracy and reasonableness of the methodology.
9. Order 84/07 did not reiterate the Board's direction of Order 79/07 that the filings required of Stittco be on a confidential basis.

In further support of its application, Stittco cited:

- a) sections of *The Public Utilities Board Act*: Section 44(3); definitions of "public utility", and "owner of a public utility" as per Section 1; Section 74(1); Section 78(1); Section 82(1); and Section 74.1(1); and

b) extracts from case law.

Stittco submitted that it is an error of law for a regulator to make a finding based on irrelevant considerations, citing Justice Dickson from *Service Employees' International Union, Local NO. 333 v. Nipawin District Staff Nurses Assn.*, (1975) 15.C.R. 382, at page 389. Stittco also submitted that it is an error of law and excess of jurisdiction for a regulator to make a decision in the absence of any evidence to support it, citing Justice Letourneau from *Telus Communications Inc. v. Canada (Canadian Radio-television and Telecommunications Commission, 2004, F.C.J. No. 1808, 2004 FCA 365, at para. 40)*.

Stittco's full argument and submission of July 6, 2007, related to case law and the Board's jurisdiction may be reviewed by accessing the Board's file, which may be viewed at the Board's office.

With respect to the Board's direction that the small business tax deduction be shared with Stittco, Stittco cited Section 125 of the *Income Tax Act*, a section that provides for a corporate tax reduction in respect of income earned by associated Canadian-controlled private corporations with active business income, up to a prescribed maximum, indicating that the express purpose of the deduction is set out in Canada Revenue Agency Interpretation Bulletin IT-73R6, which reads:

"The special low rate of tax provided by the small business deduction recognizes the special financing difficulties and higher cost of capital faced by small businesses and is intended

to provide these corporations with more after-tax income for reinvestment and expansion."

In its motion for the Board to review and vary the Orders, Stittco noted in particular the following comments from Order 79/07: *"the retention of public confidence currently requires continuation of oversight"*, and, that no customer appeared at the hearing in support of the deregulation sought by Stittco.

Stittco submitted that it is an error of law for the Board to base its decision on what Stittco considers irrelevant considerations, that is on the basis that none of Stittco's customers attending the hearing supported regulatory forbearance, and Stittco suggested that that the only relevant consideration for the Board pursuant to Section 74 of the Act is the level of competition faced by Stittco.

Stittco held that the views of Presenters are irrelevant, and that the issue with Section 74 is not a "popularity" contest but a requirement that the Board make a factual assessment of the sufficiency of competition to protect the public interest.

Stittco opined that *"to the extent that the Board based its decision on irrelevant considerations, it erred in law"*.

Stittco concluded that *"there was no evidence on the record (of the hearing) that would support a finding that Stittco does not face competition. The evidence is to the contrary... that Stittco faces severe competition from electricity, and the Board so found."*

Stittco noted that it does not have an exclusive franchise in any of its markets, and the fact that no other propane (by pipeline or tank) operators are present *"...is not evidence of insufficient competition (but)... evidence of the workings of competition. Increases in Stittco's rates for pipeline propane could well make tank propane economical (and) it is the competition from tank propane that is the competition that will keep Stittco from charging rates to commercial customers that are not just and reasonable."*

Stittco noted Order 79/07's comment that *"(the Board) suspects that Stittco's pipeline-based service provides advantages to its parent's tank-based services to the same and close-by communities in Manitoba"*, and opined that there was no evidence to support the conclusion, nor that such a conclusion would be relevant to the Board's considerations in any case.

With respect to the Board's insistence (in Orders 79/07 and 84/07) on the Board receiving an audited copy of Stittco Energy's financial statements, Stittco filed an affidavit of Mr. Gale Stitt with redacted financial statements of Stittco Energy and the March 2006 invoices of Keyera Energy (the propane supplier to Stittco Energy) and those of Stittco Energy pertaining to supplies provided by Stittco Energy to Stittco.

The redacted statements did not report sales, expense or balance sheet results and/or positions.

Furthermore, Stittco noted:

- a) Order 79/07 observes *"... it does not have a sufficient understanding of Stittco's arrangements and transactions with its affiliates"* and that *"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."*; and
- b) Order 84/07 observes *"the information still sought by the Board (including the Stittco Energy financial statements) is required to allow the Board to conclude on the fairness of current rates, and the balance of interests between customers and the utility. The Board lacks information related to affiliate transactions, and still intends to put itself in a position to better understand the utility's economic relationships and transactions with its parent and affiliate companies."*

In its application requesting the Board review and vary its Order, Stittco made the following claims:

- a) the Board can only exercise the powers granted it by its enabling legislation or that are present by necessary implication;
- b) Part II of the Act sets out the jurisdictions and powers of the Board, providing the Board broad powers of general supervision - *section 74(1); power to make orders as to owners of a public utility (section 78(1); and power to*

ensure that rates charged by a public utility are not discriminatory (section 82(1));

- c) the propane delivery pipeline system is a public utility and Stittco is an owner of a public utility, and both are thus subject to the jurisdiction and powers of the Board as set out in Part II of the Act; Stittco Energy, the sole shareholder of Stittco, is not a public utility or the owner of a public utility, "*...and is not regulated by the Board*", noting that Fallen Timber Ranch (1981) Ltd., holds the majority of the shares of Stittco Energy and also holds 77.27% of the shares of Stittco, and is the sole holder of the small business deduction;
- d) the powers granted under Part II of the Act, do not provide the Board with the power to compel the production of financial statements from an unregulated entity;
- e) the financial statements of Stittco Energy constitute confidential information of a private company, and Order 84/07 does not contain the confidentiality provision of Order 79/07. - "*Filing of Stittco Energy's financial statements would disclose confidential information of a private, unregulated company to the Board, its staff and any party that may choose to access the Board's records*";
- f) Stittco Energy is a small, unregulated corporation engaged in the competitive business of propane marketing; its competitors include large multi-national oil companies, and

disclosure would harm the competitive position of Stittco Energy and could result in significant financial loss;

- g) Stittco Energy's financial statements would not provide the Board with the information or understanding it seeks; the form of Stittco Energy's financial statements do not include the level of detail related to propane transactions sought by the Board, and would be irrelevant to the decision the Board is required to make regarding rates;
- h) with the record of past proceedings and the current application and supporting information, the Board does not lack information related to affiliate transactions; the record *"...provides full and complete disclosure of information necessary to obtain a sufficient understanding of Stittco's arrangements and transactions with its affiliates.."*; and
- i) Emerald Regulatory Services Inc.'s 1998 report, *The Emerald Allocation Report*, provides sufficient continuing support for the annual administration fee of 12% of direct operating expenses by Stittco Energy to Stittco.

In summary, Stittco submitted that the Board:

"... has before it the information it needs to find that Stittco's arrangements and transactions with its affiliates are fair and reasonable and that the propane commodity costs are being passed through at no mark-up, and that the audited statements of Stittco Energy would be irrelevant to the decision the Board is required to make."

With respect to the small business (tax) deduction, Stittco held that the deduction, when applied as directed by the Board, compared to Stittco's proposal, would result in the reduction in the allowed rate of return from 10% to 8.03%. Stittco submits the tax deduction is:

"... the property and prerogative of the four associated companies - Fallen Timber, Stittco Energy, Stittco NWT and Stittco - and may be dealt with as the management of these corporations sees fit."

Stittco held that the Board-directed transfer of one-third of the deduction from the associated ratepayers to the ratepayers of Stittco *"... is an error in law in two ways. First, it errs in law by violating the intention of the small business deduction. Second, it errs in law by establishing, by definition, a return to investors in Stittco that is less than the fair return that is required by law."*

Stittco concluded its submission by requesting that the Board review its decisions and Orders 79/07 and 84/07 and vary those decisions and orders to:

1. Make a finding pursuant to section 74.1 of the *Public Utilities Board Act* of Manitoba that, based on the evidence presented, Stittco is and will be subject to competition in both the residential and commercial/industrial sectors sufficient to protect the public interest;
2. 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 to charge such rates as competition may allow; or in the alternative,

3. Implement complaint based regulation and issue an order that provides authorization to charge the rates that it files with the Board, subject to complaints that may be received from Stittco customers;
4. Rescind its directives requiring that Stittco file with the Board the most recent audited financial statements of Stittco Energy;
5. Make a finding that the audited financial statements of Stittco Energy are not relevant or useful in testing the reasonableness of the allocation methodology used for inter-company financial arrangements between Stittco Energy and Stittco;
6. Rescind its requirement that the rates of Stittco reflect one-third of the small business deduction; and
7. Provide such other relief as Stittco may request or the Board may consider appropriate.

5.0 CAC/MSOS' RESPONSE

On September 5, 2007, CAC/MSOS responded to Stittco's application for the Board to review and vary Board Orders 79/07 and 84/07, noting that Stittco took issue with:

- a) the Board's finding that the company and its services are not subject to competition sufficient to protect the public interest;
- b) the Board's insistence on fully understanding Stittco's affiliate transactions; and
- c) the Board's requirement that Stittco's customers were to receive a benefit from the small business tax deduction.

CAC/MSOS submitted:

1. the Board's finding that Stittco and its services are not subject to competition sufficient to protect the public interest was amply supported by regulatory policy, the record and the Board's reasons;
2. it would be patently unreasonable for the Board to refrain from rate regulation given its findings of unfair cross-subsidization of one class of consumers by the rates of commercial customers;
3. given that Stittco had failed to establish that its arrangements and transactions with its affiliates (including management charges) were reasonable and prudent, it would be appropriate for the Board to disallow, for rate-setting purposes, certain costs now reflected in the prospective rate base and rates; and

4. the Board acted reasonably in directing that Stittco's rates reflect a sharing of the small business tax deduction.

In supporting the Board's finding that current competition is insufficient to protect the public interest, CAC/MSOS observed that the Act provides the Board authority to set just and reasonable rates, while allowing it to exercise forbearance when it finds, as a matter of fact that competition is sufficient to protect the public interest.

CAC/MSOS noted that the Board had found as a fact, that Stittco was not subject to competition sufficient to protect the public interest, and advised that while Stittco took issue with Board's finding, CAC/MSOS did not.

CAC/MSOS cited Professor Jerry Buckland's observation that "... imperfect competition occurs when firms (or consumers) are not price-takers and have some market power (Ragan and Lipsey, 2005, p. 264-281)", holding that imperfect competition is often associated with some form of monopoly or quasi monopoly.

CAC/MSOS submitted that in cases where no realistic competitive alternatives exist, some consumers may pay in excess of what a competitive market would allow, and that justified regulation.

CAC/MSOS determined that the Board had sufficient facts to support its conclusion that Stittco's commercial customers had been "... paying more than their fair share of costs", suggesting

that the Board's finding was supported by the Foster reports and the indication that "Stittco's tank-based competition in Thompson, Flin Flon and Snow Lake had withdrawn, due to a cited inability to earn a satisfactory return at then-market prices".

As well, CAC/MSOS noted that the Board received the perspectives of many members of the Thompson business community at the Thompson hearing, and that all "...(were) adamant that there were no realistic competitive options (to Stittco's service) for those requiring propane services."

CAC/MSOS commented that Stittco's argument against the Board's determinations was neither grounded in, nor supported by, past Court decisions. For CAC/MSOS the Board had properly considered the state of the competitive market, identified conversion costs as the primary barrier to competition for residential customers, and recognized that higher residential rates would place additional pressure on this section of the Stittco market.

CAC/MSOS submitted that the Board's conclusion that Stittco's residential customers were subsidized by the rates charged to commercial customers represented "inexorable logic", and that commercial customers "requiring the particular energy advantages of propane" have no meaningful competitive alternative.

CAC/MSOS submitted that notwithstanding Stittco's view, the perspectives of residential and commercial customers are relevant, as is the consideration of fairness. According to CAC/MSOS, the Board was correct in its finding that the pipeline

propane marketplace was "an inadequate safeguard of consumer interests", and that the fact that both commercial and residential customers also held this view provided further support to the Board's factually-based findings.

With respect to the Board's findings and positions on Stittco's affiliate transactions, CAC/MSOS agreed with the Board's conclusions and directions, and supported the Board's conclusion that, in the absence of adequate supporting documentation "... the Board may be obliged to disallow, for rate-setting purposes, certain costs now included in the prospective rate base."

CAC/MSOS submitted that Stittco bears the onus of demonstrating the reasonableness and prudence of its expenditures, and suggested that its onus has not been met by its filings to-date.

With respect to the Board's determinations related to the small business tax deduction, CAC/MSOS supported the Board's findings and submitted that Stittco's arguments to the opposite were "neither tenable nor deserving of much attention".

CAC/MSOS opined that "... it is a well recognized regulatory principle that regulatory costs may differ from accounting or other costs", and observed that the Board is "statutorily authorized to make a determination of a just and reasonable rate, and is not bound by the intentions of the Canada Revenue Agency."

In conclusion, CAC/MSOS supported the Board's findings, noting:

- a) Stittco is not subject to competition sufficient to protect the public interest;
- b) the Board should continue to exercise rate regulation, particularly given its finding of unfair cross-subsidization;
- c) Stittco failed to establish that its arrangements and transactions with its affiliates are reasonable and prudent;
- d) in the absence of further evidence supporting the reasonableness of affiliate transactions the Board would be correct in disallowing for rate-setting purposes certain costs now included in the prospective rate base; and
- e) the Board was reasonable and correct in directing that Stittco's rates reflect a sharing of the small business tax deduction.

6.0 STITTCO'S REPLY TO CAC/MSOS

In its October 4, 2007 Reply to the submission of CAC/MSOS, Stittco maintained that there is no evidence on the record that would support a finding of fact that Stittco does not face competition sufficient to protect the public interest.

Stittco also maintained that the Board has no jurisdiction to compel the production of the Stittco Energy financial statements. As Stittco submitted in its Review and Vary Application, even if the financial statements were filed on a confidential basis, Stittco has demonstrated that the information contained in the financial statements would not assist the Board in further assessing Stittco's arrangements and transactions with its affiliates, or confirm that propane commodity costs are being passed through at no mark-up.

Rather, and to assist the Board, Stittco indicated that the auditors of Stittco Energy, McAllum and Company were prepared, if asked, to provide confirmation to the Board that:

- i) one of the tasks undertaken in the course of the audit of Stittco Energy is to confirm that the cost of propane does not have any mark-up included as part of the inter-company transaction, and that there was no such mark-up; and
- ii) the allocation methodology used for inter-company financial arrangements between Stittco Energy and Stittco, as established and confirmed by the Emerald Allocation Report and the Emerald Charges Reports, have been followed.

Stittco also urged the Board to disregard CAC/MSOS' "bald expressions of opinion" on the allocation of small business deduction.

Stittco repeated its request for the Board to review its decisions in Orders 79/07 and 84/07 and vary those decisions and orders as applied for in Stittco's Review and Vary Application.

7.0 BOARD FINDINGS

The Board has considered carefully the merits of Stittco's application and the submissions made by Stittco and CAC/MSOS, following Stittco's application to vary aspects of Orders 79/07 and 84/07. Those Orders, particularly the findings sections, should be read in conjunction with this Order.

The Board appreciates Stittco amending the record by clarifying the organizational structure of Stittco and its affiliated companies. Until receipt of Stittco's review and variance application, the Board was not aware that Fallen Timber Ranch (1981) Ltd. (Fallen Timber) was the majority owner of Stittco Energy and a related company of Stittco.

That said, and the amendment to the Board's understanding duly noted, the fact that Stittco Energy's majority shareholder is Fallen Timber, owned in part by Mr. Gale Stitt, an officer and director of Stittco, does not change the fact that Stittco is a wholly-owned subsidiary of Stittco Energy.

Stittco Energy is the owner of Stittco and involved in material and ongoing inter-company transactions that, among other things, account for the majority of the costs incurred by Stittco.

Stittco is the only franchised pipeline provider of propane in Thompson, Flin Flon and Snow Lake. As understood by the Board, currently the only provider of tank-based propane is the parent company of Stittco, Stittco Energy, an entity not regulated by this Board.

While it is clear that space heating by means of electricity, if properties are equipped to be so heated, may be expected to be less expensive than by pipeline propane, there are still significant barriers to service by electricity. Those barriers include the high cost of converting from propane-based space heating to electricity, the current investment of property owners in propane heating (many having converted from conventional to high-efficiency propane furnaces), and the requirement of property ownership (renters in properties heated by propane are dependent on the owners of the properties with respect to the heating choice).

Undisputed by Stittco, the cost of converting from propane to electricity for space heating could be \$8000.00. The economic argument against conversion clearly represents a barrier to conversion for some households, particularly low-income and seniors on fixed income.

As to commercial operations requiring propane for process purposes, perhaps as well as for space heating, the barriers for conversion go beyond conversion costs. For these operators, Stittco is "the only game in town", whether they choose propane by pipeline or by tank.

To suggest, as Stittco did in its application for reconsideration and variance, that other pipeline propane operators could seek and obtain franchise access to Stittco's service areas, is to ignore the barriers against entry to the current actual monopoly market. Those barriers include the costs of securing the necessary approvals and, if approval is granted, installation of the necessary infrastructure, facilities and working capital. The small size of the market and Stittco's dominant position in it are other market entry barriers.

Stittco opined that the positions advanced by presenters at the March 2007 hearing are irrelevant. The Board has a different view. Least cost regulation, as currently practiced by the Board in relation to Stittco, has involved a degree of informality at hearings that requires the cooperation of all parties to be cost efficient and accomplish the goals of regulation. The positions advanced by presenters were not disputed by Stittco at the hearing, nor were the written submissions that followed the posting of the Notice of Hearing.

The Board's mandate requires it to determine the public interest, and the views of Stittco's customers, as advanced orally or in writing, assist the Board. Those customers indicated a preference for continued Board rate oversight.

After review of Stittco's Application and the submissions of Stittco and CAC/MSOS, the Board does not find, as a question of fact, that Stittco and its services are subject to competition

sufficient to protect the public interest. Therefore, the Board will continue its regulation of Stittco under the current least cost regulatory regime. The Board, together with Stittco, will need to continuously evaluate Stittco's regulatory regime.

The redacted financial statements of Stittco Energy, prepared on a non-consolidated basis and reported on by the firm's external auditor and filed in confidence, provide insufficient information to allow the Board to meet its responsibility to assure itself that the charges made against Stittco by Stittco Energy are just and reasonable. Those charges, particular with respect to propane costs, represent the vast majority of Stittco's costs, now reflected and recovered in interim rates.

Nonetheless, the Board appreciates receipt of copies of March 2007 invoices of Keyara and Stittco Energy, which suggest that propane costs incurred by Stittco Energy on behalf of Stittco are "passed through" to Stittco without mark-up, as asserted under oath by Mr. Stitt at the March hearing. As well, the Board appreciates receipt of redacted Stittco Energy financial statements, and the affidavit of Mr. Stitt.

To allow the Board to meet its requirement of assuring itself of the reasonableness of all transactions between Stittco Energy and Stittco, and for Stittco to meet its requirements under *The Public Utilities Board Act*, the attestation, directly to the Board, by Stittco Energy's independent external auditor will need to:

- a) confirm that propane and propane related costs incurred by Stittco Energy on behalf of Stittco for the year ended July 31, 2006 were billed to Stittco without mark-up or other charges;
- b) confirm that the allocation methodology used for inter-company financial arrangements between Stittco Energy and Stittco, as established by the Emerald Allocation Report and Emerald Charges Report, has been exactly followed;
- c) attest to the value in dollars of contract and administrative services provided by Stittco Energy to Stittco and the gross value in dollars of contract and administrative services incurred by Stittco Energy, for the year ended July 31, 2006; and
- d) attest to the value in dollars of the total sum of the contract and administrative service costs incurred by Stittco, Stittco NWT, and Stittco Energy.

The Board will provide clarification if requested by Stittco Energy's independent auditor.

The Board assures Stittco and its affiliated companies that it would retain the auditor's attestation and the analysis of the sharing of contract and administrative charges made by Stittco Energy against Stittco and Stittco NWT, in confidence, and that such filings will not be placed on the public record.

For the Board to accept Stittco's attestations and those of its beneficial controlling owner, Mr. Stitt, without confirming those attestations and receiving the attestation of the auditor, would be improper. The information to confirm Stittco's attestations is obviously available, but Stittco has chosen not to provide the information because of a confidentiality-based concern.

The Board has accepted the filing of information on a confidential basis in past proceedings involving other regulated utilities, including the major utility Manitoba Hydro, and such information is sealed within the Board's records and not made available to the public, including interveners.

The Board's request should not be taken as any disrespect to the credibility of Mr. Stitt. Rather, the Board needs to carry out its mandate, in the public interest. In the current least cost regulatory model used by the Board, Stittco is not subjected to the level of detailed scrutiny faced by large provincial Crown Corporation utilities in general rate applications. The production of the information requested is seen as expedient and cost effective, and allows both the Board and Stittco to meet their respective obligations. With the Board's assurance of confidentiality, and Stittco's co-operation in making the attestations available from the auditors of Stittco Energy, the Board now expects the information will be provided.

That said, and in the interests of restraining further regulatory costs, the Board is prepared to accept, in lieu of

the full audited accounts of Stittco Energy, the attestations by Stittco's independent professional auditor, as detailed above with the expectation that the attestations will meet the Board's requirements with respect to assuring itself that Stittco's propane supply and transportation to Stittco costs, and such costs as it has incurred through allocations and charges from its parent, are reasonable. If, for any reason, the attestations by Stittco Energy's auditors do not satisfy the Board, this issue will be revisited by the Board with Stittco.

With respect to the directed sharing of the small business deduction, the Board appreciates, having been informed through Stittco's application, that Fallen Timber is allocated the deduction in full, with no share being allocated to Stittco Energy, Stittco or Stittco NWT, and assures Stittco and its related companies that the Board has no interest in requiring Fallen Timber to change its practices for the purposes of filing tax returns.

However, for rate setting purposes, the Board remains of the view and continues the direction that Stittco be allocated a notional sharing of one-third of the small business deduction, as Stittco's ratepayers should benefit from the deduction through a sharing being reflected in rates. If the Board were made aware that Fallen Timber is an operating company and has transactions aside and apart from those involving Stittco NWT and Stittco, the Board would consider, on Stittco's request supported by evidence, a 25% allocation to Stittco rather than 33%.

As Stittco has indicated in its filing, the rationale for the deduction is to address some of the financial disadvantages of small companies. Stittco is a small company, and its ratepayers are generally expected to recover, in rates, the costs of operations including income taxes. Currently, Fallen Timber is enjoying income tax savings as a result of the operations of Stittco, those savings should be reflected in Stittco's rates.

Stittco's customers are paying rates that are currently based on costs including financing costs comprised of a 10% rate of return on rate base/shareholder's equity. That rate of return is at 10% because Stittco has been allowed a debt:equity ratio that is 100% equity and 0% debt- with the Board accepting Stittco's argument that it has not been able to acquire bank debt at lower rates on its own, and that its parent is unwilling to provide the necessary guarantees to secure debt.

Following its review of Stittco Energy's redacted audited statements, the Board confirms its view that the small business deduction should be shared, by allocation for rate setting purposes, with Stittco. The small business deduction should be shared with Stittco, and reflected in Stittco's rates whether or not the deduction is shared, in fact, through tax filings.

8.0 IT IS THEREFORE ORDERED THAT

1. Stittco Utilities Man Ltd.'s application for the Board to vary its findings that, as a question of fact, Stittco and its services are not subject to competition sufficient to protect the public interest BE AND IS HEREBY DISMISSED.

2. Stittco Utilities Man Ltd.'s application for the Board to vary its Order requiring the filing of Stittco Energy's most recent audited financial statement BE AND IS HEREBY GRANTED on the condition that the attestations required by the Board, directly from Stittco Energy's independent auditor, be provided forthwith and satisfy the Board as to the reasonableness of the amount and allocation of inter-company costs; the attestations will be received in strict confidence by the Board.
3. Stittco Utilities Man Ltd.'s application for the Board to vary its Order requiring a one-third sharing, to the maximum of Stittco's prospective taxable income of the small business tax deduction, for regulatory rate setting purposes BE AND ITS HEREBY DENIED.
4. Stittco Utilities Man Ltd. file all material as ordered in Board Orders 79/07 and 84/07 or as amended by this Order, by January 31, 2008.

THE PUBLIC UTILITIES BOARD

"GRAHAM LANE, C.A."
Chairman

"GERRY GAUDREAU, C.M.A."
Secretary

Certified a true copy of Order No. 152/07
issued by The Public Utilities Board

Secretary