



**Table of Contents**

|  | <b>Page</b> |
|--|-------------|
| 1.0 Appearances .....  | 1           |
| 2.0 Witnesses for Centra .....                                   | 1           |
| 3.0 Intervenors .....  | 1           |
| 4.0 Witnesses for CAC/MSOS .....                                 | 1           |
| 5.0 Presenter .....  | 1           |
| 6.0 Background .....   | 2           |
| 6.1 Board Order 143/90 .....                                     | 2           |
| 6.2 Application .....  | 4           |
| 7.0 Regulatory Theory .....                                      | 5           |
| 7.1 Centra's Position .....                                      | 5           |
| 7.2 CAC/MSOS's Position .....                                    | 5           |
| 8.0 Financial Performance .....                                  | 6           |
| 8.1 Centra's Position .....                                      | 6           |
| 8.1.1 Regulatory Lag .....                                       | 6           |
| 8.1.2 Post Facto Review .....                                    | 7           |
| 8.2 CAC/MSOS's Position .....                                    | 7           |
| 9.0 Regulatory Incentives .....                                  | 9           |
| 9.1 Centra's Position .....                                      | 9           |
| 9.2 CAC/MSOS's Position .....                                    | 9           |
| 10.0 Regulatory Burden .....                                     | 10          |
| 10.1 Centra's Position .....                                     | 10          |
| 10.2 CAC/MSOS's Position .....                                   | 10          |
| 11.0 Monitoring Requirements and Evaluation of Performance ..... | 12          |
| 11.1 Centra's Position .....                                     | 12          |
| 11.2 CAC/MSOS's Position .....                                   | 12          |
| 12.0 Transition .....  | 13          |

|               |  |           |
|---------------|--|-----------|
| <b>13.0</b>   | <b>Summary of Intervenors' Positions</b> .....               | <b>14</b> |
| <b>13.1</b>   | <b>CAC/MSOS</b> .....  | <b>14</b> |
| <b>13.2</b>   | <b>Municipal Gas Company</b> .....                           | <b>14</b> |
| <b>13.3</b>   | <b>Communication, Energy &amp; Paper Workers Union</b> ..... | <b>14</b> |
| <b>14.0</b>   | <b>Presentation of Stittco Utilities Man Ltd.</b> .....      | <b>15</b> |
| <b>15.0</b>   | <b>Board Findings</b> .....                                  | <b>16</b> |
| <b>15.1</b>   | <b>Need and Appropriateness of a Future Test Year</b> .....  | <b>16</b> |
| <b>15.2</b>   | <b>Regulatory Process Changes</b> .....                      | <b>17</b> |
| <b>15.2.1</b> | <b>Form of Application and Level of Review</b> .....         | <b>17</b> |
| <b>15.2.2</b> | <b>Transitional Issues</b> .....                             | <b>18</b> |
| <b>15.2.3</b> | <b>Monitoring and Reporting Requirements</b> .....           | <b>18</b> |
| <b>15.3</b>   | <b>Evaluation of Performance</b> .....                       | <b>19</b> |
| <b>16.0</b>   | <b>IT IS THEREFORE ORDERED THAT</b> .....                    | <b>20</b> |

## **1.0 Appearances**

|                                     |  |
|-------------------------------------|--|
| W. C. Gardner, Q.C.<br>R. F. Peters | Counsel for the Public Utilities Board of Manitoba<br>("the Board")  |
| J. E. Foran, Q.C.                   | Counsel for Centra Gas Manitoba Inc. ("Centra")  |
| B. J. Meronek                       | Counsel for the Consumers' Association of<br>Canada (Manitoba Chapter) and the Manitoba<br>Society of Seniors ("CAC/MSOS") |
| J. Carstairs                        | Counsel for Municipal Gas Company ("Municipal")  |

## **2.0 Witnesses for Centra**

|                 |   |
|-----------------|---|
| J. D. Brett     | Vice-President, Gas Supply and Corporate<br>Secretary |
| H. M. Kast      | Vice-President, Finance                               |
| G. B. Whitehill | Controller  |

## **3.0 Intervenors**

|  |  |
|--|--|
| CAC/MSOS   | Represented by B. J. Meronek           |
| Municipal  | Represented by J. Carstairs            |
| Communication, Energy<br>and Paper Workers<br>Union ("CEPU") | Represented by J. Hayden and G. Wilcox |
| Manitoba Energy and Mines                                    | Represented by R. Floom                |

## **4.0 Witness for CAC/MSOS**

|         |                |
|---------|----------------|
| J. Todd | Expert Witness |
|---------|----------------|

## **5.0 Presenter**

|          |   |
|----------|---|
| W. Ryall | Representing Stittco Utilities Man Ltd. ("Stittco") |
|----------|---|

## **6.0 Background**

### **6.1 Board Order No. 143/90**

The Board, in responding to public reaction to the multiplicity of hearings and numerous rate changes for natural gas, convened a public hearing in 1990 to review the regulatory process as it affected Centra. At that hearing, the Board reviewed what, if any, changes would be necessary to reduce the multiplicity of hearings and the resultant rate changes and assessed the impact that any changes in the regulatory process might have on both the ratepayers and Centra.

At that time, a mid-year historic test year was used to set natural gas sales rates in Manitoba. This regulatory process required that a General Rate Application ("GRA") be based on audited financial statements as at the December 31 fiscal year end. An application could therefore not be made until the latter part of March. Given the necessary lead time for the exchange of information, the public hearing and the issuance of a Board Order, rates typically did not take effect until September.

At that hearing, Centra specifically recommended that the following steps be considered in moving to a future test-year:

1. Set 1991 rates using a 1990 historic test year with a year-end rate base. Continue with a January 1 Interim Refundable rate increase and allow retroactivity of rates when the final Order is made;
2. Implement deferral accounts for changes in the cost of gas and related transportation tolls immediately;
3. Move to a 1992 future test year to set 1992 rates.

The Board issued Order No. 143/90 dated October 15, 1990 which included the following decisions:

1. The Board limited Centra to one GRA annually dealing with changes in its cost of service. Such an application, if sought by Centra, would have to be submitted by August 1 in the test year for rates to be effective January 1 of the following year. The test-year information would now include a forecast component.
2. The Board found that the use of deferral accounts would reduce the multiplicity of hearings and the number of rate changes. The Board further found that deferral accounts should include interest at Centra's monthly short-term borrowing rate and should be balanced, either by charging or refunding to customers at a later date.

3. The Board found that a change from the mid-year historic test-year methodology combined with the concurrent change in deferral accounts and the effective date of rate changes would not be prudent at that time.

The next major change in regulatory methodology occurred in 1991 when Centra applied to use a year-end rate base to determine its revenue requirement for 1992. Order No. 156/91 dated December 31, 1991 approved the use of a year-end rate base on the basis that it was fair and reasonable to both the consumer and Centra and would enable Centra to maintain its financial integrity and appropriately finance its capital requirements.

During the 1992 GRA (to determine 1993 rates) the use of a future test year was discussed as a possible means of reducing the number of known and measurable adjustments currently allowed by the Board. In addition, the Board was exploring options for a more prospective review of Centra's plans. No further evidence concerning the future test year was provided. However, Centra suggested that the Board ought to, under rules of natural justice, give parties an opportunity to address the issue, and hold a hearing by way of submissions early in the next year.

In Order No. 10/93, dated January 22, 1993, the Board found that the future test year issue would merit further examination but was not prepared to make a final determination at that time. The Board indicated that it would consider requesting submissions from all interested parties at a later date.

## **6.2 Application**

On August 9, 1993 Centra applied to the Board for an Order approving a year-end rate base, rate of return, cost of service and revenue requirement based on a 1993 test year with rates to be effective January 1, 1994. As part of that application, the Company requested approval to file its next GRA based on a future test year.

The significance of the proposed change in regulatory methodology, and the fact that the issue had no financial impact on the rate application, led all parties at the GRA hearing held in November and December of 1993 to agree to adjourn this issue to a separate hearing to be held in 1994.

The Board sent a letter dated January 25, 1994 to all intervenors of record indicating the scope of the hearing would be limited to a review of:

1. The need and appropriateness of a future test year;
2. Any regulatory process changes that may be required, as a result of moving to a future test year; and
3. The appropriate procedures for measuring the financial results of Centra under a future test year.

Public hearings were held on March 21 and 22, 1994 and closing argument was heard on March 24, 1994 at the Norwood Hotel, Winnipeg, Manitoba.

## **7.0 Regulatory Theory**

### **7.1 Centra's Position**

Centra testified that from the perspective of regulatory theory a future test year is the appropriate basis for determining costs under a rate base rate of return regime. An important consideration in choosing a test year is matching revenue to costs within the same fiscal period, and all parties agree that this is best achieved by the future test year methodology.

Centra argued that at the present time, "we are caught in a hybrid of methodologies under the current historical test year system in Manitoba", and this process has become cumbersome and unsatisfactory. Centra believes that the removal of the various deferral accounts and known and measurable adjustments will directly result in a reduction of the regulatory burden. As well, a future test year should focus on Centra's plans and budgets and its approach to future expenditures rather than on a detailed review of past expenditures.

Centra argued that it is beneficial to all parties for the Board to review the plans, and the forecast operating results and capital programs of the Company as a means of setting rates for the next year rather than using historic data that may or may not represent future plans. Centra stated that the Board, in reviewing the future plans, can have input and provide direction on those plans which directly affect the future rates that consumers pay. In Centra's opinion, the review of historic operating results only provides information to the Board on an after the fact basis.

### **7.2 CAC/MSOS's Position**

CAC/MSOS agreed that, under regulatory theory, the test year selected should provide the best estimate of costs and matching revenues in the rate year, and in that respect, a future test year is an appropriate basis for determining rates. However, CAC/MSOS asserted that this simple theoretical approach assumes that the choice of test year has no impact on the efficiency with which the Company operates, that incentive considerations are irrelevant, that forecasts under a future test-year basis are accurate and unbiased, and that the Board is able to assess the reasonableness of forecasts at an extensive and detailed level. In CAC/MSOS's opinion, these assumptions are false and therefore the simple theoretical approach should not be the main consideration in moving to a future test year.

CAC/MSOS indicated that the need for the regulator to review the future plans of Centra was of limited relevance except in the situation where Centra was branching into new lines of business or undertaking a massive expansion.

## **8.0 Financial Performance**

### **8.1 Centra's Position**

Centra believes that the historical test year has a negative impact on its financial integrity, primarily for two reasons. First, regulatory lag results when current rates are based on the costs of the previous fiscal period. Second, a post facto review process associated with a historical test year can have a negative impact on financial results by disallowing "spent dollars".

#### **8.1.1 Regulatory Lag**

In Centra's opinion regulatory lag prompted other jurisdictions in Canada and the U.S. to adopt a future test year methodology. Centra is presently the only natural gas distributor in Canada regulated on a historic test year. Centra stated that regulatory lag exists under a historic test year even in periods of low inflation and low customer growth, when the Company is experiencing high capital expenditures related to system betterment and non-inflationary increases in costs. Centra argued that it was beneficial to move to a future test year during a period of low inflation when the impact on rates would be low.

Centra disagreed with CAC/MSOS's assessment that customer growth and efficiency gains would offset the negative financial effects of inflation and non-revenue generating capital expenditures under an historic test year. Centra argued that because of the high level of efficiency of its current operations and its low growth potential, the negative aspects of regulatory lag would not be fully offset. Centra further argued that the goal should be to eliminate regulatory lag rather than to offset the positive and negative aspects of regulatory lag.

As a future test year would allow Centra to include forecast capital expenditures and operating costs for the rate year, the shareholder would have a better opportunity to earn the allowed rate of return. Centra argued that a future test year would even out the probability of overearning and underearning, as opposed to the historic test year which includes a greater probability of underearning. This would improve its financial integrity.

In addition to the negative financial effects associated with regulatory lag and its inability to earn the allowed rate of return, Centra testified that its financial integrity is compromised because of the use of a historic test year for the following reasons:

- 1. Reduced interest coverage;**
- 2. Lower bond ratings and the resulting higher cost of debt; and**
- 3. Increased regulatory risk and the resulting higher cost of equity capital.**

In dealing with these issues Centra testified that credit rating agencies were concerned over the use of a historic test year and that the adoption of a future test year could help to maintain or improve bond ratings. This would reduce debt costs and lower risk which could reduce the allowed return on equity by as much as 25 basis points. This decrease in the overall cost of capital would be beneficial to the consumer in the form of lower rates than might otherwise be required.

### **8.1.2 Post Facto Review**

In Centra's opinion, a post facto review and disallowance of operating or capital expenditures under a historic test year is not fair, but instead is punitive in not permitting the Company to recover those expenditures in the next year's rates. Centra believes that the Board's review and approval of forecast costs to include in rates is a fair system for all parties involved.

### **8.2 CAC/MSOS's Position**

In CAC/MSOS's view, the Board had reacted in a positive manner to the problem of regulatory lag through Order 143/90 and 156/91, the approval of deferral accounts and the year-end rate base, as well as an expansion of the definition of known and measurable adjustments.

In CAC/MSOS's opinion the financial integrity or fiscal health of Centra is not compromised by the use of a historic test year. Furthermore, CAC/MSOS concluded that bond rating agencies focus on the earnings of Centra and not on the test year methodology used. The Canadian Bond Rating Service did not mention the type of test year in its latest bond rating of Centra. CAC/MSOS also testified that in its opinion an increased bond rating was not necessarily beneficial to the consumer if rates were increased to accomplish this change in regulatory process.

CAC/MSOS submitted that the move to the future test year by other regulators was due to prior periods of high inflation. As inflation is currently low, CAC/MSOS did not advocate adopting a future test year.

CAC/MSOS set out four factors pertaining to regulatory lag which need to be considered. The two negative factors are inflation and non-revenue generating capital expenditures. The two offsetting positive factors are customer growth and efficiency gains. CAC/MSOS asserted that the net of these factors does not always result in a rate of return lower than the allowed. CAC/MSOS believes that Centra could further reduce costs during the rate year to earn its allowed rate of return. CAC/MSOS believes that the netting out of the various factors as well as the addition of known and measurable adjustments results in just and reasonable rates for the consumer and gives Centra a reasonable opportunity to earn the allowed rate of return.

CAC/MSOS also contended that not enough time had elapsed since Order 143/90 to determine whether the current regulatory practice affords the Company a reasonable opportunity to earn its allowed rate of return.

CAC/MSOS dismissed Centra's interpretation of post facto disallowances as being punitive. In CAC/MSOS's view post facto disallowances operate as a restraint or incentive to be efficient. CAC/MSOS also asserted that forecasting expenditures that are not prudent or are never spent under a future test year would be punitive to the consumer.

## **9.0 Regulatory Incentives**

### **9.1 Centra's Position**

Centra argued that the incentive regulation evidence presented by CAC/MSOS was beyond the scope of the hearing as set out in Section 7.2 of this Order. Centra testified that the Public Utilities Board Act requires the use of rate base/rate of return regulation in Manitoba and as such, this hearing was not to debate the appropriateness of rate base/rate of return regulation or alternatives such as incentive regulation. Centra testified that CAC/MSOS had misrepresented the development of incentive regulation as being the result of deficiencies in future test year methodologies.

Centra disagreed with CAC/MSOS's assertion that historic test year methodologies are incentive systems, as the efficiencies gained by the Company are not shared between the Company and consumers as is the case in most incentive regulation systems. Centra also disagreed with CAC/MSOS that a future test year did not have incentives to be efficient. Centra stated the Board could revise the Company's forecasts for rate setting purposes as it saw fit, and further could set a range of allowed rates of return that could provide incentives to be efficient.

### **9.2 CAC/MSOS's Position**

CAC/MSOS clarified that it was not recommending the use of incentive regulation but rather putting incentives forward as an issue to consider in the decision to move from a historic test year.

CAC/MSOS argued that a historic test year has a built-in incentive for the Company to cut costs and gain efficiencies in order to earn in excess of its allowed rate of return. If the Company does nothing, it will not earn its allowed rate of return. CAC/MSOS also testified that even though a forecast is the best estimate of actual costs, such costs do not necessarily equal efficient costs. CAC/MSOS asserted that there was no incentive to increase efficiencies thereby increasing the rate of return in a future test year, as this would be viewed as a forecasting error that the regulator would adjust in the future. CAC/MSOS also concluded that efficiency could not be measured in a future test year by such means as benchmarking as it was costly, not particularly insightful, and inconclusive as other comparable utilities may not be efficient. CAC/MSOS indicated that incentives available under a future test year such as a range of allowed rates of return under a future test year were limited.

## **10.0 Regulatory Burden**

### **10.1 Centra's Position**

Centra testified that moving to a future test year would make the regulatory process more efficient, provide the regulator full opportunity to review prospectively the Company's plans and eliminate the confusion of a composite mix of actual data and known and measurable adjustments. The change would facilitate a more cost effective and efficient regulatory process.

In Centra's opinion, failure to move to a future test year has increased regulatory burden. Centra testified that the current regulatory process is expensive and inefficient because of the detailed review of historic information. Centra also believes that the current hybrid of historic data, forecast data, known and measurable adjustments and deferral accounts is not only confusing and time consuming to review but the end result does not necessarily correspond to the Company's plans or current operations. Centra considers that a review of the forecasted plans and activities of the Company would be less confusing, more realistic and require less resources as the review would be at a higher, focused level as opposed to a detailed line by line analysis. Under a future test year the detailed transactional analysis would not be available.

Centra is of the opinion that the Board would not be disadvantaged in the review of forecasts under a future test year, as the Board already reviews part actual and part forecast data in the current methodology. To Centra, the question is only one of degree.

### **10.2 CAC/MSOS's Position**

CAC/MSOS's position is that a future test year will increase the regulatory burden as it will require the Board and intervenors to review the historic operating results, the bridge-year forecast, updated data and the rate year forecast data. Besides the review of three years' data, CAC/MSOS did not agree that the level of review would be necessarily higher as it would be determined by the Board, intervenors and the timeframe of the hearing, not Centra. CAC/MSOS testified that other jurisdictions which use the future test year do not use the higher level review approach. CAC/MSOS did not agree that known and measurable adjustments were time consuming and confusing and testified that if regulatory lag is a problem, then known and measurable adjustments could be expanded and consequently a future test year was not needed.

CAC/MSOS was also concerned that the extra time and resources required to review forecasts would lead to spot checking of certain expenditures rather than a thorough review of the entire application. CAC/MSOS noted that Centra always has the advantage over regulators and intervenors as Centra has better knowledge of its costs. This advantage would only increase when reviewing forecasts that were as much as 18 months into the future.

CAC/MSOS testified that the responsibility of the management of a utility was to reduce the risk to shareholders and as such, management would be conservative and tend to overstate expenses and understate sales in order to build flexibility into rates. Management would tend to spend their approved budgets so that any overearnings would not be sufficient to trigger a response from its regulator.

## **11.0 Monitoring Requirements and Evaluation of Performance**

### **11.1 Centra's Position**

Centra's stated that further discussion needs to be held between interested parties to decide on the form of the application, process and monitoring requirements. Some of the monitoring requirements suggested by Centra include periodic audits by the Board, technical conferences and monthly or quarterly reporting of forecasts versus actual results in order to reduce the time spent discussing these issues at the hearing. Centra concluded that these issues had not been canvassed at sufficient length for the Board to make a decision at this time.

Centra agreed that information on the performance of Centra and the calculation of the actual rate of return should be provided only as information and rates should only be adjusted if the difference from the allowed rate of return is significant. If there were consistent overearning, then the Board could make adjustments at future rate applications to correct this. The evaluation should be on an overall basis rather than a detailed line by line basis. Although Centra favoured the evaluation of performance on a weather normalized overall rate of return basis, Centra suggested that this matter should also be debated in the future before the Board makes its decision.

### **11.2 CAC/MSOS's Position**

CAC/MSOS's position with respect to the evaluation of the performance of the Company was that the weather normalized return on equity should be calculated based on the audited financial statements as investors and credit rating agencies do not look at regulatory calculations of rate of return.

## **12.0 Transition**

**Centra believes that moving to a future test year which relies entirely on forecasted information would not be a significant departure from the current situation, since Centra's current application is based on a combination of forecast and actual data. The financial consequences will depend on the year of transition and how certain transition issues such as deferral charges are treated.**

**Centra estimated that if the 1994 test year application is based on a future test year methodology, the impact would be in the \$900,000 range. Centra indicated that the \$900,000 was a rough estimate and that a more exact estimate could not be made until a future test year filing was completed. In Centra's opinion the rate impact should be irrelevant to the Board's decision on a future test year as the transitional impact could be phased in over a period of time.**

**Centra acknowledged that certain "bridging" information would be required in the transition process, and that further discussions should be held with the Board to formulate the future test year process and the appropriate level of information to be filed in support of a future test year application.**

## **13.0 Summary of Intervenor's Positions**

### **13.1 CAC/MSOS**

For reasons set out earlier CAC/MSOS recommended that the Board not adopt the use of a Future Test Year. However, if the Board does accept that an adjustment should be made then such adjustments should be made to the current historical test year methodology.

### **13.2 Municipal Gas Company**

Should a future test year be approved, Municipal recommended that the Board should determine the monthly reporting procedures of Centra, call a hearing if Centra overearns, reduce the overall rate of return because of lower risk, and pass on any savings to the consumers of Manitoba.

### **13.3 Communication, Energy and Paper Workers Union**

CEPU concluded that moving to a future test year would be beneficial to the shareholders and that an accountable system would have to be implemented. CEPU hoped that the adoption of a future test year would not increase the amount of confidential information filed by Centra.

## **14.0 Presentation of Stittco Utilities Man Ltd.**

Stittco asserted that the use of historic test year costs as a basis for establishment of rates creates a mismatch of historically based rates and revenues with future incurred costs which is inconsistent with the fundamental principle of income determination. In Stittco's opinion, known and measurable adjustments under a historic test year only relieve a portion of the regulatory lag.

In Stittco's opinion, an effort to determine the required rates of a utility necessarily involves some short-term forecasting. While such forecasts may be approximate and subjective, there are well established forecasting methodologies that lend these estimates a reasonable degree of accuracy, probability and credence. Should the Board have any concerns about accuracy or abuse in cost forecasting, it will be monitoring the results and has powers of remedy.

Stittco urged the Board to adopt a future test year as the basis for its regulation of utilities for the following reasons:

1. It is fair to both consumers and the utility that future incurred costs be properly reflected in future service rates and revenues;
2. The greater the consistency and appropriateness of utility cash flows and income, the better the utility's access to sources of capital, particularly access to equity capital in order to continue to provide and to expand its service to consumers; and
3. The vast majority of utility regulatory agencies in Canada employ future test year regulation to help achieve these results.

## **15.0 Board Findings**

### **15.1 Need and Appropriateness of a Future Test Year**

The Board has considered the positions of all parties with respect to the issue of a future test year. The Board is satisfied that the scope set out for this hearing has been fully canvassed including a review of the need and appropriateness of a future test year, any necessary regulatory process change that may be required as a result of moving to a future test year and the measurement of the financial results of Centra under a future test year regime.

The Board has acknowledged in previous decisions that the mid-year historic test year was not providing a fair opportunity for Centra to earn its allowed rate of return. At the time the Board accepted that a mismatch was occurring as the previous year's costs were being used to develop future rates. This has been referred to as regulatory lag.

In Order No. 143/90 dated October 15, 1990, the Board approved some changes in regulatory methodology. Changes included the use of a test year with both historic and forecast data in order to make the effective date of rate changes earlier and also included the increased use of deferral accounts and known and measurable adjustments.

In approving these changes the Board noted that the changes ". . . will improve the Company's opportunity to earn its approved rate of return but will not do so to the extent requested by the Company." (page 22, Order 143/90). The current regulatory methodology does not fully afford Centra an opportunity to earn the allowed rate of return.

The Board is satisfied that Centra should be given an opportunity to file an application on a future test year basis and accordingly be provided a fair opportunity to earn its allowed rate of return. The rate implications resulting from this change in methodology are reduced because of today's current economic climate of low inflation.

The Board accepts CAC/MSOS's position that regulatory lag creates an incentive for Centra to find efficiencies to offset the fact that its rates are out of step with its current revenue requirements. However, in the Board's view the incentive occurs by happenstance rather than by design, and, in periods of high inflation and significant non-revenue generating capital expenditures, any such efficiencies may not be sufficient to offset regulatory lag. In the Board's view, through, close scrutiny of Centra's plans and operating costs and the use of a range of allowed rates of return such incentives can be established in a future test year regime.

The use of a future test year will negate the need for known and measurable adjustments which require considerable hearing time to consider. Furthermore, to some extent, it will also minimize the use of deferral accounts which tend to

raise some questions of intergenerational equity. Accordingly, the regulatory process should become more efficient resulting in less regulatory cost which is beneficial to all customers.

Further, the use of a future test year should maintain or improve ratings from bond rating agencies which should result in lower debt and equity costs which will lower the revenue requirements of Centra. These are matters that will be examined carefully should Centra request a future test year.

In recent general rate application hearings, the Board has observed an increased level of sophistication in the Company's internal planning and financial forecasting procedures. A five-year strategic plan is now prepared and updated annually. An indepth examination of the forecast operating results and capital programs will allow the Board to better assess the direction of the Company on a pro-active rather than a re-active basis, as found under the current test year methodology.

## **15.2 Regulatory Process Changes**

### **15.2.1 Form of Application and Level of Review**

The Board does not accept Centra's position that the review of a future test year application would entail a high level examination only. The Board realizes that a forecast is based on assumptions rather than numerous actual transactions, but believes that the review of forecasts requires testing these assumptions in conjunction with the plans of Centra. The Board expects that a rate application under any regulatory model will contain sufficient detail for the Board to discharge its responsibilities under The Public Utilities Board Act. The Board also expects that a future test year application would include a similar level of detail as the historic test year application.

The Board believes that with respect to the form of application for a future test year, the application should include the previous year's actual data, the current year's actual and forecast data (updated for any material changes before the hearing) as well as the rate year's forecast data (updated for any material changes before the hearing).

The Board is sensitive to the arguments put forth by CAC/MSOS that management of a utility may tend to overstate expenses and understate sales and furthermore spend their budgets so that any overearnings do not trigger a response from its regulator. In the Board's view, through the appropriate schedules and other data and due diligence in the examination of the Company's operating results, such occurrences will be minimized. The Board will not tolerate such activity and will hold Centra's shareholders accountable for such actions.

### **15.2.2 Transitional Issues**

The Board notes that there are a number of transitional issues in the move to a future test year and as such believes that Centra's suggestion to have further discussions on transition issues as well as monitoring and reporting requirements, has merits. Such further discussions will be set by the Board at a future date.

### **15.2.3 Monitoring and Reporting Requirements**

The Board has reviewed the reporting and monitoring requirements of Centra Gas Ontario Inc. and Pacific Northern Gas Ltd. that were provided as an undertaking by Centra.

Subject to the further discussions that were described above, the Board will direct Centra to file the following on an interim basis commencing with the first quarter of the first rate year determined on a future test year basis:

1. Schedules of the following, including year to date actual results compared to year to date forecast results with explanations of significant variances and an annual outlook forecast compared to the approved forecast with explanations of significant variances:
  - i) income statement
  - ii) plant additions and retirements
  - iii) capitalization and cost of capital
  - iv) volumes and revenues by customer class
  - v) balances in deferral accounts
  - vi) shared service charges/recoveries
  - vii) operating expenses by responsibility centre
2. Any management discussion and analysis that Centra feels may impact rates shall be provided to the Board.

In addition to the reporting requirements listed above, Centra shall also file the following information on an annual basis:

1. The annual report and the audited financial statements;
2. A calculation of the actual rate of return of Centra and a discussion of the reasons for the difference between the actual and allowed rate of return;
3. A comparison of actual versus forecast rate base with explanations of significant variances; and
4. A comparison of the actual versus forecast revenue requirement and revenue deficiency or surplus.

### **15.3 Evaluation of Performance**

The Board believes that the evaluation of the performance of Centra should be on the basis of a weather normalized rate of return on equity calculated using actual debt costs and actual equity capitalization.

However, regardless of the method of evaluation, the Board believes that the reasons for the differences between the actual and allowed rate of return provide important information and could include such factors as forecasting errors, unforeseen events, changes in interest rates and additional operating efficiencies. The Board will review the reasons for variances when considering what action, if any, is required. Therefore the Board will order Centra to provide such information with the calculation of the actual rate of return.

## **16.0 IT IS THEREFORE ORDERED THAT:**

- 1. The Board will allow the use of a future test year model, should Centra choose to file future General Rate Applications on that basis.**
- 2. The form of application for a future test year should include the previous year's actual data, the current year's actual and forecast data (updated for any material changes before the hearing) as well as the rate year's forecast data (updated for any material changes before the hearing).**
- 3. The Board will convene a further meeting at a later date to discuss transition issues as well as monitoring and reporting requirements. Subject to further discussions, Centra shall file the following on an interim basis commencing with the first quarter of the first rate year determined on a future test year basis:**
  - a) Schedules of the following, including year to date actual results compared to year to date forecast results with explanations of significant variances and an annual outlook forecast compared to the approved forecast with explanations of significant variances:**
    - i) income statement**
    - ii) plant additions and retirements**
    - iii) capitalization and cost of capital**
    - iv) volumes and revenues by customer class**
    - v) balances in deferral accounts**
    - vi) shared service charges/recoveries**
    - vii) operating expenses by responsibility centre**
  - b) Any management discussion and analysis that Centra feels may impact rates shall be provided to the Board.**
  - c) In addition to the reporting requirements listed in (a), Centra shall also file the following information on an annual basis:**
    - i) the annual report and the audited financial statements.**
    - ii) a calculation of the actual rate of return of Centra and a discussion of the reasons for the difference between the actual and allowed rate of return.**
    - iii) a comparison of actual versus forecast rate base with explanations of significant variances.**
    - iv) a comparison of the actual versus forecast revenue requirement and revenue deficiency or surplus.**

