M A N I T O B A	)	**Order No. 138/06**
	)	
THE PUBLIC UTILITIES BOARD ACT	)	**October 2, 2006**

BEFORE: Graham F. J. Lane, C.A., Chairman
Monica Girouard, C.G.A., Member
Susan Proven, P.H.Ec., Member

INTERIM PROPANE RATES FOR STITTCO UTILITIES MAN LTD.

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1.0 EXECUTIVE SUMMARY

By this Order, the Public Utilities Board (Board) defers consideration of a further revision to propane rates for Stittco Utilities Man Ltd. (Stittco), and confirms a December 15, 2006 hearing date for Thompson, Manitoba at which the Board will consider Stittco's application for reduced regulatory oversight, rates and other matters.

Stittco applied for rate increases of 6.1%, most lately revising the proposed implementation date to November 1, 2006. If approved, residential rates would have increased by approximately 24.9% compounded from the rates of April 1, 2005: residential rates having increased by 10% on October 1, 2005, a further 7.00% on February 1, 2006, and, if Stittco's application had been approved with this Order, another 6.1%.

The major factor driving up rates has been, until recently, increasing propane commodity prices, a similar situation to what, also until recently, has been experienced with oil and natural gas. Secondary factors for rate increases are Stittco's non-commodity operating costs and the allowable return on shareholder's equity.

Stittco has also applied for rate deregulation, or, in the alternative, complaint-based regulation. Through a Public Notice and bill inserts, the Board invited public comments, and some customers have responded.

As is the case with rate applications, the Board may approve, decline or vary Stittco's application following the December 15, 2006 hearing.

2.0 RATE APPLICATION AND BACKGROUND

Incorporated in Manitoba, Stittco distributes propane brought in by railcar through pipeline distribution to approximately 1,100 customers in Thompson, Flin Flon and Snow Lake. As well, Stittco sells and installs propane appliances, these sales being secondary to the propane distribution business. Stittco's operations are subject to regulation and oversight by the Board.

Stittco has provided regulated propane services to customers in Northern Manitoba since 1963. The initial term of the Company'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 a longstanding option to purchase the system.

Stittco Energy, the parent company of Stittco, is not regulated by the Board. Stittco Energy sells propane through the use of tanks, rather than by pipeline, to the same communities served by Stittco, as well as other communities both within and outside of Manitoba. Stittco Energy performs certain functions for Stittco and levies an annual administration charge against Stittco of 12% of Stittco's operating costs.

In addition, Stittco pays Stittco Energy a “thru-put” fee with respect to the delivery of propane, the supply of storage facilities and for system operation and emergency service for Flin Flon and Snow Lake. On the other hand, Stittco Energy pays Stittco an annual fee for the use of Stittco’s Thompson utility storage and facilities and the propane cylinder filling facilities.

The Board has neither received nor reviewed the financial results of Stittco Energy.

Initially, on January 30, 2006 Stittco applied to the Board for rate increases of 6.1% to be effective April 1, 2006. Stittco renewed its rate application on August 9, 2006, though with a revised proposed implementation date of September 1, 2006. In late September, Stittco further revised its application, seeking consideration of a November 1, 2006 implementation date.

A comparison of existing rates, pursuant to Order No. 133/05, and the rates sought by Stittco is set out below:

	Proposed September 1 2006	Current Order 133/05
Cubic meters	Rate per cubic meter	
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 accepted by the Board.

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

Year	Order #	First 50 meters	% Inc.	Over 50	% 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
2006	proposed	2.4526	6.1	2.0283	6.10

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

Stittco’s expenditures for propane and transportation to Stittco are reflected in rates without markup. Other costs reflected in rates include other operating expenses, regulatory costs, and deprecation. As well, rates reflect a provision for income taxes and a return on shareholder equity.

With respect to Stittco's transactions with its parent company, Stittco Energy, Stittco reports for 2005/06 and/or forecasts for 2006/07 the following:

	2005/06	2006/07
Revenue, use of Thompson facility	$ 51,600	$ 51,600
Expenditures:		
Contract services	$109,502	$ 95,248
Administration fee	139,872	145,086
	$246,374	$240,334
Net, payments to parent*	$194,774	$188,734

* Excludes dividends.

While past practice has the Board reflecting all of Stittco's expenditures and the provision for income taxes and a return on shareholder equity in rates, this is not a requirement. Costs are allowed for recovery through rates if determined by the Board to be prudent and reasonable as to purpose and amount.

Stittco's application, both the initial January 2006 version and the August 2006 renewal, were driven by then-higher propane prices, the latter pursuant in part to a new twelve-month propane supply contract, which replaced a contract that expired March 31, 2006.

The new contract with Keyera Energy, which arose out of a tender issued to thirteen companies to which four companies responded, prices supplied propane volumes half on a variable basis and half on a fixed price. The fixed price portion is priced at $352.64 per cubic meter F.O.B. Thompson (prior contract fixed price component was $330.70); as of the end of July 2006, the variable price was $372.12 (as of April 1, 2006, the variable price was $338.12 per cubic meter).

Stittco's renewed interim rate application assumed an overall commodity product cost of $360 per cubic meter for fiscal 2006/07, only slightly changed from the Company's January 2006 estimate of $359.14 per cubic meter. On a cost per litre basis, commodity costs advanced from 2002's level of $0.185 to $0.2738 for the year ended July 31, 2005, and to a projected level of $0.359 for the year ended July 31, 2006.

Stittco's application projected that then-recent higher propane commodity prices would be sustained at least through to the fiscal year end of July 31, 2007.

Propane prices rose sharply during 2005, and then fell considerably in early 2006 during a period of unusually warm winter weather. From then through to the renewal of Stittco's application in August, 2006, propane prices rose again. The Board understands that wholesale propane prices, despite the commodity being a derivative of natural gas, are driven by factors similar to those that impact prices of oil, gasoline and diesel as well as natural gas.

Stittco’s audited financial statements as of and for the year ended July 31, 2005 reported:

- Revenue, $4.079 million (2004, $4.303 million);
- Cost of sales, $2.383 million (2004, $2.342 million);
- Gross margin, $1.696 million (2004, $1.961 million);
- Other expenses, $1.449 million (2004, $1.417 million), comprised of:
  - Operating expenses, $772,000 (2004, $755,000);
  - General and administrative, $527,000 (2004, $521,000);
  - Amortization and accretion, $150,000 (2004, $141,000).
- Provision for income taxes, $96,000 (2004, $211,000);
- Net income, $151,000 (2004, $333,000); and
- Dividends paid, $175,000 (2004 - $200,000).

Stittco’s July 31, 2005 Balance Sheet reported:

- assets of $1.917 million (2004 - $2.122 million), comprised of:
  - Property, Plant and Equipment, net of accumulated amortization, $1.290 million (2004 - $1.226 million); and
  - Current assets, $628,000 (2004, $896,000).
- Current liabilities, $392,000 (2004, $563,000)
- Provision for asset retirement obligations and future income taxes, $307,000 (2004, $316,000)

- Shareholder equity, $1.218 million (2004 - $1.243 million), comprised of:
  - Shares issued, $1.201 million, (2004, $1.201 million), and
  - Retained Earnings, $17,000 (2004, $42,000).

Stittco's retained earnings are the result of the cumulative result of two ongoing annual events, the recording of net income and the payment of a dividend to Stittco Energy.

Despite higher commodity prices, Stittco's cost of sales for fiscal 2004/05 were only marginally higher than for the previous year, this because of lower sales volume. Lower sales than those forecast generally result in net income being below that initially forecast, which leads to reduced income taxes and dividends, and a rate of return on equity lower than that allowed in rates.

Audited financial statements for the year ended July 31, 2006 were not available at the time of the August renewal of Stittco's application; in lieu of audited statements, Stittco then-provided the Board with projected results. According to the Company's estimates, the year ended July 31, 2006 resulted in:

- overall revenue of $4.376 million (2004/05 – $4.079 million);
- operating margin of $1.4558 million (2004/05 – $1.696 million);

- operating expenses of $1.066 million (2004/05 – $1.310 million);
- accretion expenses of $0.016 million (2004/05 – $0.015 million);
- amortization of $0.137 million (2004/05 – $0.135 million);
- income before income tax of $0.013 million (2004/05 – $0.245 million);
- provision for income taxes, $0.0005 million (2004/05 – $0.096 million);
- Net income, $8,970 (2004/05 – $150,523); and
- Dividends paid, nil (2004/05 - $175,000).

The projected balance sheet as of July 31, 2006 reported:

- total current assets, $0.542 million (July 31, 2005, $$0.628 million);
- net fixed assets, $$1.179 million (July 31, 2005, $1.290 million);
- total current liabilities, $0.197 million (July 31, 2005, $0.392 million); and
- shareholder’s equity, $1.227 million (July 31, 2005, $1.218 million).

From a shareholder’s perspective, fiscal 2005/06 results were poor, following a mediocre year in the prior year. The Board understands that the projected results for 2006/07, even worse from a net income perspective, were significantly impacted by “record” warm weather through the winter of 2005/06 and the spring of 2006.

As previously indicated, commodity costs are passed on to customers through rates without mark-up. Rates are established based on forecast commodity prices and costs, and 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 Purchase Propane Variance Accounts (PPVA), for later reflection in rates.

As at June 30, 2006, PPVA accounts had credit balances (owing to customers) of $4,222 and $86,588, for domestic (residential) and commercial (non-residential) customers respectively. In its renewed interim rate application, Stittco projected PPVA balances as of July 31, 2007 of zero, based on the assumption that propane prices remained high and the Board granted rate increases.

The Board monitors PPVA balances on a monthly basis, and will again review the balances as of November 30, 2006, at the December 2006 hearing.

In its initial January 30, 2006 filing, Stittco's support for the proposed 6.1% increase was based in part on projections of:

- modest increases in operating and other non-commodity costs;
- projected increases to the unit cost of propane;
- projections of a further decline in propane sales volume (volume declines require higher rates if non-commodity

costs and the allowable rate of return on shareholder's equity/rate base is to be generated); and

- continuation of an allowed rate of return on rate base/shareholder's equity of 10.83%.

From fiscal year 2002/03, the Board has allowed Stittco a 10.83% rate of return on rate base and shareholder's equity. Prior to 2002/03, the Board allowed an annual rate of return of 13.75% for the fiscal years ended in 1985 through 1998, and a 10.89% return for the fiscal years ended 1999 through 2001. Stittco holds that a fair rate of return on shareholder's equity would be 11.37%, approximately .5 of 1% higher than recently allowed.

Rate base and shareholder's equity (capital stock and retained earnings) are basically the same because the Company's capital structure is entirely composed of shareholder equity, with no long-term debt. Stittco's has long-contended an inability to secure long-term debt on its own creditworthiness.

With respect to actual annual rate of returns 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 the fiscal year ended July 31, 1990, Stittco has exceeded a 10% actual return in only two years, the years ending July 31, 1996 and 2003);

b) fourteen years of actual rates of return between 5% and 9.99%, the last such year being year ended July 31, 2004;

c) three years of actual rates of return between 1% and 4.99%, the last such year being the year ended July 31, 2005; and

d) One year of an actual rate of return below 1%, that being the projected return for the year ended July 31, 2006.

Stittco confirms that over the last two decades it has not obtained the average allowed annual rate of return. Simple non-weighted averages of actual and weather-normalized rates of return during this 23-year period approximate 8.19% and 9.22%, respectively – considerably below the simple average of the allowable rate of return for the period, that being 12.20%.

Stittco attributed the shortfall to competitive conditions, advising that severe competition has led to decreasing annual volumes, volumes that would have decreased even further except for:

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

Competition comes from the other sources of energy available to consumers and businesses in Stittco's service areas, in particular, electricity. Stittco reports and/or forecasts the following customer and propane volumes:

Fiscal Year	Customers Residential	Customers Commercial	Volume (litres)
2002/03	891		3,119,886
		172	6,047,673
			9,167,559
2003/04	897		3,032,376
		170	5,782,837
			8,815,213
2004/05	885		2,920,587
		163	5,457,973
			8,378,560
2005/06	869		2,507,716
		170	5,408,315
			7,916,031
2006/07	859		2,670,000
(forecast)		170	5,561,000
			8,231,000

Average consumption by residential and commercial customers in 2002/03 was 3,501 and 35,161 litres, respectively. Forecast average consumption for 2006/07 is 3,108 and 32,712 litres, respectively – representing forecast average annual consumption decreases of approximately 3% and 2%, respectively.

The current rate application continues to reflect a return on rate base/shareholder’s equity of 10.83%, though Stittco holds that the rate should be 11.37%. In its supporting material for the application filed in January, 2006, 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 Emerald Regulatory Services, a firm engaged by Stittco.

Emerald then-opined that a fair rate of return on Stittco's equity would not be less than 12.75% per annum, and that as Stittco could not secure long term debt financing on its own credit, the appropriate capital structure was 100% equity with no debt component. Notwithstanding Emerald's opinion, Stittco then-applied for and received a return on rate base of 10.89%, a rate of return subsequently marginally reduced, since fiscal 2001/02, to 10.83%.

Supporting Emerald's analytical approach to arrive at what it considered an appropriate rate of return on equity, Stittco has cited:

a) Alberta Energy and Utilities Board Order U2005-140;
b) a published National Energy Board opinion with respect to risk premiums in declining interest rate environments; and
c) Canada long bond expectations of, as of January 2006, for 2006 of 4.78% (172 basis points lower than the long bond yield of 1998 that was cited in the Emerald study).

Extrapolating from Emerald's study, Stittco opined that Emerald's study would support a revised current rate of return on common equity (shareholder capital) of 11.37%. Yet, Stittco opined that competition was such that a 11.37% rate of return on equity could be considered too low, and that a higher allowable rate of return would be fair given the extant risks.

In Stittco's opinion, this view of the effects of competition is substantiated by non-achievement of the allowable rate of return over the last two decades.

Stittco previously filed a copy of a letter from its bank denying it 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 required a guarantee from Stittco's parent company before considering granting long-term credit, and Stittco advised an unwillingness to seek a loan guarantee from its parent. 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.

3.0 DEREGULATION APPLICATION

Concurrent with its January and August rate applications, Stittco also 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.

As previously indicated, in the alternative, Stittco seeks complaint based regulation, proposing that the Board provide it with authorization to charge the rates that it files with the Board, subject to unresolved complaints that may be received by the Board from Stittco's customers.

Stittco represents itself as a small public utility with competitive disadvantages. The Company indicates that competitive pressures are strongest with respect to electricity, where, according to Stittco:

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

Stittco reported that its future viability is inextricably linked to its ability to reduce costs and charge competitive rates.

Competitive rates are based in part on restrained costs. The Company opined that the cost of regulation under the present model is not insignificant, citing that the 1991 General Rate Application hearing process cost $65,000. Stittco notes that following that process it sought adoption of a "least cost regulation", since in place, to eliminate $50,000 of the $65,000.

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 that the annual regulatory fee levy is $10,460, and opines that:

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

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

In short, Stittco claims competition would protect the public interest without the Board regulating rates, and reduced regulation would bring down costs.

In further support of its application for reduced Board oversight, Stittco cites regulatory precedent in the approach taken by the National Energy Board (NEB):

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

The Company notes 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, who may file a complaint. Stittco indicates that in the absence of a complaint, NEB normally does not undertake a review of rates, though in the event of a complaint it may review rates for fairness.

Stittco proposed that the Board hear its deregulation application in an oral hearing, following adequate notice to customers.

Stittco responded to all Board interrogatories posed following its August filing, and these responses have been considered by the Board in the preparation of this order.

4.0 PUBLIC NOTICE AND RESPONSE

Stittco, on the direction of the Board, published a notice and provided an insert in customer billings advising of its rate application, its interest a reduction of regulatory oversight, and the Board intention to hold a public hearing in Thompson on December 15, 2006.

The notice and the inserts advised customers of the opportunity to express concerns or raise issues with the Board. Several of Stittco's customers availed themselves of the opportunity.

Responses were received from five residential and three commercial customers, and had one or more of the following themes:

a) concern over rate increases as to the effect on consumers;
b) contention that Stittco exaggerated the competitive aspects of its situation;
c) opposition to a reduction in regulatory oversight; and
d) concern with respect to the notice period and/or support for the proposed increases.

The responses were shared with Stittco to assist it in preparing for the December 15, 2006 hearing.

5.0 BOARD FINDINGS

With respect to Stittco's application for revised interim rates, the Board will defer the application and not approve interim rate increases at this time.

Stittco's August filing reported on then-propane prices, which, the Board understands, have since fallen significantly. The Board monitors Shell Canada Edmonton posted propane prices and notes that between August 1 and September 19, 2006, Shell's posted price fell 17%. While Shell is not Stittco's supplier and the prices quoted by Shell are FOB Edmonton, the recent price direction is apparent and not contested by Stittco.

Stittco's propane supply contract prices 50% of its supply on a fixed price basis and 50% on a variable market price basis. Given this, the Board is not prepared to increase the interim prices ahead of the scheduled December 15, 2006 hearing.

As differences between the costs incurred by Stittco for its propane supply and the rates charged related to the supply continue to be recorded within the PPVAs, no harm will accrue to either Stittco or their customers by the deferral.

In 2006, Stittco initially filed in January 2006 for an average 6.1% rate increases but that application was not sustained. Following that, Stittco refiled for 6.1% rate increases in August, seeking a September 1, 2006 effective date.

The Board was not prepared to consider a September 1, 2006 implementation date, and suggested that the earliest date a rate change would be effected would be October 1, 2006.

The possible implementation date was delayed to allow for notice to Stittco's customers and time for customers with concerns to so advise the Board. During September, posted propane market prices fell sharply.

Based on the Board's queries in regard to this price decline, Stittco subsequently asked that the effective date for the increase be changed from October 1, 2006 to November 1, 2006. This deferral was intended to give Stittco additional time to monitor current propane prices in order to determine if an amendment to the Interim Rate Application is warranted.

Deferring a decision on further rate changes to the December 15, 2006 hearing will allow the Board and Stittco's customers the opportunity for further discussion on such matters as:

a) propane supply costs;
b) the allowable rate of return on rate base;
c) affiliate company charges; and
d) Stittco's forecasts of customer levels and consumption for fiscal 2006/07.

As to Stittco's application for rate deregulation, or failing that, adoption of complaint based regulatory oversight, that will be heard at the December 15, 2006 public hearing in Thompson.

In summary, at the December 15, 2006 hearing in Thompson, the Board will:

a) hear Stittco's application for regulatory change;
b) review and, subsequently, finalize interim rates provided by Order 133/05; and
c) consider such other matters as may come before the Board, including, if the regulatory model is not changed, possible amendments to the allowable rate of return on rate base and shareholder's equity.

The December 15, 2006 hearing will be conducted in a bifurcated way. The Board will hear and receive evidence both with respect to rates and the regulatory model, but will conclude first on the question of deregulation.

If the Board finds for either Stittco's preferred form of regulation or its alternative proposal, that being Board involvement in rates only in the case of unresolved customer complaints, then the Board will not provide any determination on rates or any aspect of rates.

Under either Stittco's preferred or alternative proposal, the Board would not further involve itself with rates, which Stittco would set. Under such a circumstance, Order 133/05 would stand as the final rate determination of the Board, subject to future developments, either with respect to a complaint that may result in the Board’s future involvement or the Board’s revocation of a decision to allow rate deregulation.

Notwithstanding the Board’s determination on the regulatory model, the Board will continue oversight of pipeline safety. In exercising that authority, established by statute, the Board will continue to engage engineering consultants and invoice Stittco for such costs as may be incurred.

If either of Stittco’s regulation alternatives are accepted and difficulties subsequently develop with respect to gas safety or other matters, the Board may then consider revoking any decision previously made with respect to rate oversight. In such a circumstance, Stittco would anticipate a return to Board regulation of rates as well the continuation of the Board’s exercise of its oversight over safety.

As previously indicated, following receipt of Stittco’s renewed interim rate application in August 2006, accompanied by an application for rate deregulation, the Board directed Stittco to:

a) publish a Notice approved by the Board in the Swan River newspaper; the Notice provided information concerning its two applications (interim rate increases and regulatory changes);
b) include an insert with its next customer billing, providing the information contained in the Notice; and
c) respond to questions posed by the Board.

Stittco complied, first by issuing the Notice and inserts and, secondly, by responding to the Board’s questions. Customers with concerns contacted the Board. Thus, while a public hearing was not held with respect to the interim rate application, Stittco’s customers were provided the opportunity to comment on the application to the Board. Concurrently, Stittco’s customers have been alerted to the Company’s interest in rate deregulation.

The Board has:

a) reviewed the interim rate application;
b) considered Stittco’s responses to questions posed by the Board; and
c) considered such other information as was available and deemed relevant with respect to the operations and financial situation of Stittco, and the general propane supply market.

These actions were taken prior to reaching a decision to defer consideration of a rate change. In deferring Stittco’s rate application the Board raises concerns for exploration through the hearing process to follow, these concerns include:

a) Stittco’s capital structure, now 100% equity without any debt component;
b) the allowable rate of return on Stittco’s rate base, now established at 10.83%;
c) the level of charges made by Stittco’s parent and Stittco’s forecasts of customer consumption volumes for fiscal 2006/07.

Furthermore, as a component of the process to be associated with the December 15, 2006 public hearing, the Board will seek Stittco's comments and such further information as may be available to support or amend:

a) a 100% shareholder equity capital structure;
b) the presently allowed rate of return of 10.83%; and
c) propane prices and other cost and revenue matters.

The allowable rate of return is a function of two factors: the capital structure and the allowable rate of interest and/or return allowed on each component. The history leading to the current rate of return on shareholder's equity goes back to 1996.

At that time, the rate of return was established at 13.75%, developed by adding a risk premium of 4.5% to the then-long term Canada bond rate of 9.25%. For fiscal 1998/99, Centra sought a rate of return of 12.75%, based on a then-Centra Gas based formula which provided for a 6.50% rate for "risk free" debt plus a risk premium of 6.25%. If Stittco's proposal had been agreed to, it would have represented an increase in the risk premium of 39%. However, while not satisfied with the proposed rate of return of 12.75%, the Board agreed to a rate of return of 10.89%, a return not based on a concept but the anticipated return for that year.

The Emerald study commissioned by Stittco in 1998 recommended a rate of return of 12.55%, rather than the 12.75% proposed by Stittco and the 10.89% agreed to by the Board.

Emerald arrived at its proposed rate of return by adding to the then-long term Canada bond yield of 6.25%, a risk premium of 6.25% and a factor of .05% representing what it considered to be a warranted additional risk premium. For fiscal 2002/03, the Board again did not accept Stittco's proposed rate of return, but approved the-then expected rate of return of 10.83%. Again, the Board's approval was not based on a concept but what it considered to be a rate that was not excessive. Since then, the rate of return allowed has been 10.83%, with it applied to the full rate base as a capital structure comprised entirely of shareholder's equity continued to be accepted.

Since then, long-term Canada bond yields have fallen considerably and are now below 4.5% which is approximately -1.75% below the rate used in the Emerald study of eight years ago though no adjustment has been made to the allowable rate of return. And, the capital structure has remained one composed entirely of shareholder's equity.

Stittco has consistently advanced the view that it cannot obtain long-term credit on its own creditworthiness, and thus employs a capital structure comprised entirely of shareholder's equity, and that being primarily issued stock.

Despite accepting Stittco's representation of its market situation as being challenging, the Board notes Stittco's lengthy history of successful operations in its market.

The Company has regularly produced an annual profit and paid dividends to its parent, while having sufficient funds to finance capital expenditures and maintain its plant and pipelines in a safe manner. As well, the Board understands that Stittco's unregulated affiliate, its parent company, which sells propane by way of tank rather than pipeline, is an active business assisted in part by the sharing of some facilities and costs with Stittco and the levying of fees against Stittco.

The Board notes it is not unusual for a credit grantor to seek security extending beyond that available through the borrower itself, and such security often includes the benefit of a guarantee from a parent company. In the case of Manitoba Hydro, electricity being the main form of competition cited by Stittco, that Crown Corporation's bondholders are secured by guarantees from the Province.

The Board notes that one option to again be discussed at the Public Hearing is whether to deem a capital structure, one that includes a debt component, and to also deem an interest rate on that component. The Board advises Stittco of this option to permit Stittco to consider and address it, but until any such information is provided, the Board has no predetermined conclusion.

Generally speaking, the Board observes that the debt:equity ratios of private utilities are in the range of 60:40, rather than Stittco's 0:100. In saying this, the Board simply reiterates its intention as stated in Order 133/05 to review Stittco's capital structure and allowable rate of return.

The Board may allow the continuation of the present capital structure and allowable rate of return in rates, or accept another alternative to the structure and allowable rate now in place.

Again, while the Board will test matters related to capital structure, rate of return and related matters through the December 15, 2006 hearing process, it will not conclude on these matters until after receiving all information and reaching a conclusion on Stittco's regulation related application.

Stittco has not earned sufficient net income over the last twenty-three years to achieve its allowable rate of return. Stittco has, as previously indicated, attributed an average annual shortfall of 3% or more to competitive conditions, advising that severe competition has led to decreasing annual volumes, volumes that would have decreased even further except for:

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

The Board intends to review Stittco's inability to achieve its annual allowable rate of return through the upcoming hearing process. The Board wishes to satisfy itself as to Stittco's claim that is has been:

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

When rates are established through a General Rate Application (GRA) process, forecast costs for a forward test year are considered, with provisions established for income taxes and the allowable rate of return. Conceptually, after new rates are established pursuant to a Board Order arising out of a GRA, the major risk to Stittco of earning less than the allowable rate of return relates to the risk that propane sales volumes do not reach forecast levels.

Volumes sold may vary from the forecast levels taken into consideration when rates were established for three main reasons: a) weather, b) volume decreases due to customer action (energy efficiency measures and/or discontinuation of service), and c) inflation not projected when rates were set.

However, the weather factor, which may have been, in particular, a major determinant of the forecast poor net income results for fiscal 2005/06, is expected to balance out over the years, and presumably is not the cause of Stittco's under-achieving of the allowable rate of return.

As to the second possible reason for not achieving the allowable rate of return, presumably Stittco's forecasts of volumes incorporated into its rate proposals account for decreased volumes. However, it is possible that forecasts were, as it turned out, unduly optimistic with respect to customer retention and/or average consumption levels.

Finally, on inflation as a factor, the rate of inflation has been modest through the period and presumably was forecast by Stittco in its rate proposals, and therefore would not account for the under-achieving of the allowable rate of return.

There may yet be another possible reason that needs to be reviewed, and this is whether Stittco's negotiated rates with industry and large volume users are such as to depress earnings. Stittco is obliged to sell propane at Board-approved rates, with the exception that, by negotiation, rates for industry and large volume users may be set as long as the rates are not above the Board-approved rates and the Board accepts the rates so negotiated.

An answer to the perplexing question as to why Stittco has not managed to achieve its allowable rate of return over the past two decades will be sought during the December 15th hearing process.

The Board will also seek updates as to propane commodity market prices, the balances of the PPVAs, actual and projected, and test Stittco's financial projections for fiscal 2006/07. It is particularly important for the Board to gain an understanding as to the extent of the deleterious impact of competition on Stittco's financial results.

The Board notes that if Stittco's forecast of propane supply costs proves to be in excess of actual experience, the balance between the Company's forecast of commodity prices and the actual experience will accumulate in the PPVA for the eventual benefit of customers in future revised rates.

Costs arise to consumers as a function of two variables, rate levels and consumption. Stittco cannot control the market price of propane, but acting in support of its customers it can assist in reducing their bills through energy efficiency and heat retention initiatives. The Board is interested in gaining a further understanding of Stittco's prior actions and programs in this regard, as well as its future plans.

Stittco is to continue to inform its customers about propane price matters, and apprise them of available heat retention and heating efficiency initiatives available to reduce consumption and restrain bills. Stittco is to continue to undertake effective energy conservation educational measures, and such prudent and reasonable costs, as are incurred, will be accepted as an allowable cost to be recovered through rates.

As heating efficiency measures lead to future reductions in propane consumed, as appears to have been the case over the past four years, affecting Stittco's ability to recover its costs through rates, the Board will continue to support rates sufficient to recover costs.

The Board will expect Stittco to inform its customers of the Board’s decision to defer consideration of the applied for interim rate increases.

Rate deregulation

In advance of the December 15, 2006 process and hearing with respect to Stittco’s deregulation application, and given its significance, the Board outlines herein some of the matters and concerns to be addressed by Stittco, and others through the process and at the hearing.

The Board’s mandate is to reflect what is in the public interest, so its regulatory approach, as far as the approach is within the Board’s discretion to determine, is focused on the interests of Stittco’s customers and the Utility. The Board seeks cost-effective regulation, and value for the Company’s customers for the costs incurred and reflected in rates from regulation.

The Board has accepted for some time that Stittco is operating in a very difficult market environment, where electricity is said to have an approximate 30% cost advantage over propane, based on BTU equivalent basis. That said, and recognizing the decline in Stittco’s customer base has been relatively modest given the cited energy cost differential, there are likely reasons other than the avoidance of conversion costs that have resulted in Stittco’s customers staying with propane.

The capital investment in propane heating and the costs involved in switching to electricity may be a sufficient disincentive alone to leaving propane heating. The Board will inquire into the factors supporting propane supply during the December 15th hearing process.

Stittco's application comments on regulatory costs billed Stittco and reflected in customer rates, suggesting they are not cost-effective for consumers. Again, balancing the public interest objectives supporting regulation against the potential deleterious effects arising out of regulatory costs requires a dispassionate examination and knowledge of past costs, future expectations and the full range of options.

The Board has an interest in conducting such a review and welcomes Stittco's application as a means by which to do so. Such customers and other interested parties as decide to join in an open and transparent review through the December 15th hearing process are welcome.

Since the 1991 public hearing cited by Stittco at which the Board involved its legal counsel and advisors, incurring a substantial cost that was later, and for one year, reflected in customer rates, the Board has, as reported by Stittco, adopted a *least cost regulatory* approach. With respect to Stittco's cost concerns over the 1991 hearing, it is of note that the Board did not bill $65,000; a substantial portion of those reported costs may have been incurred directly by Stittco or its parent.

Unlike the Board's approach to Manitoba Hydro, Centra Gas or Manitoba Public Insurance, where extensive public hearing processes are held on a regular basis, and involve considerable costs, the regulatory approach taken to Stittco has reflected the relatively small size of the operation and its limited customer base.

Ahead of the December 15, 2006 hearing date, the Board has held only one public hearing for a Stittco application in fifteen years, that held in Thompson in 2005. For that hearing, and to restrain regulatory costs, the Board was not assisted by its legal counsel or professional advisors, and relied on its staff, Board members, and Stittco.

In addition, for the 2005 public hearing in Thompson, the Board invoiced Stittco only for a portion of the Board's travel costs, which costs were also apportioned to other utilities the Board attended during the same northern trip. Over the last fifteen years, the Board has invoiced Stittco only for the Board's out-of-pocket disbursements related to occasional reference of matters to its advisors and, excepting the 2005 travel costs, costs related to the Board's safety oversight.

Stittco has not requested and the Board has no intention of ceasing its oversight of safety, regardless of any decision it may make on the current rate deregulation application.

The annual fee cited by Stittco is set by regulation, not by the Board, and is intended to cover costs incurred by the Board with respect to staff and Board salaries and per diems, and general office overhead over the course of each year.

Over the past nine years, the Board has issued fourteen rate Orders with respect to Stittco, and considered quarterly filings with respect to PPVA accounts and safety-review reports filed by its engineering advisors. Processing a rate application requires time as well as experience, and involves both Board staff and Board members, and, occasionally reference to professional advisors, all of which has cost implications.

The Board has regularly accepted its regulatory costs as a cost to be recovered through rates, so regulatory costs, after taking into account the reduction in income taxes related thereto, likely have no impact on Stittco's rate of return on shareholder equity. That said, regulatory costs do have a rate impact. After tax, average annual regulatory costs billed or levied on Stittco since 1992 have represented less than 1% of the residential rate.

A major question to be addressed through the December 15th hearing process is whether the Board's approval of Stittco's application will provide a net benefit to its customers.

To save less than 1% on a rate approaching $2.50 has to be weighed against the "protection and assurance" provided customers through the Board's oversight of rates. Of course, the reduction in rates would arise only if the present annual fee regulation was repealed, a decision outside of the Board's jurisdiction.

Stittco incurs direct costs with respect to filing applications with the Board, and these costs need to be understood and evaluated as will be costs arising out of or related to Board regulation. The Board will seek to understand the full implications associated with acceptance of Stittco's regulatory application.

The Board has statutory authority to approve, decline or vary applications it receives from regulated utilities, and this authority extends to Stittco's deregulation application. It is in the public interest that the full range of regulatory options be considered through the hearing process, not just the regulatory preference and alternative advanced by Stittco.

Subsequent to Stittco's initial regulatory model amendment filing of January 2006, Board staff suggested other options to Stittco, options that will be considered through the upcoming process.

Conceptually, the Board could agree to reduce its regulatory oversight for non-residential customers, leaving residential rates regulated as is now the case. Residential customers may lack the financial resources available to non-residential customers with respect to the availability of conversion to another heating source.

Through questions posed to Stittco, Board staff sought Stittco's opinion on this further alternative, though Stittco has yet to respond, and did reference other regulatory options in its renewal of its application for deregulation or reduced regulation. Stittco advised the Board that it did not respond to the Board's questions that followed Stittco's January 2006 filing of a GRA because:

> "… as a matter of law, the Board could only consider the GRA if it had already rejected both of the … applications for diminished regulation. The legal concern was that the issuance by the Board of the information requests related to the GRA implied that it had already rejected the two proposals for diminished regulation, without a hearing. Such an action would be a denial of natural justice and an error of law that would be reviewable by a Court."

With due respect, the Board notes that Stittco, through counsel, provided its concern about proper process to the Board in July 2006 after five months had passed since the Board posed its questions. During that period, the Board monitored market propane commodity prices and PPVA balances to assure itself that the delay in reviewing rates did not represent a risk to either the consumers or the Utility.

Stittco may have misunderstood the Board's intent in providing the questions. No decision had or has been made by the Board on Stittco's application for diminished regulation. Board staff simply asked the questions to seek Stittco's views on additional alternatives to the regulatory status quo.

Board staff anticipated that Stittco would respond to the questions given the cooperative approach followed by the Company and the Board under the *least cost* regulatory model that has been in effect since 1991. The Board is not limited to Stittco's range of regulatory options, though it will most certainly consider the proposals of the Company.

A further regulatory model possibility for consideration is that the Board could seek a reduction of the annual regulatory fee now levied on Stittco by regulation. Potentially, the annual fee could be reduced, though the Board would then levy charges based on actual efforts undertaken and costs incurred (costs including an allocation of staff and Board panel salaries and per diems, other disbursements and related costs).

Through the December 15, 2006 hearing process, the Board intends to review all the alternatives with respect to regulating and assessing Stittco, and will undertake that review from a public interest perspective.

Following the December 15, 2006 hearing and with the Order that will follow Stittco Should expect that the Board will assess costs to Stittco with respect to its 2006 applications. Costs to be assessed will include disbursements incurred by the Board for advisory services, travel-related costs, and such other disbursements as the Board may incur.

6.0 IT IS THEREFORE ORDERED THAT:

1. Stittco's application for revised interim rates BE AND IS HEREBY DENIED.
2. Stittco is to notify its customers of the Board's decision by way of bill insert, with draft insert having first been approved by the Board.
3. Stittco shall continue to monitor PPVA developments, and provide a report to the Board on a monthly basis on the status of the PPVA accounts.
4. A public hearing will be held in Thompson on December 15, 2006 at which rate and regulation matters shall be considered.

THE PUBLIC UTILITIES BOARD

"GRAHAM F. J. LANE, C.A."
Chairman

"GERRY GAUDREAU, CMA"
Secretary

Certified a true copy of
Order No. 138/06 issued by The
Public Utilities Board

Secretary