

**MANITOBA** ) **Order No. 172/02**  
 )  
 )  
**THE PUBLIC UTILITIES BOARD ACT** ) **October 2, 2002**

BEFORE: G. D. Forrest, Chairman  
M. Girouard, Member  
S. Proven, Member

**AN APPLICATION BY STITTCO UTILITIES MAN LTD. FOR AN ORDER APPROVING:**

- 1. A Schedule of Sales Rates to be effective for all propane consumed on and after September 1, 2002.**
- 2. The discontinuance of the existing Rate Rider effective September 1, 2002.**
- 3. Final Confirmation of Interim Ex Parte Orders 182/99, 120/00, 4/01, 124/01 and 28/02.**

<b>Table of Contents</b>		<b>Page</b>
1.0	Background	3
2.0	The Application	4
2.1	General	4
2.2	Gross Plant in Service	5
2.3	Depreciation Expense	5
2.4	Working Capital Allowance	5
2.5	Rate Base	6
2.6	Rate of Return	7
2.7	Propane Supply and Propane Costs	8
2.8	Purchase Propane Variance Account	9
2.9	Operating and Maintenance Costs	9
2.10	Income Taxes	9
2.11	Revenue Requirement	10
2.12	Revenues and Net Income	10
2.13	Rates and Rate Impacts	11
2.14	Confirmation of Interim Ex Parte Orders	11
3.0	Board Findings	12
4.0	IT IS THEREFORE ORDERED THAT:	16

## 1.0 Background

The Manitoba Public Utilities Board (“the Board”) last approved a Rate Base, Rate of Return and Revenue Requirement for Stittco Utilities Man Ltd. (“Stittco”), based on a 1998 future test year in Order 158/98, dated December 21, 1998. Since then, the Board has issued, five interim ex parte Orders dealing with rate changes related to the numerous changes in the commodity price of propane and to the disposition of the Purchase Propane Variance Account (“PPVA”) balances.

In recognition of Stittco’s small customer base the Board, in Order 139/91, dated October 16, 1991, approved a model for use by Stittco for general rate applications (“GRA”) designed to minimize the cost and impact of the regulatory process. The approved model consists of the following six steps:

1. The Company will file with the Board, in written form, an application together with all of its sworn evidence in support of an application. Included in this application will be the proposed rates for which the Company is seeking approval.
2. The Company will notify all of its customers and franchisees of the proposed rate increases by way of a notice in a form approved by the Board. This notice will invite the customers and franchisees to provide written submissions in respect of the application by the Company, or any part of it, whether in opposition or in support. Additionally, the Board will publish a notice advising the consuming public that unless objection is raised, the Board will consider granting the application by the Company without an oral public hearing and on such terms as specified by the Board.
3. The Board will review the material and conduct such information requests as it believes are required. Any intervenors will be included in the information request proceedings.
4. After the information request procedure and written submissions from the consuming public have been received and considered, the

Board, in its sole discretion, shall decide whether an issue has been raised such that an oral public hearing is required.

5. In the event no opposition is filed, or, in the alternative, no opposition is filed which requires reference to an oral public hearing, the Board will issue a final determination and order in respect of the application.
6. The Company will then notify all of its customers and franchisees of the decision of the Board in a form to be approved by the Board.

## **2.0 The Application**

### **2.1 General**

Stittco filed an Application (as amended) seeking the Board's approval of a reduction in sales rates to be effective for all propane consumed on and after September 1, 2002, and approval for the discontinuance of an existing rate rider imposed on January 1, 2001, also, effective September 1, 2002.

Stittco did not request any change in the currently allowed rate of return and maintained that an appropriate capital structure for the Company remains at 100% common equity. Stittco indicated that because of competition from other fuel sources, namely electricity and fuel oil, the requested rates on a forecast basis, would afford the Company with an opportunity to earn a common equity rate of return of 10.83%.

Stittco also applied for the confirmation of Interim Ex Parte Orders that had been issued by the Board since December 21, 1998.

In accordance with the least cost regulation procedure, Stittco notified its customers of the proposed reduction in sales rates by way of advertisement,

requesting any comments to be forwarded to the Board by September 20, 2002. The Board did not receive any submissions regarding this Application.

## **2.2 Gross Plant in Service**

Stittco's gross plant in service is expected to increase to \$4,070,429 by July 31, 2002 and is projected to total \$4,150,420 at July 31, 2003, compared to the plant in service balance of \$3,985,313 approved in the 1998 GRA proceeding. The projected July 31, 2003 total plant represents an increase of \$165,116 (4.14%) in the four years. The majority of the increase is related to vehicle replacements and normal plant maintenance and rehabilitation over the four year period. No major plant expenditures have been undertaken and none are planned for 2002/03.

## **2.3 Depreciation Expense**

Stittco's depreciation rates remain unchanged from those used in the 1998 GRA. Depreciation expense for fiscal 2001/02 is forecast to be \$143,738 and is projected to decrease to \$142,869 in 2002/03. Accumulated depreciation, which was \$2,252,399 as at July 31, 1998, is forecast to be \$2,624,179 at July 31, 2002 and to increase to \$2,767,049 at July 31, 2003.

## **2.4 Working Capital Allowance**

Stittco's method of calculating necessary working capital allowance for determining Rate Base remains unchanged from that used in the last GRA. The method uses average monthly balances for propane and other inventory, accounts receivable arrears and pre-payments, and allowance for doubtful accounts. Cash working capital requirements are determined as being 1/8 of annual operating expenses plus 25/365 of the cost of purchasing propane. The

income tax component is determined as being 1/12 of 2001/02 income tax, for both 2001/02 and 2002/03 fiscal years.

The Board approved a working capital allowance of \$544,306 in Order 158/98. Working Capital is estimated to be \$616,129 in 2001/02 and forecast at \$533,809 for 2002/03. The majority of variance is related to the volatility in the cost of propane over the past several years, and the expected propane cost for 2002/03.

Income tax is approximately one-half of the 1998 allowance, due to decreased Company earnings since that time.

## 2.5 Rate Base

The following table compares Stittco's forecast rate base for 2001/02 and 2002/03 with that approved in Order 158/98.

	<b>Order 158/98</b>	<b>2001/02 Forecast</b>	<b>2002/03 Projected</b>
<b>PLANT IN SERVICE</b>			
Balance beginning of year	\$ 3,919,751	\$ 4,010,429	\$ 4,070,429
Net Additions	65,562	60,000	80,000
Balance at end of year	3,985,313	4,070,429	4,150,429
<b>Mid-Year Average</b>	<b>3,952,532</b>	<b>4,040,429</b>	<b>4,110,429</b>
<b>ACCUMULATED DEPRECIATION</b>			
Balance beginning of year	2,236,824	2,480,441	2,624,179
Net Additions	104,137	143,738	142,869
Balance at end of year	2,340,960	2,624,179	2,767,049
<b>Mid-Year Average</b>	<b>2,288,892</b>	<b>2,552,310</b>	<b>2,695,614</b>
<b>Mid-Year Average Net Plant</b>	<b>1,663,640</b>	<b>1,488,119</b>	<b>1,414,815</b>
Working Capital Allowance	544,306	616,129	533,809
<b>MID-YEAR RATE BASE</b>	<b>\$ 2,207,946</b>	<b>\$ 2,104,248</b>	<b>\$ 1,948,623</b>

## 2.6 Rate of Return

Stittco submitted expert evidence in 1998 prepared by Emerald Regulatory Services ("Emerald") that concluded an appropriate return on equity for Stittco was 12.75%. Emerald also concluded that an appropriate capital structure for rate making purposes was Stittco's actual capital structure of 100% equity, resulting in an appropriate overall rate of return of 12.75%. In Order 158/98, the Board stated that it was not convinced that, given the market conditions at that time, a fair normalized rate of return would be as high as 12.75%. However, because of competitive pressures, the rates approved in Order 158/98 were expected to generate a rate of return of 10.89%, which the Board found to be not excessive.

In this Application, Stittco indicated that in order to minimize regulatory costs it has not requested a new report, but submitted that the appropriate capital structure for Stittco remains as 100% equity and that the fair rate of return for the Company continues to be no less than 12.75%.

In response to a Board information request, Stittco updated the 1998 Emerald study and submitted that the appropriate rate of return was no less than 12.55%. This was based on Stittco's conclusion that the appropriate long-term bond yield was 6.25%, 25 basis points less than the previous yield. The decline in the bond yield translates into an increase in risk premium of about 5 basis points, after applying the formula used by the Board for other gas utilities in Manitoba. Stittco submitted that the 1998 Emerald study update would result in a 12.55% return; 6.25% yield, combined with the 6.25% risk premium determined in 1998 and the 0.05% increase in risk premium. Stittco further submitted that because of continued customer erosion and high propane costs leading to a further weakening of Stittco's competitive position, Stittco's risk had increased since 1998. This increased risk exacerbates Stittco's ability to raise long-term debt, and in Stittco's view 100% common equity remains an appropriate capital structure. Stittco also stated that, because of competition from other fuel sources, the requested rates were expected to yield a normalized rate of return of less than 10.83%.

## **2.7 Propane Supply and Propane Costs**

Since the last GRA, Stittco requested competitive bids for the supply of propane for a 12-month period commencing April 1 of each year. The most recent contract was for the period from April 1, 2002 to March 31, 2003. Stittco requested bids based on fixed as well as variable pricing from fourteen companies and received six bids. After an analysis of these bids, Stittco concluded that the best offer was the variable price option contract submitted by BP Canada ("BP"), and accordingly awarded the supply contract to BP.

Based on the BP contract, Stittco estimated the average price of propane for the 12-month period ending July 31, 2003 would be \$185.00 per cubic metre, F.O.B. Thompson. Stittco submitted that, while this price was higher than current spot market prices, it was the least of any firm quotes received from the six bidders. The average annual unit cost of propane has ranged from \$134.00 per cubic metre, and approved in Order 158/99, to a forecast price of \$236.00 for 2001/02 and to a projected price of \$185.00 for 2002/03.

Stittco's annual sales volumes have generally declined since 1998 due to erosion of its customer base. Stittco was providing service to 1,093 customers as of July 31, 2002, compared to 1,112 at July 31, 1999. Annualized sales volumes for 2002/03 are forecast to be 8,749,380 litres and projected to be 8,754, 200 for 2002/03, compared to 10,470,000 litres estimated and approved in Order 158/98. Based on these volumes, plus an allowance of 2% for unaccounted for product, and the estimated unit propane price of \$185.00 per cubic metre, Stittco is projecting 2002/03 propane commodity purchase cost of \$1,651,918 for 2002/03.

## **2.8 Purchase Propane Variance Account**



Stittco forecast the July 31, 2002 PPVA balance to be \$20,700, owing to customers. Stittco further proposed to continue tracking the difference between the actual and forecast cost of propane in the PPVA, with the accumulated balance to be disposed of at a future date. Due to other fuel competition, Stittco, rather than increasing PPVA related rate riders, assumed the PPVA balances in 1998 and in 2001/02.

## **2.9 Operating and Maintenance Costs**

The direct operating costs for the 2002/03 test year are projected to \$1,016,216 and administration fees to be \$121,946. This is a total increase of \$14,242 (1.27%) over that approved in Order 158/98. Increases are forecast in insurance costs (\$29,000), property taxes (\$11,500), automotive expenses (\$8,900), and wages and benefits (\$4,000). Expense categories expected to decrease are Administrative and General (\$23,200), other operating costs (\$14,000) and contract services (\$4,000). Other categories of operating expenses are forecast to remain almost unchanged from 1998 levels.

The administrative fee, which is payable to Stittco Energy for services provided to Stittco remains at 12% of direct operating expenses.

## **2.10 Income Taxes**

The Income Tax rate remains unchanged from the 41.2% used in the last GRA, which results in a projected income tax amount of \$207,266 based on a projected pre tax income of \$418,392, compared to the \$219,757 on a pre-tax income of \$460,220 approved in Order 158/99.

## **2.11 Revenue Requirement**

The following table summarizes the requested 2002/03 revenue requirement as well as that estimated for 2001/02 with comparisons to that approved in Order 158/98.

	<b>Order 158/99</b>	<b>Forecast 2001/02</b>	<b>Projected 2002/03</b>
<b>Cost of Propane</b>	\$ 1,431,253	\$ 2,102,862	\$ 1,651,918
<b>Excess to PPVA</b>	0	(892,456)	0
<b>1998 PGVA Balance</b>	46,000	0	0
<b>Other Cost of sales</b>	92,727	73,459	67,972
<b>Operating Expenses</b>	1,123,920	1,134,502	1,138,162
<b>Depreciation</b>	128,575	143,738	142,869
<b>TOTAL</b>	\$ 2,822,475	\$ 2,562,106	\$ 3,000,921

## 2.12 Revenues and Net Income

Based on projected 2002/03 sales volumes, Stittco is projecting \$3,242,821 in revenue from propane sales. Stittco's other projected sources of revenue for 2002/03 include \$84,000 from appliance and material sales, \$26,400 from service revenue and \$14,495 from other miscellaneous revenues. As well, Stittco will realize revenues, projected to be \$51,600, from Stittco Energy in consideration of Stittco Energy's use of Stittco's propane storage facilities in Thompson. Revenue from Stittco Energy remains unchanged from that received by Stittco in 1998. Total revenues for 2002/03 are projected to be \$3,419,316. This compares to an estimated 2001/02 revenue of \$2,815,676. The major difference is in the propane sales revenue, which is projected to be \$12,345 greater than that for 2001/02. Other revenue is projected to be approximately \$11,000 less than was realized in 2001/02. By way of comparison, Order 158/98 approved total estimated revenue of \$3,282,677. The following table indicates the net income and rate or return for 2001/02 and 2002/03 with comparison to the numbers approved in Order 158/98.

	<b>Order 158/99</b>	<b>2002/02 Forecast</b>	<b>2002/03 Projected</b>
Total Revenue	\$3,282,677	\$ 2,815,676	\$ 3,419,316
Total Expenses	2,822,475	2,562,106	3,000,921

<b>Pre-Tax Income</b>	<b>460,202</b>	<b>253,570</b>	<b>418,395</b>
Income Tax	219,757	130,131	207,256
<b>Net Income</b>	<b>240,445</b>	<b>123,438</b>	<b>211,129</b>
Rate Base	2,207,946	2,104,248	1,948,623
<b>Rate of Return</b>	<b>10.89 %</b>	<b>5.87 %</b>	<b>10.83%</b>

### **2.13 Rates and Rate Impacts**

Stittco's proposed rate structure remains unchanged from that last approved by the Board. Stittco continues to have two customer classes, Domestic Service and Commercial Service, and one special contract with the Thompson General Hospital. Stittco has applied for an increase in base rates to cover the projected revenue requirement for 2002/03. Stittco has also applied to have all existing rate riders related to disposition of PPVA balances eliminated. The net result is that proposed rates, including the rate for Thompson General Hospital will, on average, be 10.6% lower than the current rates.

### **2.14 Confirmation of Interim Ex Parte Orders**

Stittco applied to confirm as final the following Interim Ex parte Orders, each dealing with the imposition, change or elimination of rate riders related to PGVA balances,

1. Order 182/99, dated November 4, 1999 imposing a unit Rate Rider of \$123.00 per cubic metre.
2. Order 120/00, dated August 21, 2000 changing Rate Rider to \$309.00 per cubic metre and designating it as Rate Rider "A".
3. Order 4/01, dated January 9, 2001 imposing and additional Rate Rider "B" of \$434.10 per cubic metre.
4. Order 124/9\01, dated August 16, 2001 reducing Rate Rider "A" to \$186.00 per cubic metre.
5. Order 28/02, dated February 11, 2002 removing Rate Rider "A" of \$186.00 per cubic metre.

### **3.0 Board Findings**

#### **Rate Base**

The Board has reviewed the additions to Rate Base since Stittco's last GRA. The Board notes that the expenditures were primarily related to attaching customers to the system, transportation equipment, computer systems and metre replacements. The Board considers the total 5-year plant additions of \$383,236 to be reasonable and justified. The Board will approve Stittco's accumulated depreciation and working capital, both of which are calculated in the same fashion as in the previous Application. The Board notes that due to Stittco's declining customer base and aging plant, the 2002/03 rate base applied for is less than that approved in Order 158/98. The Board will approve a Rate Base of \$1,948,623 based on a 2002/03 future test year, as applied for by Stittco.

#### **Rate of Return**

The Board recognizes the strong competition from other fuel sources, primarily electricity, faced by Stittco and acknowledges that this has limited the ability to raise long term debt. The Board agrees that a 100% common equity is an appropriate capital structure for this utility, at this time. In Order 158/98, the Board stated that it was not prepared to approve an equity risk premium of 6.25% to be used as a starting point for future rate of return applications. The Board finds no compelling evidence in this Application which would cause it to change its view. However, the rates requested by Stittco are expected to generate revenues that will result in a forecast return of 10.83%, which the Board finds to be not excessive.

#### **Cost of Propane**

The Board is of the view that the process used by Stittco to tender for its annual propane supply contract is reasonable, given that all bids received were opened by Stittco staff in the presence of legal counsel. As well, the Board is of the view that the method used by Stittco to estimate the average annual propane cost to be adequate. The Board accepts Stittco's conclusion that the bid submitted by BP Canada, albeit based on a variable pricing mechanism, represents the best value for the supply of propane.

### **Operating, Maintenance and Administrative Expenses**

The Board notes that this component of revenue requirement is expected to increase by the amount of \$14,242 from that forecast in 1998 which represents only 1.5% increase over 4 years. The Board further notes the costs that are forecast to increase are largely beyond the control of Stittco. Bank charges, insurance premiums, property and capital taxes, fuel costs and bad debt expense are a reflection of the current circumstances and account for increases estimated to be approximately \$72,000. Decreased administrative costs, Board fees, and most other expenses offset these increases. Inter company billings and fees have not changed materially since 1998. The Board commends Stittco for its diligence in controlling expenses, and will approve Operating, Maintenance and Administrative Expenses as requested.

### **Income Tax**

Stittco's treatment of the small business deduction and the method of calculating Income taxes remains unchanged from that approved in Order 158/98. The Board will accept Stittco's Income tax calculation for the purposes of establishing sales rates effective September 1, 2002.

### **Revenue Requirement, Rates and Rate Impacts**

The Board will approve the requested Schedule of Rates, attached as Schedule "A" to this Order, which are expected to generate the estimated revenue requirement of \$3,242,821. The Board will also approve the total revenue requirement requested by Stittco of \$3,419,316, as shown on Schedule "B" attached to this Order. The Board notes that the proposed rates will, on average, be 10.6% lower than current rates. The Board will also approve the discontinuance of the rate rider imposed on January 1, 2001 effective September 1, 2002.

**Purchase Propane Variance Account ("PPVA")**

The Board will approve Stittco's request to continue accumulating the difference between estimated and actual propane costs in the PPVA. The July 31, 2003 balance is estimated to be \$20,700, due to Stittco's customers. The Board will require Stittco to report on the status of the PPVA balances on a monthly basis. The balances will be disposed of at a future date.

### **Interim Ex parte Orders**

Interim Ex parte Orders 182/99, 120/00, 4/01, 124/01, and 28/02 all dealt with the imposition of, changes to and/or removal of rate riders related to changes in the cost of propane and PPVA balances. The Board will therefore confirm each of these Orders as final.

**4.0 IT IS THEREFORE ORDERED THAT:**

1. The requested Rate Base of \$1,948,623 BE AND IS HEREBY APPROVED.
2. The Operating, Maintenance and Administrative expenses of \$1,138,162 BE AND ARE HEREBY APPROVED.
3. The total revenue requirement of \$3,419,316 BE AND IS HEREBY APPROVED.
4. The Rate Rider imposed on January 1, 2001 be discontinued effective September 1, 2002.
5. Stittco Utilities Man Ltd.'s Schedule of Rates attached as Schedule "A" to this Order BE AND IS HEREBY APPROVED, to be in effect for all billings based on metre readings for propane consumed on and after September 1, 2002.
6. Interim ex parte Orders 182/99, 120/00, 4/01, 124/01 and 28/02 BE AND ARE HEREBY CONFIRMED as final.

THE PUBLIC UTILITIES BOARD

"G. D. FORREST"  
Chairman

"G. O. BARRON"  
Secretary

Certified a true copy of Order No. 172/02  
issued by The Public Utilities Board

\_\_\_\_\_  
Secretary