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UTILITY RATES REVIEW COUNCIL OF NUNAVUT
IGLUIN AULATJUTITIGUN AKITUTILAANGINNUT KATIMAYIIT NUNAVUNMI
CONSEIL D'EXAMEN DES TAUX DES ENTREPRISES DE SERVICES DU NUNAVUT

Report to the Responsible Minister for the Qulliq Energy Corporation On:

Qulliq Energy Corporation's 2014/15 General Rate Application- Request for Final Report Following Report 2014-4

Report 2014-05

May 16, 2014

PANEL MEMBERS	Ray Mercer	Chairperson
	Graham Lock	Member
	Anthony Rose	Member
	Jimmy Akavak	Member

SUPPORT		
	Laurie-Anne White	Executive Director
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LIST OF ABBREVIATIONS

GRA	General Rate Application
FRS	Fuel Rate Stabilization Fund
FSR	Fuel Stabilization Rider
QEC	Qulliq Energy Corporation
URRC	Utility Rates Review Council

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1.0 BACKGROUND

Qulliq Energy Corporation (QEC), as a designated utility, is required pursuant to Section 12 (1) of the Utility Rates Review Council Act (Act), to seek approval from the responsible Minister for the QEC (Minister), prior to imposing a rate or tariff. The responsible Minister in turn is required pursuant to Section 12 (2) of the Act, to seek the advice of the Utility Rates Review Council (URRC or Council) on the utility's request to impose a rate or tariff.

On April 28, 2014 the URRC issued Report 2014-04 with respect to QEC's 2014/15 General Rate Application dated the November 1, 2013 as amended on February 14, 2014 and March 7, 2014 (Application).

QEC provided its response respecting URRC Report 2014-04 to the Minister responsible for QEC on May 9, 2014 (Response). The Minister in turn requested a final report from the URRC on May 9, 2014 pursuant to section 13(3) of the Act.

2.0 CONSIDERATION OF THE REQUEST FOR FINAL REPORT

2.1 CRITERIA FOR REVIEW

The issues raised by QEC in its Response are addressed in this Section. Where QEC has requested review of the URRC's determinations as set out in Report 2014-04, the URRC will use the following criteria to determine whether the review and variance requested by QEC is warranted:

1. Where new evidence, which was not known or not available at the time evidence was adduced and which may have been a determining factor in the Council's decision, became known after the Report was issued.

2. Where a decision of the Council is based on an error in law or in fact if such error is either obvious or is shown on a balance of probabilities to exist, and if correction of such error would materially affect the Report findings.

3. Where correction of a clerical error or clarification of an ambiguity is required.

4. Where other criteria, particular to a given case, are shown to be valid.

2.2 SALARIES AND WAGES:

In its Response letter QEC states:

> Although the URRC does recognize QEC's efforts to reduce vacancy rates in coming up with the revised vacancy rate estimate of 10%, the Corporation is of the opinion that the vacancy rate as assumed in the Application is reasonable and more appropriate for the 2014/15 Test Year. As such, the Corporation is requesting that the URRC reconsider its position and recommend the salaries and wages expense forecast be approved as submitted.

URRC Response:

The URRC notes QEC has not provided any new evidence, which was not known or not available at the time evidence was adduced and which may have been a determining factor in the vacancy rate adjustment determined by the URRC. Accordingly, the URRC considers review and variance of the vacancy rate adjustment determined by the URRC in Report 2014-4 is not warranted.

2.3 TRAVEL AND ACCOMMODATION

In its Response letter QEC states:

> The URRC recommended reducing the forecast travel and accommodation expense by \$0.500 million. The reduction is based on the URRC's consideration that the Corporation has not provided any specific support for the increase in the forecast business travel expense from the average level of approximately \$2.6 million to a level of approximately \$3.5 million in the Test Year. The URRC's reduction reflects the average of actual expenses for 2010/11-2012/13 years (\$2.6 million) adjusted for 2% inflation per year and 5% per year provision for increased travel activity.

> In the responses URRC-QEC-7 and URRC-QEC-315, the Corporation provided the reasons for higher business travel expense forecast for the 2014/15 Test Year, which includes:
>
> - Implementation of the proactive engine maintenance program;
> - Increased senior management travel between regional offices;
> - Increased travel for staff to attend corporate workshops;
> - Increased travel by HR staff for public relations and senior management hiring;
> - Increased travel by operational technicians for plant inspections; and
> - Increased travel by IT staff required to upgrade the community internet/communication networks.

QEC requested that the URRC reconsider its position and recommend approval of Travel and Accommodation expenses of $5.182 million as submitted.

URRC Response:

The URRC notes QEC has not provided any new evidence, which was not known or not available at the time evidence was adduced and which may have been a determining factor in the travel cost adjustment determined by the URRC. Accordingly, the URRC considers review and variance of the travel cost adjustment determined by the URRC in Report 2014-4 is not warranted.

2.4 AMORTIZATION EXPENSE

In its Response letter QEC states:

> The URRC concluded that the difference in gross plant is attributable to customer contributions (page 49 of the report) and reduced the amortization expenses by $0.200 million using $270.0 million from Schedule 6.1 and the average amortization rate of 3.19%. However, the URRC's conclusion appears to be based on a misunderstanding; the amortization expense calculations in the March 7, 2014 filing already exclude customer contributions.

QEC provided a revised calculation of amortization expense in Appendix A of the Response letter.

URRC Response:

The URRC has reviewed the new calculations for amortization expense provided in Appendix A of the Response. Based on these calculations the URRC agrees that reversal of the amortization adjustment reflected in Report 2014-4 is warranted. This finding is reflected in the revised change in rates recommended in Section 3.0 of this Report.

2.5 RETURN ON EQUITY

In its Response letter QEC states:

> The Corporation notes URRC's rationale for adjusting the proposed ROE rate is based on comparison of resulting interest coverage ratios between rate applications. It is the Corporation's view that looking only to the interest coverage ratio is not a reasonable approach in the determination of the ROE. The proposed ROE rate for 2014/15 at 9.30% was based on the most recently approved ROE rate for Northland Utilities. It is the Corporation's view that QEC faces equal or greater business risk compared to Northland Utilities, considering the harsher environment that QEC operates in the isolated nature and smaller size of its communities (including no rail or road access), and lack of access to hydro-electric or natural gas generation.
>
> It is the Corporation's view that the ROE rate for QEC should be approved at least at the level for peer utilities with similar operating conditions. The Corporation respectfully requests that the URRC reconsider this recommendation.

URRC Response:

The URRC notes that the rate of return on equity approved for Northland Utilities in 2012 and 2013 reflects the fair rate of return for that utility at the time and, presumably reflects the specific financial and business risks of that utility. The URRC considers not only the business risks but also the financial risks should be considered in the establishment of a fair rate of return on equity. For the purposes of QEC's 2014/15 GRA the URRC used interest coverage ratios as an indicator of financial risk, among other considerations, to assess the fair rate of return on equity.

The URRC notes QEC has not provided any new evidence, which was not known or not available at the time evidence was adduced and which may have been a determining factor in the fair rate of return on equity determined by the URRC. Accordingly, the URRC considers review and variance of the fair rate of return on equity determined by the URRC in Report 2014-4 is not warranted.

2.6 COST OF DEBT

In its Response letter QEC states:

> ..the URRC's calculation of 4.74% appears to have a typographical error in Facility D, which used a rate of 2.4% instead of the coupon rate of 4.24%11. The correction of this typographical error results in an average embedded cost of debt of 4.81%, which increases the revenue requirement as adjusted by the URRC by $0.083 million. Please see Appendix B for the revised calculation of embedded cost of debt based on the mid-year balance approach.
>
> It should be noted that the method used by the Corporation for the calculation of embedded cost of debt is consistent with the method used in the 2010/11 GRA. It has been the Corporation's practice to calculate embedded cost of debt reflecting the debt service schedule of QEC, as the debt service schedule reflects the true interest expense expected to be paid by the Corporation in a given fiscal year.

URRC Response:

The URRC has reviewed the calculations for embedded cost of debt provided in Appendix B of the Response. The URRC agrees there was indeed a transposition error with respect to the interest rate applicable to facility D in the URRC's calculation of the embedded cost of debt set out at page 38 of Report 2014-4. The impact of this error on the 2014/15 revenue requirement calculation is an understatement of debt return in the amount of $0.083 million.

If this error were considered in isolation it would not meet the threshold for review given that the amount involved is less than $0.1 million and therefore not material in the context of QEC's overall costs and revenues. However, in view of the correction to amortization expense referred to in Section 2.4 the URRC considers correction of the debt return calculation reflected in Report 2014-4 is warranted. The corrected debt return is reflected in the revised change in rates recommended in Section 3.0.

Consistent with the mid year convention used to calculate rate base, the cost rate of the debt component financing the rate base is also calculated using the mid year convention in traditional rate base, rate of return regulation. It would not be appropriate to use the debt service schedule for calculating the cost rate on the debt component of capital structure and the mid year convention for rate base because this would result in a mismatch between the investment and the corresponding financing of the investment. Therefore, the URRC does not consider deviation from the mid year convention is warranted.

2.7 REGULATORY DEFERRAL ACCOUNTS

In its Response letter QEC states:

> The URRC's statement at page 10 of the report that "The Northwest Territories Power Corporation transitioned to IFRS in 2012" is not correct. For external reporting purposes the Northwest Territories Power Corporation continues to report under Canadian GAAP.

QEC also states:

> In QEC's view, the ratemaking structure in place in Saskatchewan is the closest and most appropriate comparison. QEC believes that its proposed treatment of customer contributions and the FSR for regulatory and financial reporting purposes provides reasonable information for ratemaking purposes consistent with the economic principles described in the URRC's report. QEC can continue to provide reconciliations between the financial statements recorded to PSA standards and the regulatory statements prepared for the URRC for ratemaking purposes. QEC is amenable to discussions with the URRC on how to present the information more clearly for ratemaking purposes, but has two requirements:
>
> 1. During previous discussions, the GN has stated that it cannot accept a financial reporting structure that would result in QEC's financial statements being qualified by the OAG.
> 2. QEC will want to minimize the number of adjustments made between its financial reporting statements and its regulatory statements, in order to minimize the potential for error.

URRC Response:

The Northwest Territories Power Corporation did transition to IFRS for regulatory purposes. However, for financial reporting purposes transition to IFRS has been deferred. The point however, is that NTPC continues to maintain regulatory deferral accounts for financial reporting purposes.

QEC states the ratemaking structure in place in Saskatchewan is the closest and most appropriate comparison to regulation of QEC. On this basis QEC requests that it be not required to put in place regulatory deferral accounts as discussed in Section 2 of Report 2014-4. In the URRC's view the concept of accountability is applicable irrespective of whether a utility is privately owned, publicly owned or is a crown corporation. The overall purpose is to ensure due and proper accountability on the part of QEC to its owners (Government of Nunavut), the Corporation's Board of Directors (QEC's Governing Body) and its customers.

Due and proper accountability cannot be achieved without consistent measurement and reporting for regulatory and financial statement purposes. If QEC's performance for regulatory purposes is determined using regulatory deferral accounts and financial reporting does not recognize such deferral accounts there will arise a significant gap between the two approaches in terms of revenue generation and cost recognition.

The 2008/09 and 2009/10 Auditor's Reports were qualified because of the finding the "Corporation is unable to recover its costs without significant direct or indirect financial support from the Government of Nunavut, it does not meet the criteria for rate regulated accounting". In order to address this concern, URRC stated as follows:

> The approach to regulation prescribed in the Guidelines is that "Rates should be set so that, looking ahead each year, the total revenue the utility earns from the rates will match the total cost of providing services. This is the forward test year concept under which there is a tacit agreement or compact between the regulator (the Minister with advice from the URRC) and the regulated utility (QEC) whereby the utility is provided a reasonable opportunity to earn its fair rate of return with respect to a forward test year in exchange for providing safe and reliable electric service. Implicit in the regulatory

> compact is the expectation that the utility will adopt good business practices to manage its costs and revenues. The regulatory compact is violated when the utility seeks direct or indirect financial support from the Government of Nunavut, as noted by the Auditor General.

In the URRC's view, if QEC were to reinstitute regulatory deferral accounts, the Auditor General would no longer need to qualify its report, provided QEC recovers its costs without significant direct or indirect financial support from the Government of Nunavut, consistent with the Guidelines and the regulatory compact. The reinstitution of regulatory deferral accounts is an accountability mechanism designed to facilitate compliance with the regulatory compact.

QEC has not provided any new evidence, which was not known or not available at the time evidence was adduced and which may have been a determining factor in the URRC's determinations respecting regulatory deferral accounts. Accordingly, the URRC considers review of the directions set out in Section 2.0 of Report 2014-4 is not warranted.

2.8 TERMS AND CONDITIONS OF SERVICE

In its Response letter QEC states:

> The Corporation has incorporated the recommended amendment to its revised Terms and Conditions of Service (T&Cs), provided in Appendix D.

URRC Response:

The URRC has reviewed the revised T&Cs provided in Appendix D of the Response and notes that they are consistent with the URRC's recommendations. The T&Cs as revised and as reflected in Appendix D are accepted.

2.9 REVENUE SHORTFALL BASED ON EXISTING RATES

In its Response letter QEC states:

> The Corporation confirms its intent not to seek from its customer's recovery of the revenue shortfall resulting from delay in implementation of final rates for 2014/15.

URRC Response:

The URRC accepts QEC's confirmation as noted above.

2.10 RATE STABILIZATION FUND

In its Response letter QEC states:

> The Application requested approving a revision to the Ministerial Instruction for the Fuel Rate Stabilization Fund, as discussed in Chapter 9 of the Application. Specifically, the Application discussed this matter as follows (page 9-1 of the Application):
>
> In the Corporation's view the following paragraph of the FRS Instruction would benefit from a revision to provide additional clarity:
>
> "To the extent accommodated by the Corporation's billing system, the Nunavut wide fuel rider shall be on an across the board cents per kilowatt hour basis. This will provide for a proportionate increase or decrease in costs for all communities and rate classes."
>
> The Corporation proposes to amend this paragraph of the FRS Instruction and replace it with the following:
>
> "To the extent accommodated by the Corporation's billing system, the Nunavut wide fuel rider shall be on an across the board cents per kilowatt hour basis."
>
> The proposed amendment ensures greater clarity in the FRS Instruction. The proposed amendment will not alter the calculation of the FRS riders, but simply provide improved clarity.
>
> The URRC Report does not provide URRC's review and recommendation on the above request. QEC respectfully requests that the URRC recommend approving this change.

URRC Response:

The URRC has reviewed the above proposal and accepts the proposed change to the wording of the Fuel Rate Stabilization Fund (FRS) instruction.

2.11 QEC'S RESPONSE TO URRC DIRECTIONS (RECOMMENDATIONS) [APPENDIX E]

In Appendix E QEC has set out its responses to the directions of the URRC from Report 2014-4. While the URRC has no specific comments with respect to each direction, it is worth noting that the overall purpose of directives are to ensure due and proper accountability on the part of QEC to its owners (Government of Nunavut), the Corporation's Board of Directors (QEC's Governing Body) and its customers.

In the competitive world market discipline would ensure due and proper accountability on the part of any business entity. In the regulated world the Regulator is the substitute for the competitive market. Reporting and accountability mechanisms are prerequisites for the regulator to be able to make meaningful determinations as to the prudence of utility costs and revenues.

3.0 URRC RECOMMENDATION

Sections 13(3) and 13(4) of the Act provides as follows with respect to a Final Report requested by the Minister:

> Final report
> (3) Within 30 days of receiving a report made under subsection (1), the responsible Minister, if he or she thinks it appropriate to do so, may request in writing that the Review Council make a final report, within a time stipulated by the responsible Minister.
>
> Contents of final report
> (4) Where the responsible Minister has made a request under subsection (3), the Review Council shall reconsider its report, and shall make a final report that may:
> (a) make the same recommendation as in its initial report; or
> (b) any other recommendation that may be made under subsection (1).

In this Final Report the URRC recommends as follows:

1. That a 7.1% increase in energy rates as calculated in Table 3 of the Response, be approved for QEC effective May 1, 2014. For the purpose of determining final energy rates, the existing Fuel Stabilization Rider (FSR) rider of 3.92 cents per kWh shall be consolidated into the existing base energy rates and the 7.1% increase applied to the consolidated energy rate.

2. That the Terms and Conditions of Service set out in Appendix D of the Response be approved.

3. That QEC's request to amend the FRS instructions be approved as follows:

Replace the following sentences:

> "To the extent accommodated by the Corporation's billing system, the Nunavut wide fuel rider shall be on an across the board cents per kilowatt hour basis. This will provide for a proportionate increase or decrease in costs for all communities and rate classes."

With the following sentence:

> "To the extent accommodated by the Corporation's billing system, the Nunavut wide fuel rider shall be on an across the board cents per kilowatt hour basis."

Nothing in this Report shall prejudice the URRC in its consideration of any other matters respecting QEC.

ON BEHALF OF THE

UTILITY RATES REVIEW COUNCIL OF NUNAVUT

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DATED:May 16, 2014

Raymond Mercer

Chairperson