

BR.TGC-1

Topic: Code of Conduct

Reference: Page 5

Preamble:

“Clearly, the activities undertaken by NTPC’s affiliates are in competition to the activities engaged in by NTPC. Therefore, it is appropriate for safeguards to be put in place to ensure the resources of the regulated arm, if used, are properly priced and all such revenues are recorded in the books of the regulated operations.”

The Board wishes to better understand the specific issues that better disclosure and code of conduct might address.

Requests:

- a. Please provide support for the view NWTPC affiliates are in competition with NWTPC.
- b. By reference to the practices in other jurisdictions, please specify the principles and guidelines that should be used to determine transfer prices for goods and other shared resources provided by NWTPC to its affiliates and vice versa.
- c. By reference to the practices in other jurisdictions, please specify the principles and guidelines that should be used to determine charges to affiliates for management and shared services.
- d. Please indicate whether transparency of transactions can be improved by way of more disclosure in published documents such as the annual report. If so please identify the type of information that should be so disclosed.
- e. Please provide examples with specific reference to NWTPC, where preferential access by affiliates is applicable and the potential impact thereof on the corporation’s regulated services. Provide examples where preferential access may be acceptable given particular circumstances.

RESPONSE

- a) Mr. Merani is not a legal counsel; however, based on a simple reading of Section 5 of the *Northwest Territories Power Corporation Act*, it appears that NTPC may supply

electricity using any form of generation. To the extent the one or more of the affiliates is also in the business of providing electricity to the same set of customers as those currently served by NTPC, a potential exists for NTPC and its affiliates to be operating in direct competition with each other.

Unless the power generated by the hydro and district heating projects owned and operated by affiliates is destined for customers other than those served by the regulated entity, it is apparent the regulated entity (NTPC) and its unregulated affiliates are in direct competition. As noted in TGC evidence (pages 3-4), the Bear project which is to be owned and operated by an affiliate, will provide power to the Mackenzie Valley Pipeline and several communities in close proximity to the proposed transmission line. The TGC understands that customers in these communities are currently being provided power by NTPC, the regulated arm. Hence, in this instance, there is a clear potential for an unregulated affiliate to provide power to the same customers as those currently being served by the regulated arm.

- b) The key principle, to determine transfer prices for goods and other shared resources provided by NWTPC to its affiliates and vice versa, appears to be a nexus to the fair market value ["FMV"] concept.

For example, the AEUB-approved code of conduct for ATCO provides the following principles/guidelines for transfer pricing:

Services from Affiliates

- Where a utility decides to outsource to an affiliate a service it currently provides, it shall "in addition to any other analysis it may require to demonstrate the prudence of a For Profit Affiliate Services arrangement, undertake a net present value analysis appropriate to the life cycle or operating cycle of the services involved. [Decision 2003-040, App 5, page 8]
- Each utility should periodically review the prudence of such outsourcing agreements.
- Any service from affiliates should be priced at no more than the FMV with the "onus being on the utility to demonstrate that the For Profit Affiliate Services have been acquired at a price that is no more than the Fair Market Value of such services." [Decision 2003-040, App 5, page 8]

One useful means of ensuring customers of the regulated entity pay no more than FMV for services procured from an affiliate is public tendering. To this end, the OEB Code states:

In purchasing a service, resource or product, from an affiliate, a utility shall pay no more than the fair market value. For the purpose of purchasing a service, resource or product a valid tendering process shall be evidence of fair market value. [Section 2.3.2]

Source: Ontario Energy Board Affiliate Relationships Code for Electricity Distributors and Transmitters, Revised November 24, 2003 (Originally issued on APRIL 1, 1999)
http://www.oeb.gov.on.ca/documents/affiliatecode_amendedcode.112403.pdf

Shared Services from Affiliates

With respect to shared services procured from an affiliate, the governing principle should be that the utility should not pay its affiliates costs that are in excess of FMV. For example, in Decision 2004-066 respecting the 2004 ENMAX Power Corporation rate case, the Board directed the utility as follows:

In Decision 2004-066, the Alberta Energy and Utilities Board (the “Board”) directed ENMAX Power Corporation (“EPC”) to provide evidence as follows:

The Board directs EPC, in its next GTA Application, to file an independent study demonstrating that EPC could not obtain any of the services provided by ENMAX Corporation at a lower cost, by developing internal resources or by directly procuring such services from the market. [Decision 2004-066, page 46]

Hence, the test or guideline should be that the service provided by an affiliate could not be obtained at a lower cost, either by developing internal resources or by directly procuring such services from the market.

Services to Affiliates

Where the utility provides For Profit Affiliate Services, according to the ATCO Code, the utility “shall not charge less than the Fair Market Value of such services. The onus is on the Utility to demonstrate that the For Profit Affiliate Services have been charged at a price that is not less than the Fair Market Value of such services.” [Decision 2003-040, App 5, page 8]

Shared Services to Affiliates

When the regulated utility is providing a shared service (e.g. accounting services, payroll services etc.) to an affiliate, the ATCO code calls for pricing to be based on “Cost Recovery Basis” as defined in the Code. While this is one option, the TGC suggest another alternative is that such shared services be priced at no less than FMV.

Services Agreement

Any agreement to enter into transactions with affiliates must, of necessity, be governed by a Services Agreement for the services the utility acquires or provides to an affiliate. For example the Ontario Energy Board Affiliate Relationships Code for Electricity Distributors and Transmitters provides the following with respect to shared services with an affiliate:

2.2.1 Where a utility shares services or resources with an affiliate it shall do so in accordance with a Services Agreement, the terms of which may be reviewed by the Board to ensure compliance with this Code. The Services Agreement shall include:

- (a) the type, quantity and quality of service;
- (b) pricing mechanisms;
- (c) cost allocation mechanisms;
- (d) confidentiality arrangements;
- (e) the apportionment of risks (including risks related to under or over provision of service); and
- (f) a dispute resolution process for any disagreement arising over the terms or implementation of the Services Agreement.

Source: Ontario Energy Board Affiliate Relationships Code for Electricity Distributors and Transmitters, Revised November 24, 2003 (Originally issued on APRIL 1, 1999)
http://www.oeb.gov.on.ca/documents/affiliatecode_amendedcode.112403.pdf

Other Jurisdictions

The TGC has not done an exhaustive search on the practices of the other utilities. However, based on what is available in the public domain, the following information has been garnered with respect to Transfer Pricing.

a) OEB

2.3.3 Where a fair market value is not available for any product, resource or service, a utility shall charge no less than a cost-based price, and shall pay no more than a cost-based price. A cost-based price shall reflect the costs of producing the service or product, including a return on invested capital. The return component shall be the higher of the utility's approved rate of return or the bank prime rate.

2.3.4 A utility shall sell assets to an affiliate at a price no less than the net book value of the asset.

Source: Ontario Energy Board Affiliate Relationships Code for Electricity Distributors and Transmitters, Revised November 24, 2003 (Originally issued on APRIL 1, 1999)
http://www.oeb.gov.on.ca/documents/affiliatecode_amendedcode.112403.pdf

b) The Michigan Public Service Commission

The Michigan PSC has also established a somewhat different transfer pricing standards compared to the Alberta Board, in that the Michigan PSC takes into consideration the fact that the fully allocated embedded cost may be different than the market price.

Michigan provides services, products, or property to any affiliate or other entity within the corporate structure, compensation shall be based upon the higher of fully allocated embedded cost or market price. If an affiliate or other entity within the corporate structure provides services, products, or property to an electric utility or alternative electric supplier offering regulated service in Michigan, compensation for services and supplies shall be at the lower of market price or 10% over fully allocated embedded cost and transfers of assets shall be based upon the lower of fully allocated embedded cost or and transfers of assets shall be based upon the lower of fully allocated embedded cost or market price. [Consumers' Energy Company and the Detroit Edison company Case # U-12134, dated Oct 29, 2001, before the Michigan Public Service Commission, Exhibit A].
http://www.cis.state.mi.us/mpsc/electric/download/elec_coc_order.pdf

The key distinction appears to be the Michigan PSC takes into account the fact that when a utility provides service to an affiliate, the transfer price may be higher than the market value. Accordingly, if the market price is \$120, and the fully allocated embedded cost is \$130, the utility will provide services to the affiliate for \$130 (higher of fully allocated embedded cost or market price).

Likewise, if the affiliate is providing service to the utility, the pricing may be less than the market price. Hence, if the market price is \$120, and the fully allocated embedded cost in this case is \$100, the transfer pricing is at \$110 (i.e. lower of market price or 10% over the fully allocated embedded cost).

Based on the three jurisdictions reviewed, the following simplified summary is provided with respect to transfer pricing:

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Jurisdiction	Provider	Basis
Alberta	Utility	Cost Recovery basis, except for the For Profit Affiliate Service
	Affiliate	No more than FMV
OEB	Utility	No less than FMV
	Affiliate	No more than FMV
Michigan PSC	Utility	Higher of FMV or Fully Allocated Embedded cost
	Affiliate	Lower of FMV or 110% of Fully Allocated Embedded cost

- c) Please refer to BR.TGC-1 (b) above.
- d) The TGC understand the annual report of NTPC is audited by the office of the Auditor General of Canada, and as such, reflect compliance with GAAP. For regulatory purposes, we propose an additional requirement for disclosure of transactions with affiliates, and reporting on compliance of such transactions in accordance with a Board-approved code of conduct.

In our view, the information provided in annual report should not be viewed as an appropriate surrogate for regulatory purposes. The objectives are inherent in the principles embodied in the CICA Handbook and speak to the need to have a fair and consistent application of GAAP. On the other hand, the regulator needs data to set just and reasonable rates and can set whatever reporting requirements it considers necessary to fulfill its mandate. Therefore the objectives of GAAP and the regulator may not always be in synch.

- e) As a general rule, the TGC does not view preferential access acceptable under any circumstances. To do so suggests that an affiliate is being provided with a “preferred” position with respect to access etc not available to other competitors who may want to compete with the same business as that of the affiliate. The TGC does not have any specific examples where NTPC has provided preferential treatment to its affiliates. However, that is not to state that such preferential treatment does not or will not take place.

Left unchecked, there may be a number of instances in which such a preference may manifest itself. Examples include the endorsement of an affiliate by a regulated utility and solicitation of business by a regulated utility on its behalf of the affiliate. Alternatively, the utility may combine its marketing activities and promotions so that it appeared that the regulated utility has acted on behalf of the affiliate. To this end, the TGC notes the Ontario Energy Board’s code is quite succinct:

2.5 Equal Access to Services

2.5.1 A utility shall not endorse or support marketing activities of an affiliate which is an energy service provider. A utility may include an affiliate as part of a listing of alternative service providers, but the affiliate's name shall not in any way be highlighted.

2.5.2 A utility, including its employees and agents, shall not state or imply to consumers a preference for any affiliate who is an energy service provider.

2.5.3 A utility shall take all reasonable steps to ensure that an affiliate does not use the utility's name, logo or other distinguishing characteristics in a manner which would mislead consumers as to the distinction between the utility and the affiliate.

2.5.4 A utility shall take reasonable steps to ensure that an affiliate does not imply in its marketing material favoured treatment or preferential access to the utility's system. If the utility becomes aware of inappropriate marketing activity by an affiliate, it shall:

- (a) immediately take reasonable steps to notify affected customers of the violation;
- (b) take necessary steps to ensure the affiliate is aware of the concern; and
- (c) inform the Director in writing of such activity and the remedial measure that were undertaken by the utility.

2.5.5 A utility shall apply all Rate Orders and rate schedules to an affiliate in the same manner as would be applied to similarly situated non-affiliated parties.

2.5.6 Requests by an affiliate or an affiliate's customers for access to a utility's transmission and distribution network or for utility services shall be processed and provided in the same manner as would be processed or provided for similarly situated non-affiliated parties.

2.5.7 A utility shall not transfer or assign to an affiliate a consumer for whom the utility is providing utility services (as defined in this Code), unless the customer gives permission to such transfer or assignment in writing.

Source: Ontario Energy Board Affiliate Relationships Code for Electricity Distributors and Transmitters, Revised November 24, 2003 (Originally issued on APRIL 1, 1999)
http://www.oeb.gov.on.ca/documents/affiliatecode_amendedcode.112403.pdf

Obviously, a code of conduct does not remove the incentive to provide preferential access to affiliates, but the code must provide consequences in the event the rules of fair play are not followed.

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BR.TGC-2

Topic: Generation using fuel sources other than diesel

Reference: Page 8

Preamble:

“To this end, NTPC should file quarterly reports of all its efforts to obtain funding from all levels of government to kick start projects to deliver electrical energy from ‘green’ sources and replace diesel fuel thermal power generation. NTPC should also report on any available private and/or public funding for projects using and exploiting renewable, and/or low-emission energy sources and comment on the viability of such endeavors.”

Requests:

- a. Please comment on whether the Board has the jurisdiction to prescribe how the utility does resource planning or mandate a renewable energy portfolio?
- b. Please provide TGC’s view of what action or initiatives ought to be taken by the Board following the filing of the quarterly reports, within the context of the Public Utilities Act.

RESPONSE

- a) The request essentially relates to a question of legal statutory interpretation, and thus is outside the expertise of Mr. Merani. That said, the following layman’s observations are offered.

At the outset, the TGC note that Section 5 of the NWTPC Act provides explicitly that one of the objects of the Corporation is to “undertake programs to conserve energy.”

Any prudent resource planning must take into account a portfolio of capital projects that result in the least overall cost to the customers. The hitherto “diesel only” focus on capital additions carries with it a significant risk of environmental costs in connection with diesel contamination and spills.

The TGC note that for NTPC as a whole, the provision for Future Removal and Site Investigation costs is about \$38 million (per Note 1, 2005-06 Annual Report) while the total net plant-in-service is about \$186 million at March 31, 2006. [Schedule 5.1] In other words, for every dollar of net plant, there is a provision of about 20% in respect of Future Removal and Site Investigation costs. Accordingly, any discussion of prudent resource planning must take into account not only the current capital costs, but also costs related to future potential environment remediation. As part of such

resource planning, it is incumbent on the utility to compare all costs, current and future, associated with diesel plant as well as a renewable energy portfolio.

The notion of prudence is also embedded in legislation. The TGC also note from a simple reading of the *Public Utilities Act*¹ (s. 49) that in determining rate base, the Board shall consider:

- (a) the cost of the property referred to in subsection (1) at the time that property was first devoted to public use, and to *the prudent acquisition cost* to the public utility, less depreciation, amortization or depletion; and
- (b) the necessary working capital of the public utility. [S49] {Emphasis added}

While it appears Section 49 does not specifically include jurisdiction for the Board to evaluate how the utility does resource planning or mandate a renewable energy portfolio, “prudent acquisitions” may be those that involve renewable energy. As Section 49 deals primarily to costs paid by customers, government funding and incentive for “green power” initiatives may very well directly affect the determination of prudent acquisition costs, and thus do fall within the Board’s jurisdiction. Additionally, it should be noted that the NTPC itself has highlighted its environmentally attuned activities.²

The TGC also note the *Public Utilities Act* requires that the PUB coordinate with other NWT statutory regimes:

48. (1) No public utility shall

(a) make, demand or receive

...

(ii) a rate that otherwise contravenes this Act, the regulations, another enactment or an order of the Board; ...

The TGC note that several other statutes address environmental matters, particularly the *Environmental Rights Act*³ and the *Environmental Protection Act*⁴ may be relevant. The TGC suggest that Section 48 requires that the Board to at least consider environmental matters, and particularly should prefer those alternatives that that are economically feasible and sound, provide reliable service to the consumer, and have the least short-term and long-term negative environmental impacts.

¹ *Public Utilities Act*, R.S.N.W.T. 1988, c. 24 (Supp.).

² Nov 24, 2006 Cover Letter to GRA, page 3-4, Nov 24, 2006 Cover Letter to GRA; Schedule 2.1, L40-43

³ *Environmental Rights Act*, R.S.N.W.T. 1988, c. 83 (Supp.).

⁴ *Environmental Protection Act*, R.S.N.W.T. 1988, c. E-7.

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- b) The objective in recommending the filing of quarterly reports is to provide the Board and stakeholders with a sense of how proactive and aggressive NTPC has been in the pursuit of federal and territorial funding available for green power. As the Board has broad general and supervisory powers, as well as a mandate to ensure prudent acquisition of capital property when first devoted to public use (s. 49 of *Public Utility Act*), the Board may as a result of a review of such quarterly filings direct NTPC to conduct further study, or direct to undertake or not to undertake such projects.

The TGC recognize that approval of capital projects is typically in the context of a GRA; however, given the limited amount of environmentally focused funding, and the many demands placed by various parties for such funding, it may not be appropriate to wait until the filing of the next GRA to seek approval of such projects. As well, we note that NTPC currently has a significant number of potential “green projects” on the table (see TGC Evidence, page 8), which may only proceed if there is some external federal/territorial funding to defray the total costs of these projects. Absent the requested oversight in the form of quarterly reporting, and given the natural incentive for a utility to increase rate base in order to increase its return, there is no real incentive for NTPC to incorporate a “green portfolio” as part of its overall resource planning.

BR.TGC-3

Topic: Adjustment of Fuel Efficiencies to Actual

Reference: Page 12

Preamble:

“Accordingly, my recommendation is when the FSF is trued up, NTPC should replace the forecast (last approved by the Board) with the actual heat rate for the most recent year.”

Requests:

- a. If actual fuel efficiencies were to be used in place of forecasts under the fuel cost true up procedures, please comment on the incentive on the part of NWTTPC to improve fuel efficiencies.
- b. Please explain why the proposed treatment which would see fuel efficiencies adjusted to actuals, is appropriate, considering the majority of the company’s costs are treated on a forecast basis.
- c. Please provide the criteria the Board must consider in determining whether the fuel efficiency component of fuel costs should be treated on a deferral account basis similar to fuel price.

RESPONSE

- a) The current mechanism requires the use of the 3:2:1 weighting factors as described in Response BR.NTPC-6 (a). In essence, using the last three years of actual data, NTPC assigns a weight of 3 to the year in which it experienced the highest efficiency, a weight of 2 to the second highest efficiency year, and 1 to the third highest efficiency year. As actual fuel efficiencies may be higher or lower than forecast, it is not entirely clear what incentives exist within the current framework to improve over the forecast fuel efficiencies, nor what incentives are taken away from NTPC by the incorporation of actual fuel efficiencies when the FSF is trued up, as recommended in the TGC evidence. Fuel efficiencies arise primarily from the installation of new engines and NTPC will replace these engines, as required, as part of its mandate to provide safe and reliable service.

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- b) The proposal advanced only relates to fuel costs, and currently only the price variance is trued up, not the volume variance (i.e. only one half of the total variance is trued up). Fuel efficiencies drive the volume of fuel required and therefore impact the actual cost of fuel. Since the price variance is trued up, so should the volume variance.

In essence, under the TGC proposal, both the price and volume variance are trued up so that the Company is held revenue neutral. As new engines are installed in years post the GRA, the continued use of the 3:2:1 weighting factors described in Response BR.NTPC. 6 (b) may not reflect the improvement in fuel efficiencies from such newer engines. The tilt, if any, is therefore to the benefit of the utility as it charges customers based on a weighted average calculation of fuel efficiency that may be materially understating the actual fuel efficiency for the true-up year in question.

For example, assume that a brand new diesel engine is installed in the first year after the Test Years. The example below demonstrates that based on the fuel efficiency approved in the GRA, the cost of fuel was \$21,708; however, in the first year following the test year, a new engine was installed and the efficiency using the 3:2:1 factor approved by the Board increased to 3.480, which in turn resulted in a price of fuel of \$21,552, a reduction of \$156; under the current set up, this portion of the fuel cost variance would be to the benefit of shareholders.

Year	Fuel Eff	Weighting	Weighted	Weighted	Kwh	Fuel Vols	Price	Total Fuel Cost
2006	3.500	3	10.5					
2007	3.440	2	6.88					
2008	3.350	1	3.35					
		6	20.73	3.455	100,000	28,944	0.75	21,707.7
2009	3.550	3	10.65					
2008	3.350	1	3.35					
2007	3.440	2	6.88					
		6	20.88	3.480	100,000	28,736	0.75	21,551.7
								(155.9)
								-0.7%

- c) Please see Response BR.TGC.3 (b)

BR.TGC-4

Topic: Fuel Stabilization Fund and Riders

Reference: Page 11 of Evidence

Preamble:

“Therefore, my recommendation is the true-up should be in reference to the community’s own diesel costs. This will involve the calculation of a community-specific rate rider, no different than the community-specific base rates currently in place. This would also then be consistent with the Board-approved community-based approach to rate-making.”

Requests:

- a. Given that the fixed elements of fuel costs such as transportation are reflected in the forecast fuel cost included in the base rates, please identify the reasons why TGC believes the use of a single Corporation wide fuel rider to pass through fuel price increases is likely to result in cross subsidies between communities. Explain by reference to how the Corporation receives its fuel pricing information from PPD and other sources
- b. Provide examples to illustrate how the use of a single rider may have resulted in cross subsidies among communities in the past. Comment on the extent of the subsidies.

RESPONSE

- a) While the TGC agree there are a number of fixed components in the price of fuel, the cost of transportation or delivery is a variable component as noted in Response TGC.NTPC-40 (c). Appendix APM-3 (page 1 of 2) of the TGC evidence shows the costs can vary from a low of 8.70 cents per litre in Fort Simpson to a high of 39.19 cents per litre in Colville Lake and the average is about 19.60 cents per litre. The community-based rates approved by the Board in a GRA reflect these delivery-cost differences.

However, this is not the case upon true-up, when the actual weighted average price (for all communities in the diesel fund) is compared to the approved forecast price included in rates. In the example provided in Appendix APM-3 (page 1 of 2), the forecast rates for Fort Simpson include a fuel price of 86.36 cents per litre. As a result of the use of a weighted average price for all communities in the diesel fund, on true-up, its price is 93.02 cents per litre, thus subsidizing the communities with the higher fuel costs.

- b) Please refer to Response BR.TGC-4 (a) above.

BR.TGC-5

Topic: Fuel Efficiency-Inuvik

Reference: Page 14 of Evidence, Appendix APM 6

Preamble:

“This review of changes in efficiency associated with a new plant or engine suggests an efficiency increase of at least 5% is appropriate. Based on a conservative 5% improvement, the fuel costs for Inuvik should be reduced by \$177,000 in 2006/07 and \$179,000 in 2007/08, as shown in Attachment APM-6.”

The proposed adjustment to fuel efficiency reflects an overall 5% improvement applicable to all gas generation at Inuvik.

Requests:

- a. Please confirm that considering the mix of generation by unit in the calculation of overall improvement in fuel efficiencies would provide a more precise assessment of the impact of the addition of the new gas unit.
- b. If confirmed please provide an estimate of the impact of adding the new gas plant having regard to the forecast mix of generation by existing and new plant in each of the test years.

RESPONSE

- a) Generally yes. However, in the case of Inuvik, since 95% of the generation is from the 3 natural gas engines (see Response TGC.NTPC-9 (c) (i), and Schedule 2.3 and Schedule 3.3.1 and 3.3.2 for the respective gas and diesel volumes), it is not clear if a further refinement that considers the mix of generation by unit (gas and diesel) will have a material impact on the proposal advanced by the TGC. In any event, the TGC note the fuel efficiency with respect to diesel is a separate computation from that for the gas engines.
- b) Please see Response TGC.BR-5 (a) above.