SUBMISSION BY

THE CONSUMERS' ASSOCIATION OF CANADA, SASKATCHEWAN BRANCH

TO

THE SASKATCHEWAN RATE REVIEW PANEL

REGARDING

THE APPLICATION BY SASKPOWER TO CHANGE ITS RATES FOR 2007

November 14, 2006

306 – 220 Third Avenue South
Saskatoon, Saskatchewan S7K 1M1

Phone: (306) 242-4909 **Toll free:** 1-888-395-5661 **FAX:** (306) 955-5810
Email: office.cacsk@sasktel.net

The Consumers' Association of Canada, Saskatchewan Branch, welcomes the opportunity to come before the Rate Review Panel and to comment on the application by SaskPower to increase its rates for electricity in Saskatchewan in 2007.

We have read the documentation supplied by SaskPower in support of its application. It describes what Sask Power does, how well it does what it does, the high costs of providing power to the users in Saskatchewan and the high costs encountered by Sask Power compared with other electric utility companies in Canada. It concludes that Sask Power rates and its request for increased rates are fair and reasonable.

The rate proposal consists of two components; (a) rate increases, and (b) rate rebalancing and redesign. We will address the issue of rate increases first.

1. Rate Increases.

On page 1 of its submission, SaskPower states it is seeking rate changes to increase its Net Revenues (Total Revenues less Total Expenses) by $ 55 million in 2007. The increased rates are necessary because SaskPower expects its operating, maintenance, administration, depreciation, and finance expenses to increase in 2007 to $ 768 million from $ 733 million in 2006, a projected increase of $ 38 million. (Page 16) It should be noted that the requested rate increase of $ 55 million exceeds the projected cost increase by $ 17 million.

Without the requested rate increase of $ 55 million, SaskPower projects that its net income in 2007 will be $ 70 million (Page 39). That level of net income means the Return on Equity (ROE) will be 4.5% which is well below the target rate of 9% for SaskPower as specified by the Board of Directors of Crown Investments Corporation of Saskatchewan (CIC). The governance structure of SaskPower is described on Page 3 of the submission and CIC is identified as the shareholder and the owner of SaskPower.

It appears therefore that the key forces behind the current rate proposal are the SaskPower projections of increasing costs combined with a directive from CIC to Sask Power that it should generate a rate of return on equity (ROE) of 9 % and pay a dividend to its owner, the CIC, equal to 65% of SaskPower's net revenue. "The key principle behind the request (rate increase) is that SaskPower should have the opportunity, through its rates, of recovering prudently incurred costs for providing electrical services to all its customers, ***within the target return on equity (ROE) of 9.0%.*** (Page 11, emphasis added)

The Consumers Association has estimated that $ 38 million of the rate increase can be explained by the cost increases projected by SaskPower; $ 17 million of the requested rate increase can be attributed to the ROE policy of CIC and its dividend policy.

1.1 Rate increases and Cost projections

SaskPower is a large corporation by Saskatchewan standards. During 2006 it is projected to have total revenues of $ 1.43 billion of which $ 1.26 billion will represent revenues from sales of electricity in Saskatchewan. During the same year, SaskPower projects it will incur expenses of $ 1.32 billion. The expenses break down in two major categories, (a) fuel and purchased power (FPP) at $ 474 million which is not a factor in the current rate application, and (b) a composite of operating, maintenance and administration expenses (OM&A) at $ 364 million, depreciation expenses (DEP) at $ 208 million, and finance expenses (FIN) at $ 161 million for a total of $ 733 million. It is the projected increase in the second category of expenses that SaskPower is using as a basis for the rate increases.

We all know that costs are increasing and that Sask Power will have to pay more for the use of labour and capital to generate electricity and that these costs must be passed on to the consumers eventually. Unfortunately, the information provided by SaskPower does not provide much evidence or proof that Sask Power is doing its utmost to minimize the costs of producing electricity in Saskatchewan nor does the Consumers Association possess the resources to engage in a detailed analysis of the expense information that has been made public. We are unable to comment on the projected OM&A expenses and we therefore request that the Rate Review Panel use its resources to examine those projections.

We note the significant increase in Depreciation and Amortization cost (DEP) between 2005 and 2007 which SaskPower attributes to the Centennial Wind Project. (Page 33). We learn on page 36 that SaskPower invested $ 250 million in that project through SaskPower International. That is a large investment in generating capacity given the relatively small output from that facility. Was that a prudent investment? We do not have sufficient information to express an opinion on that matter but we encourage the Rate Review Panel to determine the cost per MW from that facility and compare those costs with the MW costs of generating power from other power plants in Saskatchewan.

Finance Charges (FIN) are projected to increase by $ 5 million in 2007 and reach $ 166 million. We assume these expenses represent interest payments on funds borrowed in the past for capital investments and now carried on the books of SaskPower as long-term debt. It appears the corporation's long-term debt is guaranteed by the Province of Saskatchewan and for that reason SaskPower is able to borrow at favourable rates in the bond market. Based on the numbers presented in the submission we have estimated that SaskPower has accumulated about $ 2.3 billion in long-term debts which must be serviced from its revenues.

While the submission makes reference to an "industry interest coverage ratio of 2" (page 34) it should be noted that the average for government owned utilities is 1.35 only. It would appear that current cash flows of SaskPower are quite adequate to service its current long-term debts without an increase of $ 5 million in the rates.

1.2 Rate Increases and ROE policies of CIC and SaskPower

This is an important issue section because it describes what CIC considers its equity investments in Crown corporations should earn by way of rates of return and how Sask Power's economic performance as a supplier of electricity can be measured.

A significant portion of the current rate increase application rests on the CIC principle that SaskPower must generate a level of net income that will correspond to a rate of return on equity (ROE) of 9.0%. This target rate of return appears to rely heavily on a comparative analysis found on pages 37 and 38. The problem is that most of the comparators are not publicly owned electric utility companies but investor owned gas distributors and some investor owned power companies. There is no reference to Manitoba Hydro and B.C. Hydro which would be the natural comparators for purposes of considering appropriate rates of return for government owned utilities. We believe it is important to make a distinction between privately owned and publicly owned corporations when one is assessing rates of return on equity and particularly when these rates are used to determine appropriate prices the suppliers can charge for their products.

The Consumers' Association hopes the Rate Review Panel will require Sask Power to provide more information to justify a ROE of 9.0% and how one should determine an appropriate ROE for the Crowns in Saskatchewan. It appears to us that the people of Saskatchewan have collectively assumed many of the risks associated with the production and the distribution of electricity in this province by its decision to have electricity provided through a crown corporation. The decision to assume many of the risks faced by investor owned public utilities ought to be reflected in the determination of appropriate rates of return for the Crowns in Saskatchewan subject to review by the Rate Review Panel.

Finally, it is important to question the linkage between the ROE and the dividend payouts to CIC. The capital structure of SaskPower in terms of the debt/equity ratio is difficult to determine. The readers of the submission are forced to make some calculations to estimate long-term debts and the level of equity investment in the corporation. As mentioned earlier, the Consumers Association has calculated that SaskPower's long-term debt in 2007 will be approximately $ 2.3 billion. Based on SaskPower's request to achieve net revenues of $ 127 million in 2007 and that this revenue level will correspond to a ROE of 8.5% we estimate that CIC has an equity investment valued at about $ 1.5 billion in SaskPower.

Is it fair and reasonable to provide CIC with a guaranteed rate of return of 9.0% on its equity investments in SaskPower and a correspondingly high rate of dividends ranging from a low of 65% to a high of 90% of the annual net revenues of SaskPower? Few privately owned corporations pay dividends of this magnitude; they like to retain a significant portion of their earnings for purposes of future investments and growth. Given the repeated statements in the submission about the need to upgrade and invest in new plants it is clear that SaskPower will need to undertake significant capital investments in the near future. In the absence of a policy to permit SaskPower to retain a much greater portion of its net revenues, the Consumers' Association cannot support the request for the $ 17 million rate increase which we have determined is solely for the purposes of increasing net revenues of SaskPower with a subsequent transfer of 65% of these increased earnings to CIC.

1.3 Summary of Rate increases

SaskPower has requested that rates be changed in order to increase its net earnings in 2007 by $ 55 million. The Consumers Association recommends that the rate increase be limited to $ 33 million for the reasons outlined above.

2. Rate Balancing and Rate Design

The Consumers' Association has few comments on the second part of the document, Rate Rebalancing and Redesign. This section describes how each class of consumers will be affected by the proposed rate increases based on the principle of minimizing the cross subsidies between the different classes of customers and between customers within each class of customers. This is an acceptable principle but it is a very difficult process to evaluate because of the information required about each group and class of customers. We trust that the Review Panel will get this information from Sask Power and review it carefully.

3. Concluding Remarks

The issue before the Rate Review Panel is to review an application for rate changes by SaskPower based on projected expense increases in 2007.

The documentation submitted to the Panel by SaskPower includes information about many additional and important issues facing SaskPower and which must be addressed in the near future. The Consumers' Association would like to explore some of these issues and would like to know how and where these issues can be discussed without framing the discussion in the context of a rate change application for a specific 12 month period. The financing, production and delivery of electricity cannot be analyzed in the short term. Likewise, we believe the evaluation of SaskPower's performance must be done in the context of longer time period than 12 months.

At the end of the oral presentation, The Consumers' Association made several additional comments. The Review Panel asked that these additional comments be added to the written presentation for the record.

The Consumer's Association has identified several pressing issues for further review and discussion. Among them are the following:

[I] The current submission by SaskPower speaks in many places to the need for SaskPower to replace and/or upgrade one or more of its ageing coal powered generating plants and to add additional generating capacity which must meet yet undefined environmental standards. Until now SaskPower has relied on coal mined and produced in Saskatchewan for the old plants. Public statements from the corporation indicate it intends to develop an environmentally "super clean" coal powered generating plant at a cost of approximately $ 1.5 billion. The impact of these expenditures will surely be felt on future rates.

The Consumers' Association would like to know how much of the estimated cost can be attributed to making the new plant environmentally "super clean" in order to reduce greenhouse gas emissions. Are there less expensive ways of adding new generating capacity that would not incur the high costs of reducing greenhouse gas emissions? Is the use of coal produced elsewhere in Canada a less expensive fuel from the perspective of environmental standards? Is the use of nuclear power an alternative at this time or is it a future alternative only, applicable in 20 or 30 years? In many jurisdictions new generating plants rely on natural gas as the preferred fuel. Why do SaskPower's current development plans put such heavy emphasis on coal powered generating plants while ignoring gas powered plants considered by many experts to be a relatively "clean" solution compared with coal?

[II] During the last two months, SaskEnergy and SaskPower have appeared before the Rate Review Panel asking for rate changes. Both corporations included in their submissions lengthy descriptions of their "natural gas management policies" describing how they handle the price and supply volatility problems associated with the purchases of natural gas. Both emphasize their use of hedging contracts to cover their future needs and adverse price movements.

The evidence presented by SaskEnergy suggests it spends approximately $ 400 million a year to purchase gas for resale. The evidence presented by SaskPower suggests it spends approximately $ 70 million to purchase gas for its own use; gas purchases used for Co-Generation add another $ 200 million to its gas costs. SaskEnergy is both a purchaser and a vendor of natural gas but not a significant user; we assume SaskPower is purchaser and user of natural gas only.

We do not know how much of the $ 270 million spent by SaskPower on natural gas purchases represents purchases from SaskEnergy. We have to assume that a significant portion of SaskPower's purchases are from suppliers other that SaskEnergy. For that reason we assume that the combined purchases by both corporations is greater than $ 400 million and could well approach $ 500 million or more annually.

The Consumers' Association would like the Rate Review Panel to analyze, review, compare, and evaluate the natural gas purchase policies and gas management policies of the two corporations. It does not appear to make sense for one Crown corporation to hedge its purchases from another Crown corporation which is also hedging its purchases when both are owned and controlled by another Crown corporation, the Crown

Investment Corporation. The Rate Review Panel has access to information about the corporations' natural gas strategies which is not available to the Consumers' Association and the other interveners at the rate hearings. Are there potential savings available by centralizing the purchasing of the natural gas for the two Crown corporations and operating with one central office to handle the purchasing and hedging strategies for the combined needs of both SaskEnergy and SaskPower?