Saskatchewan Rate Review Panel

Report to the Minister Responsible for Crown Investments Corporation of Saskatchewan

regarding the

SaskPower Application Effective date January 1, 2013

Report submitted November 19, 2012

Executive Summary

On July 10, 2012, SaskPower submitted its Application for a rate change to take effect January 1, 2013. The Application requested a 4.9% increase for all customer classes except large industrial customers in the Power-Contract Rate class, where a 6.1% increase was requested, resulting in a system-wide average 5.0% rate increase.

An Order from the Minister for Crown Investments Corporation (the Minister) instructed the Panel to review SaskPower's Rate Application and submit its recommendations by November 19, 2012. Under its mandate, the Panel assessed the fairness and reasonableness of SaskPower's rate request, while balancing the interests of the Public, its customers and the Crown Corporation. The Minister's Order and Terms of Reference for this review are attached as **Appendix A**.

In its Application, SaskPower identified 3 main factors driving its rate request: the need for long-term investment in new generation, transmission and distribution capacity to meet the growing demand for electricity, the need to rebuild and reinforce its existing system built 30 to 50 years ago, and the requirement to upgrade its environmental performance. The Application notes that capital expenses have increased in recent years, with planned capital spending in 2012 of $998 million, rising to a forecast $1.15 billion in 2013. Over the 10-year period beginning in 2013, SaskPower forecasts capital spending of $10 billion, plus a further $3 billion to purchase power from various suppliers through Power Purchase Agreements.

In September 2012, SaskPower submitted a Mid-Application Update to the Panel that included information from SaskPower's completed 2013 Business Plan. Based on this updated information, including revenues from the proposed rate increase, SaskPower forecasts net income in 2013 of $126.1 million, down from the forecasted $165.9 million in the original Application. The Mid-Application Update also indicated that the requested increase for the Power-Contract Rate class would be 6.3% in 2013, rather than the 6.1% in the original Application. The original Application is attached as **Appendix B**, and the Mid-Application Update as **Appendix C**.

The Panel contracted Forkast Consulting (the Consultant) to serve as the technical consultant reviewing the application and supporting documentation. The Consultant's report is attached as **Appendix D**.

The Panel conducted an extensive public consultation process that included public meetings in Saskatoon and Regina. The Panel notified key stakeholders about the Application by letter and email, and invited them to make presentations to the Panel and provide written submissions. Members of the public were encouraged through advertisements and posters to make submissions by email, telephone and regular mail, and to attend the public meetings. The Panel is encouraged that some stakeholders devoted significant time and effort to make submissions and prepare presentations for the public meetings.

As noted above, SaskPower must make significant capital investments over the coming decade, and these investments will affect its revenue requirements. Every $100 million added to SaskPower's balance sheet will add $7 million in finance costs and depreciation charges, which would, on their own, result in an annual rate increase of 4.4%. These costs will continue to rise significantly over the next decade as the $10 billion in planned investments proceed. The factors affecting SaskPower's financial situation are analyzed in greater detail in **Section 6.2** of this report, **Factors Affecting Future SaskPower Rates**.

During the review of this Application, both the Consultant and major Stakeholders encouraged the Panel to revisit previous recommendations and ask the Minister to consider supporting greater disclosure by SaskPower on future cost implications, noting that the current review process of providing information related only to the current Application limits the ability to examine future costs and rate implications. The Consultant pointed out that the industry norm is to provide at least 5 years of future financial projections, with some regulators requiring 10-year forecasts. The Panel appreciates the positions of the Stakeholders and encourages SaskPower to do more of this type of planning and disclosure in the future. The need for a greater focus on planning, and more communication between SaskPower and its large customers, was borne out in presentations made by the Saskatchewan Mining Association, Paper Excellence and the Canadian Association of Petroleum Producers during the public meeting in Regina. These and other large users represent a significant portion of the province's current and future demand for power, and power is one of the cost inputs they consider when making decisions regarding locations for major future investments.

The Panel does, however, acknowledge SaskPower's efforts in initiating long-term planning in two critical areas: a Far North Resource Supply Plan and a 40-Year Resource Supply Plan, both of which recognize that the largest growth in future demand is expected to take place in northern Saskatchewan. More information on this topic and the submissions made at the Regina public meeting are provided in **Section 6.5** of this report, **Future Planning and SaskPower's Largest Customers.**

Following a late June storm that struck large areas of central Saskatchewan, SaskPower made a concerted effort to restore service to customers affected by power outages. This damaging storm added almost $15 million in unexpected 2012 OM&A expenses, underlining the balance that SaskPower must maintain in providing a reliable source of power at a competitive cost. The Panel wishes to acknowledge the outstanding efforts by SaskPower and its employees in restoring essential services to its customers following this storm.

Taking into consideration the information provided by SaskPower, input from the public and the analysis in the technical report provided by the Consultant, the Panel makes the following recommendations:

Recommendation 1: That the following forecasts be accepted as justified and reasonable for the purpose of setting a rate that will allow SaskPower to earn net income of $126.1 million in 2013:

- **Total Fuel and Purchase Power forecast of $545.1 million**
- **Estimated natural gas consumption of 43.6 million Gigajoules (Gj) at a forecast cost of gas of $4.00 per (Gj)**
- **The total cost of Operation, Maintenance and Administration expenses of $615.2 million**
- **Depreciation and Amortization expenses of $363.0 million**
- **Corporate, municipal and other tax obligations of $53.5 million**
- **The Return on Equity and Overall Rate of Return of 6.4%**
- **Other costs set at $9.0 million**

After a thorough analysis of all aspects of SaskPower's business the Consultant recommends, and the Panel concurs, that the forecast revenue and expense items above be accepted, and that the proposed 4.9% rate increase for all customer rate classes except the Power-Contract Rate class, will allow SaskPower to earn net income of $126.1 million in 2013.

Recommendation 2: That SaskPower's proposed 4.9% rate increase for all customer classes, except the Power-Contract Rate Class, resulting in a system-wide average increase of 5%, be approved. The proposed increase would be effective January 1, 2013.

The Terms of Reference for this review state that the Panel is to accept as given that SaskPower will have an opportunity to generate a Return on Equity (ROE) of 8.5% in 2013. While the original Application included revenue and expense forecasts that would have allowed SaskPower to achieve the target Return on Equity with the proposed average 5% rate increase, the Mid-Application Update forecast a drop in net income in 2013 of almost $40 million, to $126.1 million. As a result, the Return on Equity was lowered to 6.4%. For the Panel to meet its mandate to allow SaskPower the opportunity to achieve a Return on Equity of 8.5%, SaskPower indicated in its response to Round 2 Information Request Q2 that it would require a rate increase of 7.5%. However, in its Mid-Application Update, SaskPower did not ask for a change in its rate request. While the 6.4% Return on Equity is lower than the target specified in the Terms of Reference, SaskPower's Return on Equity for 2009, 2010, 2011, together with expected returns for 2012 and 2013, will average in excess of 9.0%. The Consultant offers the opinion, and the Panel concurs, that the 5-year average yield meets the spirit of the 8.5% target.

The table included in **Section 7.1** of this Report, **Impact on the Customer**, illustrates the impact of the proposed rate change on the various customer classes.

Recommendation 3: That SaskPower continue to develop, implement and track in a consistent manner, measurable cost control, productivity and efficiency initiatives resulting from its Business Renewal program and other efficiencies on a year-over-year basis, and report these findings in future rate applications.

The Panel had expressed concerns about significant annual increases in Operations, Maintenance and Administration (OM&A) expenses in its review of SaskPower's 2009 and 2010 Rate Applications. In its 2010 report, the Panel recommended, and the Minister directed, that SaskPower achieve annual productivity savings of 2% in its OM&A expenses. In response, SaskPower launched a multi-year, multi-phase Business Renewal program to streamline business processes and use technology to achieve cost savings and/or reduce costs.

The Panel congratulates SaskPower on its Business Renewal initiative, and its Service Delivery initiative, which it launched in 2009. These two initiatives are simplifying business and service delivery processes and employing technology to achieve savings and reduce costs, especially in the Operations, Maintenance and Administration category.

The Panel acknowledges that it will take time, an investment in financial and human resources, and a firm commitment from SaskPower's leadership to reap the benefits of current and future initiatives under the program. While the program is still in its early stages, SaskPower has set a target of $12.3 million in savings in 2012, rising to a forecasted $220 million in 2013. However, this figure includes Finance Savings and savings from changes to Capital Structure that total $140 million. The Panel regards these two items as part of good business practices, which are not appropriately allocated to the OM&A category. Removing these two items reduces the forecast

OM&A savings for 2013 to $80 million, which is still well in excess of the target 2% annual productivity improvement.

The Panel welcomes the progress SaskPower has made on Business Renewal and Service Delivery Renewal that will benefit its customers in the future. The Panel believes it is important that SaskPower have a consistent, easy-to-understand format for measuring and tracking these savings on a year-over-year basis, and would like to see this information reported in future rate applications. The Panel also emphasizes that these efficiency and productivity initiatives are important to SaskPower's future financial well being, and will help to mitigate the impact of future rate increases on customers.

The rationale for each of the Recommendations is provided in greater detail in **Section 5** of this Report**, Panel Recommendations and Analysis.**

More detailed discussion of OM&A expenses and the Business Renewal program are provided in **Section 6.3** of this Report**, Operations, Maintenance and Administration.**

Table of Contents

1.0 Role of the Saskatchewan Rate Review Panel

1.1 Authority

Through an Order-in-Council dated January 1, 2010, the Minister Responsible for Crown Investments Corporation (the Minister) received continued authority to reappoint the Saskatchewan Rate Review Panel (the Panel) as a Ministerial Advisory Committee. The Panel's mandate states that it shall:

> *(a)* *conduct a review and provide an opinion of the fairness and reasonableness of proposed Crown corporation rate changes, referred to the Panel by the Minister of Crown Investments Corporation; and*
>
> *(b)* *incorporate as part of its mandate specific terms of reference for particular Crown corporation rate change reviews that may be attached by further Minister's Order.*

Whether in the original Order-in-Council establishing the Panel (437/2000 dated July 27, 2000), or in the Terms of Reference for particular reviews, the Panel has always been instructed to consider: "…the interests of the customer, the Crown corporation, and the public."

The Panel's mandate extends to three Crown corporations in Saskatchewan – SaskEnergy, SaskPower and SGI's Saskatchewan Auto Fund. Serving as an advisory body to the Minister Responsible for Crown Investments Corporation, the Panel analyzes all of the materials received from the Crown corporation, customers, the public and its consultants. It prepares and submits a written report containing its observations and recommendations to the Minister for the Crown Investments Corporation and the Minister responsible for the particular Crown. The Panel's report and a media release summarizing the main elements of the report are posted on the Panel's website.

The Minister for the Crown proposing a rate change presents the Panel's final report, together with the Crown corporation's analysis of the report and recommendations, to Cabinet.

The final decision regarding these proposals continues to rest with the Saskatchewan government.

1.2 Members of the Panel

Through the January 1, 2010 Minister's Order, the following members were appointed to serve on the Saskatchewan Rate Review Panel:

Chair	Kathy Weber	Saskatoon
Vice-Chair	Bill Barzeele	Little Bear Lake
Members	Steve Kemp	Regina
	Delaine Barber	Weyburn
	Lyle Walsh	Yorkton
	Daryl Hasein	Biggar
	Burl Adams	Kelvington

1.3 Panel's Terms of Reference

The Saskatchewan Rate Review Panel is requested to conduct a review of SaskPower's request for an increase in its electricity rates targeted for implementation on January 1, 2013. Cabinet may implement any rate change adjustment on an interim basis pending receipt of the Panel's recommendation(s).

The Panel's mandate, provided in its entirety in Appendix A, is to provide an opinion of the fairness and reasonableness of SaskPower's proposed rate change, taking into consideration the interests of the Crown Corporation, its customers and the public; the Crown corporation's mandate, objectives and methodologies; relevant industry practices and principles; the effect of the proposed rate change on competitiveness; the reasonableness of the proposed changes to the rates in the context of forecasted delivery cost of service in 2013; the revenue requirement resulting from the delivery cost of service; and the future impact of the proposed rate change on different customer groups.

The Panel is also to consider several parameters as given, including the proposed 2013 Return on Equity target of 8.5%; and the revenue to revenue requirement ratio target range of 0.95 to 1.05.

Consistent with the "Confidentiality Guidelines" for the Panel (March 11, 2010), the Panel will not publicly release or require SaskPower to publicly release Confidential Information supplied by the Crown corporation to the Panel during the course of the rate change application review.

The Panel will release, as part of its report, the results of the review of SaskPower's rate request as conducted by an independent third party. By doing so the Panel shall ensure there has been no indirect release of any of SaskPower's Confidential Information.

The Panel will present its primary report detailing its analysis and recommendations on SaskPower's proposed electricity rate change request to the Minister of Crown Investments and the Minister Responsible for SaskPower no later than Monday, November 19, 2012. The reporting date may be modified by the Minister of Crown Investments in consultation with the Panel Chairperson.

2.0 SaskPower's Rationale for the Application

The Panel received SaskPower's proposal for a rate increase (the "Application") on July 10, 2012.

SaskPower provides electricity generation, transmission and distribution to more than 480,000 customers throughout a geographic area of approximately 651,000 square kilometres. SaskPower manages more than $6.3 billion in assets to generate and supply power to its customers.

In its Application, SaskPower states that a rate increase is required for long-term investment in new generation, transmission and distribution capacity to meet the growing demand for electricity in Saskatchewan. In addition, in common with other utilities across North America, SaskPower is facing an extended period of reinvestment in an electrical system that was built 30 to 50 years ago. This comes at a time when SaskPower is experiencing increases:

- in the number of customers connecting to the system;
- in electricity demand/load;
- in physical assets necessary to meet that load; and,
- in the maintenance requirements on its generation, transmission and distribution facilities.

SaskPower forecasts in its Application that load growth over the next decade will increase by 2.9% per year in system energy requirements, and by 2.5% in system peak load, which is the highest level of demand placed on the system at any one time. By contrast, during the 2000-2010 period, system energy requirements increased by an average 1.4% per year, and the system peak load increased by 1.1% per year.

In its Application, SaskPower states: *"A reliable supply of electricity is essential to help sustain the growing provincial economy. Saskatchewan residents will benefit from a modern, efficient, reliable and environmentally sustainable power system, along with competitive rates."* (p. 3)

3.0 Review Process for SaskPower's Application

3.1 Consultant

The Panel engaged Forkast Consulting as an independent technical advisor to review and make recommendations on the fairness and reasonableness of SaskPower's rate request, consistent with the Panel's Terms of Reference for the review.

As part of the review process, the Consultant filed two sets of Information Requests and supplementary questions (totaling 200 information requests) with SaskPower. The Consultant also had conversations with SaskPower regarding the Application and other information provided. The Consultant also reviewed interrogatories, formal submissions and oral presentations at public meetings from various organizations.

The Consultant also met several times with the Panel and had many telephone conversations and other communications with the Panel during the course of this review.

Confidentiality Guidelines and a Protocol of Confidentiality were employed to assist in the timely flow of interrogatories, responses and other information between SaskPower, the Consultants and other interested stakeholders. The Guidelines can be viewed at: www.saskratereview.ca/images/docs/confidentiality_guidelines_02192010.pdf.

The Panel also engaged a technical writer for this report.

3.2 Public Consultations

As with other recent reviews, the Panel adopted a proactive approach to encourage public comments as part of its review of the SaskPower application. The public consultation process included:

- Public meetings;
- Submissions by mail;
- Online messages received through the Panel's website;
- Messages received directly to the Panel's email address; and
- Messages received through the Panel's toll-free voice mailbox.

The SaskPower rate application received news coverage immediately after the original application was announced. All methods of public input were advertised in the province's four daily newspapers and select weekly newspapers, on community cable channels, and on select radio stations in Saskatoon and Regina. The Panel developed posters that were displayed in public spaces at offices of SaskPower, SaskEnergy and SGI. Public meetings were held in Saskatoon on September 19, and in Regina on October 2.

Copies of the Application were available on the Panel's website, at SaskPower's offices and on SaskPower's website.

Several key stakeholders attended the public meetings and made submissions to the Panel. These organizations included Paper Excellence, the Consumers Association of Saskatchewan, the Canadian Association of Petroleum Producers, the City of Swift Current, the City of Saskatoon, the Saskatchewan Industrial Energy Consumers Association, the Saskatchewan Mining Association and the Greater Saskatoon Chamber of Commerce; all made submissions at the public meetings. This input, and transcripts of the public meetings are accessible at the Panel's website, www.saskratereview.ca. No other communications were received from the public.

One of the key themes emerging from the presentations made by representatives of SaskPower's large industrial customers was that it is a critical supplier, and that the price, security and reliability of future electricity supplies are key considerations in their ongoing operations, and when they plan to expand existing facilities and/or develop new projects over the next 10 to 20 years. In its presentation, Paper Excellence, which operates Meadow Lake Mechanical Pulp, noted that electrical power is a significant component of its costs, and that electricity pricing affects its ability to be competitive with other competing suppliers around the globe to the point that the price of electricity can make the difference between being profitable, or not.

The Greater Saskatoon Chamber of Commerce observed that while SaskPower makes comparisons against other electric utilities across Canada, it should also include utilities in neighbouring states such as Montana and North Dakota to achieve a more accurate picture of SaskPower's competitiveness in attracting new investment in relation to other utilities.

The electric utilities for the cities of Swift Current and Saskatoon, which buy power in bulk from SaskPower, noted that the Reseller rate they are charged is higher than the Urban Residential and Urban Commercial rates charged in other communities, using the Revenue to Revenue Requirement (R/RR) ratio as the measure. Saskatoon Light and Power objected to the 1.03 ratio for Resellers in the original Application, while noting that this was reduced to 1.01 in the Mid-Application Update. Saskatoon City Light and Power urged the Panel to recommend that the R/RR for Resellers be 1.00.

The City of Swift Current also argued that the R/RR for Resellers should also be the same as for Urban Residential and Urban Commercial customer classes, at 0.98, rather than the R/RR ratio of 1.01 in the Mid-Application update.

The Saskatchewan Mining Association noted the large investments SaskPower is making in power generation, and particularly transmission and distribution infrastructure in northern Saskatchewan. The SMA registered its concern regarding the availability of sufficient power to meet demand as large new mining developments take place in the north.

The Canadian Association of Petroleum Producers (CAPP) noted the difficulties SaskPower faces in gathering information from its largest customers about their future power needs, but also encouraged SaskPower to foster better relationships to improve the quality and quantity of information exchanges between the two. CAPP and the Saskatchewan Industrial Energy Consumers Association both expressed concerns regarding confidentiality of certain information and its effect on the transparency of the review process. The Panel and its Consultant re-examined this issue following the public meeting in Regina, and reviewed each of the 37 responses to Information Requests that were provided in confidence. The Consultant identified 29 responses that clearly fell within the Confidentiality Guidelines adopted by the Panel and SaskPower in 2010. The remaining 8 confidential responses were not material to the Application or under active consideration at this time, and there was no merit in pursuing the matter any further. The Panel did follow up on this matter with a letter to the Saskatchewan Industrial Energy Consumers Association, which was subsequently posted on the Panel's website.

4.0 Summary of the Consultant's Report

The Consultant's Report, entitled *Independent Review of the SaskPower 2013 Rate Proposal Application*, is provided as **Appendix D** of this report. The report provides an overview and thorough analysis of SaskPower's rate development over time, its current financial and operational challenges, and its future outlook.

The Consultant examined in detail each of the main revenue and expenditure categories required for this review. In addition, the Consultant examined various activities and programs that are part of SaskPower's current operations and future planning. The Consultant also reviewed SaskPower's existing Cost of Service Study, including the methodology used and all updated forecasts and rate structure. They found that the rate structure remained virtually unchanged from that used in SaskPower's 2010 rate application to the Panel. SaskPower is currently conducting a review of the Cost of Service methodology, which will be used in the next rate application.

SaskPower also provided a significant amount of supplementary information during the review process, including responses to two rounds of Information Requests made by the Consultant, responses to supplemental questions from the Consultant, arising from the Mid-Application Update, and an update on an Advanced Metering Infrastructure program managed jointly by SaskPower and SaskEnergy.

4.1 Operations, Maintenance and Administration

After reviewing all revenue components and elements of operating expenses, the Consultant states that the major expense categories, such as for fuel and purchase power, depreciation and amortization, finance charges and tax obligations are justified and reasonable. (p. 3) The Consultant pays particular attention to the Operations, Maintenance and Administration (OM&A) expense category, noting that in its 2010 Report, the Panel recommended and the Minister directed SaskPower to achieve annual productivity savings of 2% in its OM&A expenses. In response, SaskPower initiated the Business Renewal program to seek out cost savings and increase efficiency.

The Consultant recognizes that SaskPower is in the early stages of implementing initiatives under the Business Renewal program, and that some initiatives will require significant investment in financial and human resources to achieve future cost savings. They also point out that such initiatives are long-term projects for a complex and widely dispersed organization like SaskPower. The Consultant notes that in 2012, SaskPower will realize benefits from some Business Renewal initiatives, with a target of $12.3 million, rising to a forecasted $220 million in 2013, relative to the 2009 baseline. (p. 81) While the mandate of the Business Renewal program is to review all aspects of SaskPower's expenses, the savings and/or reduced/avoided costs are incorporated in the OM&A expense category. The Consultant points out that borrowing in the short term at lower interest rates and replacing equity with lower cost debt in the capital structure make good business sense in the current environment, but these savings may not be appropriately classified as OM&A savings:

> *"The cost savings initiatives in procurement, the reduction in power plant outage duration and frequency, information technology initiatives and office space utilization are real and significant. The reduction in finance costs and capital structure are also savings, but we*

> *would suggest that these are just good current business practices which many utilities now employ, which effectively result in significant cost savings for the corporation, but we would not classify them as operations, maintenance and administrating savings."* (p. 81)

A clearer picture of the forecasted OM&A savings for 2013 emerges when the forecasted savings of $140 million in finance costs and capital structures identified on page 76 of the Consultant's report are removed from OM&A. This would reduce the actual OM&A savings for 2013 to a forecasted $80 million.

The Consultant notes that more than half of the increase in OM&A expense for 2012 – almost $15 million – was related to efforts to restore service following a major storm that rolled through central Saskatchewan during the summer.

In 2009, SaskPower launched the multi-year Service Delivery Renewal initiative to improve business processes and cut costs related to delivering customer services. As part of Service Delivery Renewal, SaskPower will soon begin replacing customer meters with new, advanced meters that will enable it to manage service connects and disconnects remotely, and track outages more accurately, among other benefits.

The Consultant congratulates SaskPower's leadership and Board of Directors for undertaking the Business Renewal program and other cost reduction initiatives, noting that:

> *"Success is not guaranteed, but with the leadership taking a wholesome approach and providing the general direction and specific focus should augur well for the organization as a whole, and their end use consumers."* (p. 82)

The Consultant cautions, however, that the Panel, the public and SaskPower's customers must understand that successful Business Renewal initiatives will reduce, but not eliminate the need for future rate increases, which will be driven not only by operating costs, but by the significant investments in infrastructure renewal and new generation, transmission and distribution facilities needed to provide a safe and reliable electric system for Saskatchewan's growing economy. (p. 82)

The impacts of these capital investments and reinvestments are noted in the Consultant's review of finance charges and depreciation and amortization expenses, both of which contribute to increased revenue requirements. SaskPower explained in its response to First Round Information Request 125, as a general rule, every $100 million in capital expenditures increases depreciation expense by $3 million, and finance charges by $4 million. SaskPower forecasted depreciation and amortization for 2012 of $321.1 million, rising to a forecast $363 million in 2013, a year-over-year forecasted increase of $41.9 million, or a 13% increase. (p. 84) Currently, SaskPower forecasts finance expenses for 2012 at $202.1 million, rising to a forecast $303.3 million in 2013, a year-over-year forecasted increase of $101.2 million. (p. 88) In response to the Consultant's second round IR 48 regarding the rate increase that would be required to cover the cumulative impacts of the 2010 through 2013 capital programs on the depreciation and finance cost categories alone, SaskPower stated that the required rate increase in 2013 would be 13.1%.

4.2 Two-Way Communication with Large Customers

The Consultant notes that a small number of SaskPower's largest customers in the Power – Contract Rate customer class account for more than 40% of total domestic demand for electricity in Saskatchewan, and that these large customers will represent almost 50% of all demand by 2022. SaskPower's ability to forecast demand is somewhat constrained by its reliance on information provided by these large customers, who in turn are sensitive to changing conditions in the global economy, which affect their current demand and their future planning and investment decision-making. In this dynamic environment, SaskPower and its large customers benefit from having the best reliable information available about current costs and future cost trends. This is particularly true for large customers looking at electricity costs as one of the inputs they consider in making important investment decisions. The Consultant notes that SaskPower's Key Account representatives communicate regularly with these large customers, and that sharing reliable information will become even more critical in the future as their share of total domestic demand increases.

The Consultant notes that the current review process of providing information related only to the current Application limits the ability to examine future costs and rate implications. They point out that the industry norm is to provide at least 5 years of future financial projections, with some regulators requiring 10-year forecasts. Accordingly, the Consultant recommends that the Panel consider supporting greater disclosure on future cost implications and make a similar recommendation to the Minister. (p. 168)

On a positive note, the Consultant observes that SaskPower has developed a 3-stage Far North Resource Supply Plan and a 3-stage 40-Year Resource Supply Plan to evaluate system resource needs in the short-, mid- and long-term to meet forecasted load growth, with future industrial growth taking place primarily in the province's north. The Consultant is encouraged that for the first time, SaskPower is looking beyond the usual 10-year planning horizon, and has conducted extensive analysis of its northern requirements. (p. 171)

4.3 Net Income and Return on Equity

Under the Terms of Reference for this review, the Consultant points out that the Panel is required to provide SaskPower an opportunity to generate Return On Equity of 8.5%. In its Mid-Application Update, SaskPower forecasts net income for 2013 of $126.1 million, a decrease of almost $40 from the original application. If approved, the proposed 5.0% overall system average increase and the forecasted net income of $126.1 million will deliver a Return On Equity of 6.4% for 2013. Using the revenue and expense forecasts in the Mid-Application Update, SaskPower calculates that a 7.5% increase would be required to achieve a 8.5% Return on Equity in 2013. (p. 97)

While the requested 5.0% system average increase, if approved, would yield only a 6.4% Return on Equity, the Consultant notes that SaskPower's ROE for 2009, 2010 and 2011, together with expected returns for 2012 and 2013, will average in excess of 9.0%. On this basis, the Consultant states that the 6.4% Return on Equity *"…it is our opinion that it meets the spirit of the target in that for the five-year period ending in 2013 the overall return is or is expected to be greater than the specified target of 8.5%."* (p. 3) Accordingly, the Consultant recommends that the revenue requirement be set to allow SaskPower to earn net income of $126.1 million in 2013, and achieve Return on Equity of 6.4%.

4.4 Revenue to Revenue Requirement

The Terms of Reference for this application state that the revenue to revenue requirement (R/RR) ratio target range for all customer classes be between 0.95 and 1.05. The Terms of Reference also state that the final rate change will be applied equally to all rate classes, except the Power – Contract Rate class. The Consultant points out that R/RR ratios will change from year to year because of changes in revenue within each customer class, and class revenue requirements, noting a slight shift in ratios between the original Application and the Mid-Application Update:

> *"The current Application rate request would result in the R/RR ratio for Residential, Farm, Urban Commercial and Power Contract forecasted to be slightly below 1.00, and above 1.00 for all other classes. In the previous application, only Farm and Residential classes were below 1.00. This change means that, generally the Farm, Residential and Urban Commercial and Power Contract customers are being subsidized by the Power, Oilfield and Reseller classes. This shift is because, while the revenue has increased equally for all classes in this application, costs have not. The R/RR ratio for the Reseller class was originally calculated to be 1.03, but was changed to 1.01 in the Mid-Application Update. This compares to an R/RR of 1.00 in the 2010 application."* (p. 144)

The Consultant states that SaskPower has one of the narrowest R/RR ranges among all Canadian utilities, and is satisfied that the Application meets the goals and target defined by the Minister. (p. 173)

4.5 Competitiveness

Regarding SaskPower's competitiveness in relation to other electric utilities, the Consultant points out that hydro power is the most economical to generate. Since SaskPower generates only approximately 7% of its power from hydro, the most meaningful comparison is with "thermal" utilities that generate power primarily using fuel sources such as coal and natural gas. The Consultant states that SaskPower's rates compare favourably with other provinces – on average 8% lower than the Canadian average and 22% lower than the Canadian average for thermal utilities. They caution, however, that each utility has unique characteristics that make direct comparisons difficult, such as generation fuel mix and variables related to customer density, population distribution and the potential to earn export revenues. (p. 155)

5.0 Panel Recommendations and Analysis

The Saskatchewan Rate Review Panel, after conducting its review and analysis, conferring with its consultant, and taking into account input from the public regarding this application, makes the following recommendations:

Recommendation 1: That the following forecasts be accepted as justified and reasonable for the purpose of setting a rate that will allow SaskPower to earn net income of $126.1 million in 2013:

- **Total Fuel and Purchase Power forecast of $545.1 million**
- **Estimated natural gas consumption of 43.6 million Gigajoules (Gj), at a forecast cost of gas of $4.00 per Gj**
- **The total cost of Operation, Maintenance and Administration expenses be $615.2 million**
- **Depreciation and Amortization expenses be $363.0 million**
- **Corporate, municipal and other tax obligations be $53.5 million**
- **The Return on Equity and Overall Rate of Return be 6.4%**
- **Other costs be set at $9.0 million**

After a thorough analysis of all aspects of SaskPower's business, the Consultant recommends, and the Panel concurs, that the forecast revenue and expense items above be accepted, and that the proposed 4.9% rate increase for all customer rate classes except the Power-Contract Rate class, will allow SaskPower to earn net income of $126.1 million in 2013.

Recommendation 2: That SaskPower's proposed 4.9% rate increase for all customer classes, except the Power-Contract Rate Class, resulting in a system-wide average increase of 5%, be approved. The proposed increase would be effective January 1, 2013.

Under the Terms of Reference for this review, the Panel is to accept as given that SaskPower will have an opportunity to generate a Return On Equity (ROE) of 8.5% in 2013. When the original Application was filed, the proposed system-wide average 5% increase would have achieved the target Return on Equity of 8.5%. However, in its Mid-Application Update of its forecasted revenues and expenses, even with the proposed increase, SaskPower forecasted net income for 2013 of $126.1 million, almost $40 million below the forecast in the original Application. This in turn would result in a reduced Return on Equity of 6.4% in 2013.

It is important to note that SaskPower did not ask for a revision to the original rate request after submitting the Mid-Application Update. In its response to Q2 in the second round of Information Requests, SaskPower indicated that the rate increase for 2013 would have to be 7.5% to achieve the target Return on Equity of 8.5%. While the updated forecast net income would result in a Return on Equity below the target in the Terms of Reference, the Panel recommends that the revenue requirement be set to allow SaskPower to earn net income of $126.1 million in 2013. This will result in a Return on Equity of 6.4%. The Consultant notes that SaskPower's Return on Equity for 2009, 2010 and 2011, combined with expected returns for 2012 and 2013 will average in excess of 9.0%. From this perspective, the Consultant states in its report that the 6.4% Return on Equity *"…meets the spirit of the target in that for the five-year period ending in 2013 the overall rate of return is or is expected to be greater than the specified target of 8.5%."* (p. 3)

After due consideration, the Panel concurs with this conclusion and believes its recommendation in this regard fairly represents the interests of all concerned parties.

The Terms of Reference for this review also require the Panel to accept as a given that the revenue to revenue requirement (R/RR) ratio for all customer classes be between 0.95 and 1.05. The Terms of Reference also state that the final rate change will be applied equally to all rate classes, except the Power-Contract Rate class.

One objective of rate structure and design is to create equity and fairness among all customers within each rate code, regardless of size or load factor. The R/RR ratio is a measure used to determine if equity and fairness is being achieved. For example, a R/RR ratio of 1.00 for a customer class indicates that revenues equal the revenue requirement for that class, and that it neither subsidizes nor receives subsidies from other classes. A ratio below 1.00 means that class is being subsidized by other classes, which would have a ratio above 1.00.

As the proposed increase is spread equally across the board, the R/RR ratio for the various customer classes has spread so that it is projected to be just within the 0.95 to 1.05 range. There has also been a shift in ratios among classes because, while the revenue has increased equally for all classes in this Application, costs have not. The Consultant observes that SaskPower has one of the narrowest R/RR ranges among all Canadian utilities, and is satisfied that the Application meets the target set in the Terms of Reference.

Recommendation 3: That SaskPower continue to develop, implement and track, in a consistent manner, measurable cost control, productivity and efficiency initiatives resulting from its Business Renewal program and other efficiencies on a year-over-year basis, and report these findings in future rate applications.

In its 2009 and 2010 reviews of SaskPower's rate applications, the Panel expressed its concerns regarding Operations, Maintenance and Administration (OM&A) expenses, SaskPower's second-largest expense category. In its 2010 report, the Panel recommended, and the Minister directed, that SaskPower achieve annual productivity savings of 2% in its OM&A expenses.

In its report, the Consultant notes that SaskPower recognized that it had not been operating at optimum efficiency. Following up on the 2010 directive, SaskPower launched a multi-phase Business Renewal program focused on new initiatives to streamline business processes, eliminate duplication and inefficiencies, and leverage technology to achieve cost savings and/or reduce or avoid costs. SaskPower has invested significant financial and human resources to launch the Business Renewal program, and the Panel recognizes that it will take time and strong commitment from SaskPower's leadership to reap the full benefit of the many current and potential initiatives under the program. Achieving efficiencies requires not only changing and streamlining processes, but also changing the culture of the organization.

Although SaskPower's Business Renewal program is in its early stages, it set a target of $12.3 million in savings in 2012, rising to a forecasted $220 million in 2013. However, the Consultant's report points out on page 76 that savings of $140 million are attributable to finance savings and changes in capital structure, and are not appropriately allocated to the OM&A category. The actual forecast savings for OM&A in 2013 are likely to be $80 million. This is still well in excess of the target 2% productivity savings that had been directed.

The Panel applauds SaskPower for the progress it has made so far, and supports continued efforts to seek out savings, streamline customer services and operate more efficiently. The Panel would like to see results from the Business Renewal program presented in a consistent and clear format so that they can be tracked year over year in future SaskPower rate applications. These cost-saving efforts will have beneficial effects for SaskPower's customers in the future, although the Panel cautions that successful Business Renewal initiatives may reduce, but not eliminate, the need for future rate increases to support needed capital investments and higher fuel and power purchase costs to meet the growing demand for power in Saskatchewan.

More discussion on OM&A expenses, the Business Renewal program, and SaskPower's future outlook is provided in **Section 6.2** of this Report, **Factors Affecting Future SaskPower Rates** and **Section 6.3** of this Report, **Operations, Maintenance and Administration Expenses.**

6.0 Panel Observations

6.1 General Concurrence with the Consultant's Report

The Panel completed a comprehensive review of SaskPower's revenue requirements, load forecast, cost of service, system operations, competitiveness and future outlook, and supports the Consultant's conclusions in the following areas:

- That the forecasts for the cost of natural gas, cost of Fuel and Purchase Power, OM&A expenses, depreciation and amortization expenses, tax obligations, Other costs and ROE of 6.4% are all reasonable.
- SaskPower's approach on fuel dispatch is reasonable, and within industry norms, and should be continued.
- SaskPower's methodology for forecasting numbers of customer's results are reasonable estimates, considering the province's projected economic growth relative to the rest of the country and the global marketplace.
- The 2013 Cost of Service Study properly reflects change in the various components that constitute Rate Base and Operating Expenses and that the functional classification of all items, as submitted in the Application and the Mid-Application Update, are reasonable.

6.2 Factors Affecting Future SaskPower Rates

In its report on SaskPower's 2010 Rate Application, the Panel pointed out SaskPower's rising debt and the amount of spending required to build new generation stations and replace or upgrade existing transmission and distribution infrastructure. The current Application and Mid-Application Update make clear that this trend will continue for at least the next 10 years.

Capital spending, however, is just one of the factors that SaskPower faces as it delivers a reliable supply of electricity to its customers. Short-term and long-term debt charges, depreciation charges, municipal and other taxes, finance lease charges tied to power purchase agreements, the fuel mix used to generate power, the generation costs for each fuel type, and operation, maintenance and administration expenses are all factors that will affect SaskPower's financial health, and consequently, the rates it must charge its customers. It is important to note that SaskPower's position is not unique; utilities across North America are facing the same factors as they invest in new infrastructure to replace aging facilities and adjust their fuel mix to meet higher environmental standards. While these factors are somewhat variable, the general trend is toward higher costs.

The situation facing SaskPower is best illustrated by offering some examples of the factors affecting SaskPower's balance sheet. As a general rule, SaskPower states that every additional $100 million in capital expenditures increases depreciation expenses by $3 million, and finance charges by $4 million. This impact alone would require an annual rate increase of 4.4%. SaskPower forecasted depreciation and amortization expenses for 2012 of $321.1 million, rising to a forecast $363 million in 2013, a year-over-year increase of 13%.

Similarly, SaskPower's forecast interest expenses for 2012 are $202.1 million, rising to a forecast $303.3 million in 2013, a year-over-year increase of $101.2 million. Looking into 2014, the completion of the Integrated Carbon Capture and Storage project at Boundary Dam (likely in

2014) will add approximately $998 million to SaskPower's finance charges and depreciation expenses. Since each $100 million increase in capital expenditure represents a 0.5% increase in customer rates, this single project represents a significant future rate increase on its own. It is a project, however, that is needed to meet new environmental regulations and future generation capacity.

SaskPower has financed its recent capital investment program by borrowing through the Province of Saskatchewan, resulting in attractive interest rates on short-term debt. While there are significant savings in funding capital projects using short-term financial instruments in the current environment, there is also a risk element in the event that interest rates move upward. Should that happen, SaskPower may need to move some short-term debt into longer-term financial instruments to protect itself and its customers from volatility in financial markets, which could affect customer rates.

The Crown Investments Corporation has directed that SaskPower's debt to equity ratio be in a target range of 60-75% debt, with the balance being in equity. In 2009, SaskPower's debt/equity ratio was 62.4%, rising to 66.4% in 2012. It is forecast to reach a debt/equity ratio of 71.3% in 2013. While the ratio is expected to remain near this level as large capital projects are undertaken and completed over the next several years, SaskPower's long-term plan is to lower the ratio closer to previous levels.

Notwithstanding the shift in the debt/equity ratio, SaskPower still has one of the strongest balance sheets among utilities in Canada. While this is the case at present, the Panel believes it is important to identify the factors and variables that could expose SaskPower's balance sheet and debt/equity ratio to greater risk in the future. There is potential risk in replacing equity with short-term financing in the current interest rate environment, although it currently makes good business sense. Since it is ultimately the customer who bears the risk, the Panel urges SaskPower to monitor this situation closely, and to have a plan in place to address a rising interest rate environment.

SaskPower's balance sheet is also affected by its obligations under Power Purchase Agreements of varying lengths with independent suppliers. SaskPower expenses these agreements as capital lease amortization under International Financial Reporting Standards. An additional finance charge of $18 million reported in the Mid-Application Update provides a striking example of the impact a capital lease can have. The additional $18 million charge is due to Northland Power's North Battleford Energy Centre being commissioned in 2013, just a few months earlier than anticipated. SaskPower forecasts that its long-term debt allocated to lease obligations will be $552 million in 2012, rising to $1.25 billion in 2013.

SaskPower is also subject to Corporate Capital, municipal and other taxes. The province's Corporate Capital Tax formula is driven by capital investment, which means SaskPower's ambitious capital spending program is driving its Capital Tax expenses higher. SaskPower expects Corporate Capital taxes will increase from $18.7 million in 2009 to a forecast $31.8 million in 2013. This category will continue to rise significantly as new capital projects are put into service. SaskPower forecasts it will pay $53.5 million in corporate, municipal and other taxes in 2013. While the shareholder benefits from the Corporate Capital Tax, SaskPower and its customers bear the cost.

Growth in demand and variations in weather, coupled with the availability of lower-cost hydro and coal sources, affect the amount of natural gas generation and imported power required to meet the demand in any given year. For example, in 2011 SaskPower generated much higher than average amounts of power from its hydro stations. River flows were lower in 2012, but still higher than normal, resulting in an increased use of higher cost natural gas-fired generation, including through Power Purchase Agreements, to meet demand.

Gas-fired plants can be built more quickly than coal or hydro generation units, but natural gas generation costs are higher than coal or hydro. Gas prices are also more volatile and difficult to predict. SaskPower manages a natural gas hedging program that helps to manage some of this volatility as far into the future as 2022. Currently, natural gas prices in North America are depressed because of an oversupply, but as SaskPower expects to add more natural gas to its fuel mix, a rise in gas prices would leave SaskPower and its customers vulnerable to higher generation costs.

The following table provided in the Consultant's report illustrates the shift in fuel generation mix by fuel type, including generation provided through Power Purchase Agreements with private suppliers, from 2009 to 2013. This table highlights the significant increase forecast in natural gas consumption in 2013 over the 2012 level:

SaskPower Generation Mix in GigaWatt hours

Class	2009	2010	2011	2012	2013*
Coal	12,317	12,038	11,614	11,694	11,777
Gas	3,432	3,683	4,032	4,749	7,200
Hydro	2,962	3,866	4,641	4,136	3,327
Imports	440	518	502	652	288
Wind**	714	656	683	683	675
EPP - Other	n/a	n/a	140	151	173
Total Fuel & Purchased Power	**19,865**	**20,759**	**21,611**	**22,063**	**23,483**

*Based on the 2013 Business Plan
** Combined Wind/Other for 2009 and 2010

SaskPower forecasts that despite the current low price for gas, because of the large volume increase, natural gas will represent the largest cost for its fuel purchases in 2013, at $241 million. Coal is forecast at $238 million. On a unit cost basis, hydro is the most economical fuel source, forecast at $4.36 per megawatt hour in 2013. Coal is next, at a forecast $20.43. SaskPower forecasts its 2013 natural gas cost at $32.96 per megawatt hour. Environmentally Preferred Power is forecast at $80.86, or about 18 times more costly than hydro power, and about four times more costly than coal.

The Panel supports SaskPower's use of hedging to manage gas price risks, particularly in light of SaskPower's increasing reliance on natural gas as a fuel source. For example, a $1.00 per GJ increase in natural gas prices would reduce Net Income by $30 million. Looked at from a rate perspective, a 1% increase in customer rates results in a gain of $18 million in net income, so a $1.00/GJ increase in gas prices represents an increase in customer rates of almost 2%.

Hydro generation represents another volatile factor affecting generation costs, since river flows vary widely from year to year. If river flows prove to be less than forecast, the lost capacity has to be replaced by higher-cost generation, the majority of which is natural gas. In 2012, water flows are expected to be above the median, which benefits consumers. However, median flow conditions are forecast for 2013.

In addition, SaskPower owns and operates 2 wind farms and purchases power produced by wind, natural gas, heat recovery and biomass from suppliers under the Environmentally Preferred Power and Independent Power Producer programs. SaskPower invested in wind power in southwestern Saskatchewan to reduce the environmental footprint of its coal generation facilities. However, by its nature, wind power is variable and must be backed up by other firm generation sources. Wind represents a relatively minor portion of SaskPower's overall generation mix. Wind power is also a high cost generation source relative to other sources such as hydro, coal and natural gas.

6.3 Operations, Maintenance and Administration

Following Panel recommendations in its review of SaskPower's 2009 and 2010 Rate Applications, the Minister directed that SaskPower achieve annual productivity savings of 2% in its Operations, Maintenance and Administration (OM&A) expenses. Subsequently, SaskPower launched a multi-year, multi-phase Business Renewal program to streamline business processes, eliminate inefficiencies and use technology to realize cost savings and/or reduce or avoid expenses. Some examples include strategic procurement and getting better value from suppliers, reducing power plant outage duration and frequency, reducing information technology costs through a number of initiatives, streamlining scheduling and dispatch systems, equipping service vehicles with portable computers, and standardizing office designs to reduce office costs.

Although the Business Renewal program is in its early stages, SaskPower forecasts a target of $12.3 million in savings for 2012, and a forecasted $80 million in 2013, relative to the 2009 baseline, when finance charges and capital structure savings are removed from the OM&A category. Savings of $80 million would still be well above the target 2% productivity savings in OM&A that was directed by the Minister in 2010.

In its discussions with the Consultant, SaskPower recognized that it had not been operating at optimal efficiency. The early results of the Business Renewal program demonstrate its value to SaskPower and its shareholders. The Panel is pleased with the results so far, and urges SaskPower to continue its initiatives under the Business Renewal program, for its own benefit and for its customers. Savings realized through this program will help to mitigate the upward cost pressures SaskPower is experiencing in many other expense categories where it has less control over costs.

The Panel notes that actual OM&A expenses for 2011 were $575.1 million, and were forecast to be $603.3 million in the Mid-Application Update, an increase of $28.2 million. Significant changes from the original Application to the Mid-Application Update include $11.8 million in pension expenses reassigned from OM&A to the Finance Expense category, and the addition of just under $15 million to OM&A to cover restoration efforts following a major storm that hit central areas of the province in late June. The Panel also notes that overtime hours, which were significant during the recovery from the storm, are lumped in with contract labour expenses, making it difficult to track overtime expenses.

The Panel notes that OM&A expenses for 2013 are forecast at $615.2 million, an increase of $11.9 million over the 2012 forecast. This increase is mainly attributable to investments in a risk-based Asset Management program, a Nuclear Feasibility Study initiative and training for the

Integrated Carbon Capture and Storage project at Boundary Dam, Unit 3. The Panel supports the $3 million investment in the Asset Management program, regarding it as providing the foundation for improved business performance of SaskPower's Transmission and Distribution and Power Production assets. Similarly, SaskPower forecasts it will spend $20.2 million on Demand Side Management programs in 2012, and a further $20 million in 2013. These programs encourage customers to conserve energy, and the energy savings result in cost savings and/or avoided costs for SaskPower.

In 2011, SaskPower established a 5-year Workforce Plan to assess its workforce needs and develop a succession strategy. SaskPower expects the number of full-time equivalent (FTE) employees to peak at 3,477, before falling to 3,200 by 2016. The Panel notes that moving overtime costs from the FTE count makes it more difficult to compare FTEs from year to year.

The following table prepared by the Consultant illustrates the number of FTEs by year, with the number of customers, and the resulting customer/employee ratios:

SaskPower FTE & Customer Comparison for 2007 to 2012

	Actual					Forecast
	2007	**2008**	**2009**	**2010**	**2011**	**2012**
SaskPower FTEs	2,744	2,801	2,947	3,018	3,000	3,225
# of Customers	451,713	460,006	467,329	473,007	481,985	486,926
Customer/SP FTEs	165	164	159	157	161	151

The Consultant points out that SaskPower forecasts 3,352 FTEs in 2013, and 495,031 customers, resulting in a customer/FTE ratio of 148. The Consultant expects this ratio to improve significantly by 2016.

The following table, also from the Consultant's report, shows OM&A costs per customer. The 2009 numbers were calculated using Canadian GAPP. Later years use the International Financial Reporting Standards (IFRS):

OM&A Cost per Customer for 2009 to 2013

	Actual			Forecast	
	2009	**2010**	**2011**	**2012**	**2013**
OM&A Cost (millions)	$ 495	$ 513	$ 575	$ 603	$ 627
# of Customers	467,329	473,007	481,985	486,926	492,887
OM&A Cost per Customer	$ 1,059	$ 1,085	$ 1,193	$ 1,238	$ 1,272

The Mid-Application Update revised downward the OM&A forecast cost to $615 Million, and using the same methodology, the 2013 cost per customer decreases from $1,272 to $1,248.

The following table, adapted from the Consultant's report, shows OM&A costs for all areas, in millions of dollars:

SaskPower OM&A (millions)						
	2010	2011	2012		2013	
	Actual	Actual	Initial	Final	Initial	Final
President Office	1.6	1.2	2.7	2.9	2.8	2.8
Power Production	173.6	183.0	187.7	187.7	183.6	183.6
Transmission&Distribution	123.3	165.1	159.5	174.5	162.7	163.5
Finance	17.8	17.3	13.5	12.9	14.2	14.2
Customer Service	38.1	40.6	40.0	41.6	42.0	42.0
Planning, Environment & Regulatory Affairs	10.2	10.8	11.4	11.4	12.0	12.0
Law, Land, Regulatory	5.5	4.8	4.3	4.3	4.5	4.5
CI&T	41.9	48.7	56.8	58.4	57.9	62.7
Human Resources	22.4	22.6	27.3	28.7	28.7	28.7
Business Development	0.0	12.6	2.8	5.3	2.9	3.5
Shand Greenhouse	0.6	0.7	0.7	0.7	0.7	0.7
NorthPoint Energy	8.3	8.4	6.4	6.4	6.7	6.7
Supply Chain	0.0	0.0	7.3	7.3	8.5	8.3
ICCS	111.1	2.2	2.4	3.2	7.6	4.7
SDR	12.3	11.0	8.5	9.1	8.9	8.9
DIP Premium Increase	0.0	0.0	0.0	0.0	1.6	1.6
Asset Management	0.0	0.0	0.0	0.0	0.0	3.0
Wage&Benefit Adjustment	0.0	0.0	0.0	0.0	0.0	3.0
Total Operation Costs	**566.7**	**528.9**	**531.3**	**554.4**	**545.3**	**554.4**
Other						
Nuclear Initiative	0.0	0.0	1.5	1.5	6.4	6.4
Insurance Expense	4.8	5.0	5.3	5.3	7.6	5.6
Pension Expense	53.3	(1.2)	(4.5)	(4.5)	11.8	0.0*
Bad Debt Expense	1.9	2.5	2.7	2.7	2.3	2.3
Human Resource Program	1.5	1.8	2.3	2.5	2.5	2.5
Other Expense	2.5	8.2	0.0	0.0	0.0	0.0
PPA OM&A	7.9	18.1	23.5	22.4	25.0	24.0
Total Other Costs	**71.9**	**34.4**	**30.8**	**29.9**	**55.6**	**40.8**
Demand Side Mgmt	8.8	11.8	20.2	19.0	26.1	20.0
Total OM&A	**641.3**	**575.1**	**582.3**	**603.3**	**627.0**	**615.2**
2012 Initial Submission Forecast based on March 31 Forecast; 2012 Final Submission Forecast based on June 30 Forecast; CGAAP for 2010 - 2011 & 2012 IFRS						

*Pension Expenses reassigned from OM&A to the Finance Expense category

SaskPower has several initiatives underway through its Service Delivery Renewal project. During 2011, SaskPower implemented a new billing system that provides employees with pertinent customer information, and can be adapted to changing business requirements. The new billing system has paved the way for the introduction of an Advanced Metering Infrastructure (AMI) joint initiative with SaskEnergy that will see the installation of 500,000 new, advanced meters at customer locations by 2014. The new meters will feed near real-time data from customers to SaskPower's offices, enabling repair crews to respond more quickly to power outages and manage connects and disconnects remotely. The meters will also monitor customer usage data more accurately, eliminating estimated billings. SaskPower has completed a field test in the Hanley area, and will conduct two larger tests before it begins installing the new meters in summer 2013. The estimated cost of the AMI project is $190 million, with a payback over 11 years. SaskPower estimates AMI will generate $470 million in benefits over a 20-year life cycle.

The Panel welcomes the many initiatives that SaskPower is undertaking through its Service Delivery Renewal and Business Renewal programs. The Panel is particularly interested in the potential improvements in customer service and system maintenance and reliability offered by equipping field employees with mobile access to information that will enable them to respond more quickly to customer requests and service requirements.

After examining all aspects of OM&A expenses, the Consultant states, and the Panel agrees, *"… that SaskPower is making significant strides to operate more efficiently, especially in light of the fact that materials and other external costs in general have all faced upward cost pressures, and the significant increase forecast for the 2013 capital program."* (p. 75)

6.4 Competitiveness

In comparing rates in other jurisdictions, SaskPower rates compare favourably with other provinces, with rates that are on average 8% lower than the Canadian average. When SaskPower is compared with other "thermal" utilities, which also rely primarily on fuel sources such as coal or natural gas for power generation, SaskPower's rates are 22% below the Canadian average. It must be emphasized that each utility has its own unique characteristics, making direct comparisons difficult. However, the Panel is satisfied that SaskPower is more than competitive, particularly in light of the costs it faces due to customer density and population distribution.

The Panel also notes that Canada's future environmental regulations are a significant cost driver for utilities like SaskPower that rely heavily on coal for power generation. The Integrated Carbon Capture and Storage (ICCS) project at SaskPower's Boundary Dam station represents a significant investment - $1.24 billion – by the federal and provincial governments, and SaskPower, to demonstrate the benefits of clean coal and carbon capture technology. However, even with government providing a portion of the funding, SaskPower has budgeted $998 million for this project, which will significantly affect SaskPower's rates. By contrast, just across the border, the electrical utility in North Dakota, which also relies heavily on coal for generation, is not subject to same environmental standards. This is reflected in the rates it is able to charge its customers.

6.5 Future Planning and SaskPower's Largest Customers

In its presentation to the Panel, the Saskatchewan Mining Association welcomed a new line project being constructed by SaskPower to deliver more power to customers in northern Saskatchewan. The Saskatchewan Mining Association noted, however, that losses on power transmission alone cost Saskatchewan Mining Association members $20 million a year on their mining operations. The Saskatchewan Mining Association stated that it supports SaskPower's reinvestment in infrastructure because its members need to be sure the infrastructure is in place, not just to support mining growth, but any growth in northern Saskatchewan. Speaking on behalf of the Saskatchewan Mining Association the presenter stated that:

"…members are investing over $50 billion in the next 20 years in expansions and new projects and they're making that investment with the anticipation that there will be power available to run their operations. SaskPower has identified that in the next 20 years, they're going to have to rebuild or replace or acquire over 100 percent of their existing capacity, and if that doesn't scare

everybody in Saskatchewan, then I don't know where they are because we're at a critical stage here that we have to have significant re-investment in the power infrastructure in Saskatchewan." (Transcript of public meeting in Regina, October 2, 2012, p. 57)

The Panel believes the Saskatchewan Mining Association's comments deserve close scrutiny because its members represent a large portion of the growing demand for power, particularly in northern Saskatchewan. Further, the magnitude of future investment planned by the Saskatchewan Mining Association's members will make a significant contribution to the province's future prosperity.

In its presentation, Paper Excellence, which owns and operates Meadow Lake Mechanical Pulp (MLMP), stated that it requires as much stability and certainty as possible in all of its cost inputs so that it can plan for the future. MLMP is Meadow Lake's largest employer and SaskPower's fourth-largest customer, with an annual power bill of $36 million. The company markets its product in a global marketplace, and many of its competitors are newer mills located in lower-cost Asian countries, making it particularly sensitive to variable market prices and changes in input costs. According to Paper Excellence, the proposed 4.9% rate increase would take MLMP from being a profitable to an unprofitable operation. The presenter for Paper Excellence suggested there might be other alternatives or offsets that the company could explore with SaskPower to mitigate the effects of the increase.

The Canadian Association of Petroleum Producers (CAPP) stated in its presentation at the public meeting in Regina that it does not oppose the proposed rate increase. While CAPP continues to have concerns about the level of disclosure of information by SaskPower, the Association recognized that SaskPower relies on reliable forecasts of future power demand from large customers such as the members of CAPP. Speaking on behalf of the Association, the presenter stated that it had made a commitment to SaskPower to work more closely:

"… to provide those forecasts, so I would encourage SaskPower to foster that relationship with CAPP and its few members because we do understand the need for accuracy in forecasting and to make sure that your (SaskPower's) plans are the best and that if you're more efficient, then we're going to be more efficient and profitable in the long run as well." (Transcript of the Regina public meeting, October 2, 2012, p. 28)

The Panel understands that the current review process that involves providing information related only to the current Application limits the ability to examine future costs and rate implications. The Consultant pointed out that the industry norm is to provide at least 5 years of future financial projections, with some regulators requiring 10-year forecasts. The Panel appreciates the positions stated by CAPP and Paper Excellence and urges SaskPower to do more of this type of planning and disclosure in the future.

The Panel acknowledges that SaskPower has taken important steps forward in its planning efforts by creating a Far North Resource Supply Plan and a 40-Year Resource Supply Plan. The comments from the Saskatchewan Mining Association, Paper Excellence and CAPP indicate that they believe even more energy and resources will need to be devoted to this type of planning, if SaskPower is provide a reliable supply of power to all of its customers in all areas of the province.

6.6 Weather Normalization

In its review of SaskPower's 2010 rate application, the Panel recommended that SaskPower conduct an external review of its Load Forecasting Methodology, including its weather normalization methodology. The consulting firm Itron has completed this review, and while Itron found that SaskPower's use of 30 years of weather data in defining normal weather appears to be the industry norm, the Panel's Consultant notes that it is not clear if greater weight is given to the most recent years, recognizing the trend to warmer-than-normal temperatures. SaskEnergy recently introduced an adjustment factor for recent years, and this has resulted in a change to the definition of normal weather. The Panel suggests that SaskPower review this matter to determine if a similar approach might affect the results of its weather normalization process.

6.7 Fuel Cost Variance Account

In its review of SaskPower's 2010 Application, the Panel recommended that SaskPower begin an immediate dialogue with stakeholders to determine the need for a fuel cost variance account, so that a decision could be made before the next general rate application. The Panel is pleased that the dialogue and review has taken place, and that the consultant engaged to review this matter submitted a report in October 2012. The Panel expects that SaskPower will, in due course, advise what its future intentions are on this matter.

6.8 Reliability is Critical

A severe storm that rolled through central Saskatchewan in late June 2012 was one of the topics raised during the Panel's public meeting in Saskatoon. The storm brought down power lines in many areas, leaving SaskPower repair crews scrambling to restore power to affected communities and industries. While most customers had power restored in less than 48 hours, almost two weeks of intensive effort was needed to restore service to all SaskPower customers who were affected by the powerful storm. It also resulted in an unexpected repair bill of almost $15 million added to SaskPower's 2012 budget.

The storm underscored how reliant all SaskPower customers are on a reliable supply of electricity for their homes, businesses and industries. It also highlighted how an unexpected event can affect revenues and expenses. The Panel applauds SaskPower for the massive and determined effort it made to restore power following this extreme weather event.

7.0 Impacts

7.1 Impact on the customer

The Panel recognizes that while Saskatchewan's economy is performing well relative to other parts of Canada and the world, the province remains heavily reliant on global trade for much of its prosperity. With a fragile recovery underway around the globe, and continuing uncertainty about the state of the world's financial system, particularly in Europe and the US, increased power rates add one more element to the cost pressures that individuals and businesses must bear.

One of the messages the Panel receiving from the public consultations is that many of SaskPower's largest customers operate not just in the national marketplace, but also in global markets. Energy rates are one of the considerations these customers take into account when they examine the viability of their ongoing operations, and when they make investment decisions about future expansions or new developments. The Panel recognizes that public utilities are not mandated or responsible to provide subsidies to industry, however, the Panel also believes utilities must be sensitive to the costs they impose on the provincial economy.

The Panel recognizes that strong economic growth poses challenges to SaskPower, and also contributes to its financial well-being. The Panel must balance SaskPower's ability to provide its customers with a reliable supply of electricity as it develops additional generation capacity and upgrades and expands its transmission and distribution system, while also meeting higher environmental standards. In its Application, SaskPower forecasts capital expenditures of approximately $10 billion over the next decade, with related increases to its depreciation and finance charges.

The Panel also notes that SaskPower is in the early stages of a multi-year Business Renewal initiative that is already producing savings through more efficient business processes and customer service delivery. The Panel cautions, however, that these savings will reduce, but not eliminate, the need for future rate increases related to the cost pressures facing SaskPower. The Panel also welcomes SaskPower's Demand Side Management programs, which assist customers in managing their electricity consumption through a variety of energy efficiency and conservation programs.

The following table, adapted from SaskPower's Mid-Application Update, shows the impact of the proposed rate change on each customer class:

2013 Customer Impacts

Rate Increase With No Rate Rebalancing

Customer Class	2013 Rate Change (%)	2013 Revenue Change ($)	Monthly change for customers by class ($)
Urban Residential	4.9	15,823,125	4
Rural Residential	4.9	4,322,743	6
Farms	4.9	7, 313,378	10
Urban Commercial	4.9	12,324,263	24
Rural Commercial	4.9	4,379,995	29
Power-Published Rates	4.9	20,197,218	15,301
Power-Contract Rates	6.3	5,892,058	37,770
Oilfields	4.9	14,330,927	70
Streetlights	4.9	772,321	19
Reseller	4.9	3,843,972	106,777
Total (System)	**5.0**	**89,200,000**	**15**

7.2 Impact on SaskPower

The Panel recognizes that SaskPower is operating in a difficult and challenging environment, balancing the need to develop new generation capacity and invest in new and upgraded infrastructure to maintain a reliable supply of electricity to its customers, while at the same time building a more environmentally sustainable system.

To assist readers in understanding some of the basic cost drivers and assumptions contained in the Application and the Mid-Application Update, and used in preparing the current forecasts, planning process and the possible impacts of changes in assumptions on SaskPower's operational results, the Consultant prepared the following sensitivity analysis. It is important to note that the following examples are not strictly correlated. For example, if water flows are higher than the median water flow used in the forecast, this will result in more hydro generation, and less use of natural gas. Conversely, if hydro generation is below the median, then more natural gas – a more costly form of generation – would be needed to meet the demand for electricity. With all things being equal, the saving the first instance would be less than the additional expense in the second. Coal fired generation is used to supply the base load, and is not usually available to smooth out variances in hydro generation. Here are some highlights of changes and their effects on SaskPower's balance sheet:

<u>Revenue</u>	Impact on Net Income
1% increase in customer rates	$18.0 million
100 GWh change in power customer consumption	$3.0 million
100 GWh change in residential power consumption	$10.0 million
1% change in ROE	$20.0 million
<u>Fuel & Purchase Power</u>	
$1/GJ change in natural gas price assumption	$30.0 million
10% change in hydro assumption	$15.0 million
10% change in coal generation assumption	$40.0 million
<u>Capital</u>	
$100 million change in 2012 capital budget (depreciation)	$4.0 million
$100 million change in 2012 capital budget (finance charges)	$3.0 million

The Panel applauds SaskPower's productivity initiatives to avoid costs and achieve greater efficiencies in its business processes and customer service programs. The Panel recognizes that conducting Business Renewal initiatives in an organization as complex and geographically diverse as SaskPower will require investments of money, time and human resources to realize fully the cost savings that can be achieved. The Panel encourages SaskPower to stay the course on these initiatives.

Notwithstanding that even with the proposed rate increase SaskPower will not achieve the target Return on Equity of 8.5% in 2013, the Panel notes that SaskPower did not ask for a change in its rate request after its Mid-Application Update forecast lower net income for 2013, and a resulting decrease in the Return on Equity to 6.4%. The Panel notes that, averaged over the 2010 to 2013 period, SaskPower's actual and forecasted Return on Equity is in excess of 9.0%. Therefore, the Panel is satisfied that the 4.9% increase on all customer rate classes, except the Power Contract Rate class, resulting in an average 5.0% rate increase for 2013, is fair and reasonable.

7.3 Impact on the shareholder

Every citizen of Saskatchewan, whether they are a SaskPower customer or not, is a shareholder in SaskPower, and has an interest in its operations and performance. SaskPower manages an asset base of more than $6.3 billion, and is forecast to generate more than $2 billion in Revenue in 2013. Net Income for 2013 is forecast at $126.1 million, resulting in a Return on Equity of 6.4%.

In recent years, SaskPower has invested significantly larger amounts on capital projects to meet the province's growing demand for electricity, and this trend is expected to continue, with approximately $10 billion in capital expenditures planned over the next decade. This trend has already resulted in a shift in SaskPower's debt-to-equity ratio from 63.8% in 2010 to 71.3% at the end of 2013, if all planned capital projects proceed. While SaskPower's financial strength will be affected by the addition of debt by its ambitious capital investment program, SaskPower's debt-to-equity ratio will remain within the range of other electric utilities. (p. 108)

The Panel's rate recommendation, if approved, will allow SaskPower to deliver service to its customers at a cost that is fair and reasonable to the public. Preventing SaskPower from earning a reasonable return only serves to push costs onto future generations of customers, and could put at risk SaskPower's ability to provide a reliable supply of electricity during a period of economic growth. Earning a reasonable return also allows SaskPower to finance internally a portion of its capital program, which would otherwise have to be financed through borrowing.

The Panel welcomes SaskPower's Demand Side Management programs, which encourage customers to conserve energy, benefitting both customers and SaskPower. The Panel points out that SaskPower's investments in clean energy production come with a cost, but these costs are mandated by environmental standards that will be imposed in coming years. It is important to emphasize that these costs will produce positive environmental benefits for all the people of the province.

8.0 In Appreciation

The Panel thanks SaskPower for the helpful and timely assistance it provided during this review, particularly President and CEO Robert Watson, Vice President and Chief Financial Officer Sandeep Kalra, General Manager of Corporate Planning and Regulatory Affairs Ian Yeates, Supervisor of Rate Regulation Shannon Rayner and Senior Strategic Advisor Tim Coucill. The Panel thanks them and other SaskPower employees for their co-operation and giving generously of their time over the past several months.

The Panel also thanks Gerry Forrest and Myron Kostelnyk of Forkast Consulting for their thorough analysis of the application and their assistance to the Panel in gaining a fuller understanding of its complexities.

The Panel thanks the stakeholders who provided submissions and made presentations during the review. We appreciate these contributions to the process.

The Panel thanks technical writer Bill Armstrong for his assistance in preparing this report.

The Panel thanks administrator Karina Seidle for her assistance and support.

Appendix A

Minister's Order and Terms of Reference

Appendix B

SaskPower's
Rate Application

to be effective January 1, 2013

Appendix C

SaskPower's
Mid-Application Update

to be effective January 1, 2013

Appendix D
Consultant's Report

Independent Review of the SaskPower 2013 Rate Proposal Application

provided by:

Forkast Consulting