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**BRITISH COLUMBIA
UTILITIES COMMISSION**

**ORDER
NUMBER** G-38-04

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**IN THE MATTER OF
the Utilities Commission Act, R.S.B.C. 1996, Chapter 473**

and

**Aquila Networks Canada (British Columbia) Ltd.
2003 Annual Review and 2004 Revenue Requirements Application**

BEFORE: L.A. Boychuk, Panel Chair and)
Commissioner)
L.F. Kelsey, Commissioner) April 16, 2004
R. Milbourne, Commissioner)

O R D E R

WHEREAS:

- A. On November 19, 2003, Aquila Networks Canada (British Columbia) Ltd. ("Aquila" or "Company") filed a Preliminary 2004 Revenue Requirements Application ("the Application") with the Commission. Aquila applied pursuant to the applicable provisions of the Utilities Commission Act ("the Act") and in particular Sections 58, 60, and 61 for an Order to set rates in accordance with a rate adjustment mechanism for 2004. Aquila recommended a Negotiated Settlement Process ("NSP"), pursuant to the Commission's Guidelines, to determine the 2004 Revenue Requirements and the parameters of the Incentive Mechanism. The Company also requested that the 2003 Annual Review of its performance be scheduled prior to the NSP; and
- B. Due to the impending sale of the Canadian business of Aquila Networks Canada Corp. to Fortis Inc. and the potential for restructuring, Aquila proposed, for this period of transition, a one-year extension of the Settlement Agreement, which expired on December 31, 2003, subject to certain changes as described in the Application; and
- C. Commission Order No. G-91-03 approved an interim increase of 3.6 percent, effective January 1, 2004, subject to refund with interest calculated for the refund period at the average prime rate of the principal bank with which Aquila conducts its business; and
- D. By Order No. G-6-04 the Commission established a regulatory timetable for an Annual Review and a Negotiated Settlement Process; and
- E. An Annual Review and a Negotiated Settlement Process was held on February 24 - 25, 2004 in Penticton, B.C. and the Negotiated Settlement reached among the participants was circulated to all Registered Intervenor and the Commission on March 23, 2004; and
- F. No letters of comment were received from other Registered Intervenor; and

**BRITISH COLUMBIA
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- G. The terms in the Settlement Agreement yield a revenue deficiency of \$6.611 million and a resulting rate increase of 4.0 percent, effective January 1, 2004; and
- H. The Commission has reviewed the Negotiated Settlement for Aquila's 2003 Annual Review and 2004 Revenue Requirements Application and finds that it should be approved.

NOW THEREFORE the Commission orders as follows:

1. The Commission approves for Aquila the Negotiated Settlement as issued on March 23, 2004 and attached as Appendix A to this Order.
2. A general rate increase of 4.30 percent for all customer classes effective with consumption on and after May 1, 2004 is approved.
3. The Commission will accept revised Electric Tariff Rate Schedules in accordance with the terms of this Order.
4. Aquila is to inform all customers of the rate changes approved by this Order.

DATED at the City of Vancouver, in the Province of British Columbia, this 23rd day of April 2004.

BY ORDER

Original signed by:

Lori Ann Boychuk
Panel Chair and Commissioner

Attachment



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VIA FACSIMILE

March 23, 2004

To: Registered Intervenor
Aquila-03AR04RR-RI

Re: Aquila Networks Canada (British Columbia) Ltd.
2003 Annual Review and 2004 Revenue Requirements Application

Enclosed with this letter is the proposed settlement package with respect to the Aquila Networks Canada (British Columbia) Ltd. Application for Approval of the 2003 Annual Review and 2004 Revenue Requirements Application.

This settlement package is now public and is being submitted to the Commission and all intervenors. Also enclosed are letters of comment received from the participants in the negotiated settlement process.

Prior to consideration by the Commission, intervenors who did not participate in the settlement negotiations are requested to provide the Commission any comments on the settlement package by Monday, March 29, 2004. Thereafter, the Commission will consider the settlement package. A public hearing may not be required unless there is significant opposition to the proposed settlement.

Yours truly,

A handwritten signature in dark ink, appearing to read "B. McKinlay".

B. McKinlay
Manager, Rates and Finance

BMcK/dlf
Enclosure

BARRY MCKINLAY
MANAGER,
RATES AND FINANCE
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CONFIDENTIAL

Log No. 4384

VIA FACSIMILE

March 16, 2004

Dear Participants:

Re: Aquila Networks Canada (British Columbia) Ltd.
2003 Annual Review and 2004 Revenue Requirements Application

Commission staff received no suggested edits to the draft of the Negotiated Settlement Agreement on the Aquila Networks Canada (British Columbia) Ltd. Application for Approval of the 2003 Annual Review and 2004 Revenue Requirements Application and it is therefore accepted as the final copy.

Please provide written correspondence confirming your acceptance of this settlement by Monday, March 22, 2004. The Negotiated Settlement Agreement and letters of comment from the participants will be made public and forwarded to the Commission for its review.

Prior to consideration by the Commission, intervenors who did not participate in the settlement negotiations will be requested to provide to the Commission their comments on the settlement package by Wednesday, March 31, 2004. Thereafter, the Commission will consider the settlement package.

Yours truly,

A handwritten signature in dark ink, appearing to read "Barry McKinlay".

Barry McKinlay

BMcK/rt
Enclosure

~~CONFIDENTIAL~~

Aquila Networks Canada (British Columbia) Ltd.

**2003 Annual Review and 2004 Revenue Requirements,
dated November 19, 2003 and revised February 12, 2004**

NEGOTIATED SETTLEMENT

All parties, including Aquila Networks Canada (British Columbia) Ltd. ("Aquila"), agree to this Settlement as a transition year between the existing ownership structure and the expected acquisition by Fortis Inc. It is anticipated that the 2005 Revenue Requirements Application will be a detailed evaluation of the B.C. utility, as owned by Fortis Inc. and the review will occur in an Oral Public Hearing. The parties recognize concern for adequate expenditure levels to ensure ongoing safe and reliable operation.

1. Sales Load

The Sales Load forecast recommended by the Load Forecast Committee is accepted.

2. Demand Side Management

The report and recommendations of the DSM Subcommittee are accepted as filed. The 2003 DSM Incentive of \$69,240 is allowed and the incentive mechanism is continued to 2004. If new Pilot Projects are proposed they will be reviewed by the B.C. Utilities Commission ("Commission") and, if approved, in 2004, they will receive deferral account treatment, therefore not impacting 2004 rates.

3. Base Capital Expenditures

Aquila proposed to adjust Base Transmission and Distribution Upgrade and Base Distribution Extension Upgrade by \$5,052,000 and \$748,000, respectively (February 12, 2004 Update, Tab 2, p. 32).

The parties agree these adjustments will not be made in the 2004 Test Year and total Base Capital expenditures will be reduced from \$23,515,000 to \$17,684,000. In accordance with the 2003 Settlement, the Base Capital budget will only be adjusted "after detailed review of each individual Base Cost category". Aquila is to provide this information in its 2005 Application.

4. Productivity Improvement Factor ("PIF") and Consumer Price Index ("CPI")

The Utility has explained its difficulty in meeting the Base O&M and Base Capital targets in recent years and, recognizing the special circumstances in 2004 and that rebasing will not occur this year, the parties agree that productivity improvement should be suspended this year, and accordingly the proposed factor of 0% is accepted and will apply to all Base Operating & Maintenance and Base Capital Expenditure targets for 2004. The B.C. CPI will be adjusted down to 1.6%, as reflected in clauses 3 and 6.

5. Extraordinary Capital Expenditures

The proposed extraordinary capital program for 2004 is accepted subject to review and Commission approval of individual CPCN's (February 12, 2004 Update, Tab 2, p. 41).

6. Base Operating and Maintenance Expenses

Aquila proposed to increase Base O&M expenses by \$800,000 (November 19, 2003 Application and February 12, 2004 Update, Tab 2, p.10).

The parties agree this adjustment will not be made in the 2004 Test Year and total Base O & M expenses will be reduced to \$29,560,000. In accordance with the 2003 Settlement, the Base Operating and Maintenance expense budget will only be adjusted "after detailed review of each individual Base Operating and Maintenance expense category". Aquila is to provide this information in its 2005 Application.

7. Wheeling, Water Fees and Other Income

The forecast amounts for 2004 are accepted.

8. Extraordinary Operating and Maintenance Costs

8.1 *Pension Expense*

The parties accept the total pension expense of \$3.79 million for the 2004 Test Year (February 12, 2004 Update, Tab 2, p. 13). This amount is supported by the report from the actuaries, Towers Perrin.

8.2 *Insurance Expense*

The parties accept the total insurance expense of \$2.123 million for the 2004 Test Year (February 12, 2004 Update, Tab 2, p. 14).

Aquila will provide evidence that fully illustrates the process the Company followed in arriving at the most cost-effective insurance solution for the 2005 Test Year.

8.3 *Brilliant Terminal Station Expense*

The lease payments are accepted and are to continue to be recorded as an O&M expense (\$3.169 million) in accordance with Commission Order No. G-2-04.

8.4 *Generating Unit Brake Replacement*

Parties agree to the Commission approving a variance from Generally Accepted Accounting Principles, permitting the Company to capitalize the \$702,000 cost in Table 4-D (February 12, 2004 Update, Tab 2, p. 16).

8.5 *All other Extraordinary Operating and Maintenance Costs*

Parties agree that these are accepted as filed in the February 12, 2004 Update.

9. Incentive Sharing Mechanism

The 50/50 incentive sharing mechanism will apply only to the first \$1 million of Base Operating and Maintenance Costs in excess of the Base O&M Target defined in item 6 above, under the condition that, if there are such expenditures, only those expenditures relating to brushing (budgeted at \$1,400,000 for 2004) and/or substation maintenance (budgeted at \$750,000 for 2004) will be subject to sharing. It will be incumbent on the Company to demonstrate that such expenditures are related to brushing and/or substation maintenance at the 2004 Annual Review. The 50/50 sharing on the \$1 million will only occur where the Company has met its service quality indicators judged on the same basis as previous settlement agreements. All other Base O&M expenditures that are outside of the target will be treated as a flow through to the Company's account.

There will be no sharing mechanism relating to the Base Capital Expenditures.

Incentive adjustments related to power purchase costs will continue to function as agreed to previously and as detailed in the February 12, 2004 Update, Tab 2, pp. 26 and 27.

10. Income Tax Expense

The parties agree that the cushion for Test Year 2004 Work in Progress differences of \$5,000,000 should be eliminated from the Capital Cost Allowance Estimate, dated February 12, 2004.

The parties further agree that the capital expenditures of \$118,486,700 (February 12, 2004 Update, Tab 2, Table 7-B) should be used as the starting amount to calculate at the forecast 2004 additions to the Undepreciated Capital Cost pool.

Variances from the forecast effective income tax rate will be 100 percent flow-through to customers.

11. Deferral Accounts

11.1 *Resource Plan*

11.2 *Long Term Transmission & Distribution System Plan*

11.3 *Future incremental costs related to regulatory and related activities as they arise*

11.4 *Issue expense for new debt issues until such time as those costs can be incorporated into rates.*

The parties agree that all of the above deferral accounts should be established. Any costs that Aquila records in these accounts will be subject to a full prudency review before approval is granted for recovery.

12. Amendment to the Customer Satisfaction Index

Changes to the Customer Satisfaction Index will be considered in the 2005 public hearing.

13. Amortization in 2004 of \$47,000 incurred for the 2002 Annual Review and 2003 Revenue Requirements.

All parties agree that \$47,000 should be amortized and added to the 2004 Cost of Service.

14. 2003 Brilliant Terminal Station Expense and amortization period

Commission Order No. G-2-04 approved the establishment of a deferral account and the recording of 2003 BTS expenses of \$1,085,600 therein (February 12, 2004 Update, Tab 2, p.15). The amount is accepted for recovery over a two year period commencing in 2004.

15. Final 2002 and 2003 Incentive Adjustments Adjustment

The adjustments are accepted as filed.

16. Power Purchase Expense Forecast

The 2004 Power Purchase Expense forecast is accepted as filed. Adjustments to entitlements due to generation capability will be flowed through to rates after resolution with B.C. Hydro.

The forecast will be adjusted for final rates approved under B.C. Hydro rate schedule 3808.

The existing sharing mechanism is to continue.

17. Capital Structure and Financing Costs

The financing costs identified in Tab 8, slide 13 of the Workshop materials are accepted, recognizing the deemed 60% debt and 40% equity capital structure, and that they are driven off the forecast capital expenditures to be completed in 2004 and the 2003 closing plant in service balance.

2004 Revenue Requirements

March 3, 2004

Introduction

This Update to the 2004 Revenue Requirements reflects the Negotiated Settlement Agreement (Agreement) of February 25, 2004. The terms of the Agreement yield a revenue deficiency of \$ 6.5 million for 2003, and a resulting rate increase of 4.0%, effective January 1, 2004. As Table 8-A on page 14 demonstrates, an effective date of April 1, 2004, would mandate a rate increase of 0.62% on that date in addition to the 3.6% interim rate increase of January 1, 2004.

Table 1-A Components of Rate Increase

	2004 Revenue Requirements	Increase/(Decrease) Over 2003 Revenue Requirements	
	(000s)		%
POWER PURCHASES	\$ 61,366	\$ 731	0.4%
EXTRAORDINARY O&M EXPENSE	6,085	5,013	3.1%
OTHER EXPENSES	35,885	259	0.2%
FINANCING COSTS	53,666	6,023 ¹	3.7%
TAX EXPENSE	15,954	(553)	(0.3%)
	172,956	11,473	7.0%
INCENTIVE ADJUSTMENTS	(3,030)	(1,717)	(1.1%)
LOAD GROWTH			(2.0%)
TOTAL REVENUE / INCREASE	<u>\$ 169,926</u>	<u>\$ 9,757</u>	<u>4.0%</u>
OF WHICH LOAD GROWTH:	(3,146)	²	
REVENUE AT PRIOR YEAR RATES	\$ 163,315		

¹ Amortization of Deferred Charges included in Other Expenses

² Load growth is the increase in 2004 revenue at 2003 rates,
minus 2003 Revenue Requirements.

2004 Revenue Requirements

March 3, 2004

2. Revenue Requirements

The 2004 Power Purchase Expense forecast is unchanged from the February 12 Update (Settlement Item 17). Other changes resulting from the Settlement Agreement are confirmed in the following sections.

Table 2-A Revenue Requirements

	<u>2004</u>	Reference <u>Page</u>
	(000s)	
1 POWER PURCHASES	\$ 61,366	Tab 4
2 OPERATING EXPENSES		
3 O&M Expense	29,560	4
4 Extraordinary O&M	6,085	
5 Capitalized Overhead	(2,800)	
6 Wheeling	3,822	
7 Water Fees	7,328	
8 Other Income	(3,783)	
9 Extraordinary Income	(78)	
	<u>40,134</u>	
10 FINANCING COSTS		6
11 Interest Expense	22,157	
12 Cost of Equity	19,638	
13 Amortization Expense	16,805	
14 AFUDC	(3,098)	
	<u>55,502</u>	
15 TAX EXPENSE		7
16 Income tax	6,134	
17 Property tax	9,820	
	<u>15,954</u>	
18 REVENUE REQUIREMENTS	172,956	
19 ADJUSTMENTS TO REVENUE REQUIREMENTS		
20 Final 2002 Incentive Adjustment	(171)	8
21 Final 2003 Incentive Adjustment	(1,663)	9
22 Final 2002 Power Purchase Incentive	(91)	10
23 Final 2003 Power Purchase Incentive	(1,105)	10
26 REVISED REVENUE REQUIREMENTS	<u>169,926</u>	
27 REVENUE AT PRIOR YEAR RATES	<u>\$ 163,315</u>	11
28 RATE INCREASE REQUIRED	<u>4.0%</u>	

2004 Revenue Requirements

March 3, 2004

3. Target Cost Variables

The 2004 forecast for the BC Consumer Price Index (CPI) has been updated to reflect the February 2004 forecast of the BC Ministry of Finance of 1.6% (Settlement Item 4).

Table 3-A Target Cost Variables

	Normalized 2002	Normalized 2003	Forecast 2004	Notes
1 Cost Drivers				
2 Number of Direct Customers (Year-End)	90,718	92,753	94,015	(1)
4 Number of Direct Customers (Simple Average)	89,970	91,736	93,384	
5 Customer Growth (Simple Average)	3.1%	2.0%	1.8%	
6 System Energy Sales (GW.h - Normalized)	2,797	2,841	2,890	(1)
7 Losses (GW.h - Normalized)	333	332	328	(1)
8 Gross Load (GW.h - Normalized)	3,130	3,173	3,218	
9 System Energy Sales Growth	2.0%	1.6%	1.7%	
10 Peak Load (MW - Normalized)	671	655	690	(1)
11 Generation (GW.h)	1,507	1,518	1,437	(2)
12 Power Purchases (GW.h - Normalized)	1,623	1,655	1,781	(2)
13 Gross Load (GW.h - Normalized)	3,130	3,173	3,218	
14 Base Cost Escalators				
15 CPI - Canada	2.2%	2.8%	1.5%	(3)
16 CPI - British Columbia	2.3%	2.1%	1.6%	(4)
17 Notes:				
18 (1) 2004 Load and Customer Forecast (Tab 3); 2003 results per Feb. 12, 2004 Update				
19 (2) 2004 Power Purchase Forecast (Tab 4), Feb. 12, 2004				
20 (3) Consensus Economics Forecast, January 2004				
21 (4) B.C. Ministry of Finance, B.C. Economic Review and Outlook, February 2004				

2004 Revenue Requirements

March 3, 2004

4. Target Costs

4.1 Operating Expenses

In addition to the revision to Base O&M expenses from the BC CPI update, the 2004 forecast has been calculated in accordance with the existing formula (Settlement Items 4 and 6). Extraordinary O&M Costs have been revised to reflect the accounting treatment of the Generating Unit Brake Replacement as capital (Settlement Item 8.4). Other Operating Expenses are unchanged from the February 12, 2004 Update (Settlement Items 7 and 8).

Table 4-A Operating Expenses

			Target	Actual	Target	Actual	Target
			2002	2002	2003	2003	2004
			(\$ 000s)				
1 Operating & Maintenance							
2 Cost Driver	Direct customers		89,970		91,736		93,384
3 Base Cost	(\$ 1998)		305.30		305.30		305.30
4 Base Cost Escalator	CPI BC (Cumulative)		1.072		1.095		1.113
5 Productivity Improvement Factor (Cumulative)			0.941		0.932		0.932
6			27,709	29,299	28,564	31,848	29,560
7 Software Development Expense				2,075	-		
8 BC/Alberta Integration Expense				2,200	-	(41)	
9 Extraordinary O&M			686	715	1,072	1,028	6,085
10 Capitalized Overhead							
11 Cost Driver	Capital exp. excl. DSM		78,030		53,220		112,191
12 Base Cost			2.5%		4.0%		2.5%
13 Base Cost Escalator	None						
14			(1,951)	(2,195)	(2,214)	(2,815)	(2,800)
15 Wheeling							
16 Cost Driver	MW Months		2,409		2,199		2,259
17 Base Cost	(weighted average)		1,697		1,689		1,692
18 Base Cost Escalator	BC Hydro rate		1.000		1.000		1.000
19			4,089	3,996	3,715	3,727	3,822
20 Water Fees							
21 Cost Driver	GW.h		1,510		1,504		1,518
22 Base Cost	(includes upgrade)		4,775		4,967		4,827
23 Base Cost Escalator	BC Hydro rate		1.000		1.000		1.000
24			7,210	7,120	7,470	7,369	7,328
25 Other Income							
26 Cost Driver	Direct customers		89,970		91,736		93,384
27 Base Cost	(\$ 1998)		(35.44)		(35.44)		(35.44)
28 Base Cost Escalator	CPI Canada (Cumulative)		1.096		1.126		1.143
29			(3,494)	(5,841)	(3,661)	(4,979)	(3,783)
30 Extraordinary Income			(75)	(75)	(75)	(271)	(78)
31 Total Operating Expenses			\$ 34,175	\$ 37,294	\$ 34,870	\$ 35,866	\$ 40,134

Table 4-B Deleted

2004 Revenue Requirements

March 3, 2004

Table 4-C Brilliant Terminal Station Expense

	2003	2004
Sustaining Capital Charge	\$ 845,600	\$ 2,314,000
Property Taxes	90,000	240,000
Insurance Expense	4,000	14,000
Operating & Maintenance	28,000	283,000
Administration & Management	118,000	318,000
Operating Expenses	240,000	855,000
Total BTS Expense	\$ 1,085,600	\$ 3,169,000

Table 4-D Extraordinary O&M Expenses

	Target 2002	Actual 2002	Target 2003	Actual 2003	Target 2004
1 Head Office Lease Payments	\$ 104	\$ 104	\$ 104	\$ 170	\$ 373
2 Pension Expense Adjustments	333	333	773	773	773
3 Wide Area Network Lease	271	302	309	241	250
4 Lease Savings - Kelowna Consolidation	(22)	(24)	(114)	(156)	(156)
5 Subtotal - 2003 Settlement Agreement	686	715	1,072	1,028	1,240
6 Incremental Pension Expense					351
7 Incremental Insurance Expense					1,479
8 Transmission Facilities Leases					
9 BTS Sustaining Capital Charge					2,314
10 BTS Operating Expenses					855
11 Cominco Facilities					(154)
13 Total Extraordinary O&M Expenses	\$ 686	\$ 715	\$ 1,072	\$ 1,028	\$ 6,085

Table 4-E Extraordinary Other Income

	Target 2002	Actual 2002	Target 2003	Actual 2003	Target 2004
1 Head Office Lease Receipts	\$ (75)	\$ (75)	\$ (75)	\$ (75)	\$ (78)
2 Third Party Penalty Revenue			-	(196)	
3 Total Extraordinary Income	\$ (75)	\$ (75)	\$ (75)	\$ (271)	\$ (78)

2004 Revenue Requirements

March 3, 2004

4.2 Financing Costs

Financing costs are reduced from the February 12, 2004 Update as a consequence of the revisions to 2004 Capital Expenditures (Settlement Items 3 and 8.4). Capital structure and financing costs are calculated in accordance with Settlement Item 17.

Amortization of deferred charges increased slightly as a result of the 2002 and 2003 Demand Side Management Incentives (Settlement Items 2, 13 and 14). 2004 additions to Deferred Charges include the costs approved in Settlement Item 11, and their disposition will be the subject of future applications.

Table 4-F Financing Costs

			Actual 2002	Actual 2003	Forecast 2004
1	Interest Expense				
2	Cost Driver	Weighted average debt	\$ 227,999	\$ 262,890	\$ 308,454
3	Base Cost	Weighted average cost of debt	7.4%	7.6%	7.2%
4			16,959	19,871	22,157
5	Cost of Equity				
6	Cost Driver	Average shareholder's equity	151,999	175,242	205,636
7	Base Cost	Return on equity (Note 1)	9.53%	9.82%	9.55%
8			14,486	17,209	19,638
9	Amortization Expense				
10	Cost Driver	Assets subject to amortization	n/a	n/a	n/a
11	Base Cost	Weighted average amortization rate	n/a	n/a	n/a
12			14,344	14,637	16,805
13	AFUDC				
14	Cost Driver	Capital expenditures subject to AFUDC	n/a	n/a	n/a
15	Base Cost		8.0%	8.0%	8.0%
16			(2,451)	(3,370)	(3,098)
17	Total Financing Costs		\$ 43,337	\$ 48,348	\$ 55,502
18	Note:				
19	(1)	The approved return on equity, not the actual, is shown for the purposes			
20		of calculating the return on capitalization for financing cost adjustments.			

Table 4-G Amortization Expense

		Actual 2002	Actual 2003	Forecast 2004
1	Amortization Expense	12,352	12,340	14,969
2	Amortization of Plant & Equipment			
3	Amortization of Deferred Charges			
4	Previously Approved	1,992	2,297	1,246
5	To be Approved			
6	2003 Revenue Requirements			47
7	2003 BTS Costs			543
8		\$ 14,344	\$ 14,637	\$ 16,805

2004 Revenue Requirements

March 3, 2004

4.3 Tax Expense

Income tax expense has been calculated as directed in Settlement Item 10. The expense increased from the February 12 Update as a result of changes in the deductibility of capital expenditures as projects are placed into service. Variances from the Target Expense for Income Tax, as calculated under the existing incentive mechanism, will be flowed through to 2005 rates.

Table 4 – H Tax Expense

			Actual 2002	Actual 2003	Forecast 2004
1 Income Tax					
2	Cost Driver	Earnings before income taxes	\$ 20,522	\$ 27,769	\$ 25,772
3	Base Cost	Effective tax rate	28.7	27.3	23.8
4			<u>5,892</u>	<u>7,578</u>	<u>6,134</u>
5 Property Tax					
6	Cost Driver	Assessed Value	294,820	292,406	306,000
7	Base Cost	Composite mill rate	30.6	31.2	32.1
8			<u>9,024</u>	<u>9,115</u>	<u>9,820</u>
9 B.C. Capital Tax					
10	Cost Driver	Total capitalization	379,998		
11	Base Cost	Effective tax rate	1.50		
12			<u>569</u>		
13 Total Tax Expense			<u>\$ 15,485</u>	<u>\$ 16,693</u>	<u>\$ 15,954</u>

Incentive Sharing Adjustments

The 2002 and 2003 Incentive Adjustments are unchanged from the February 12 Update (Settlement Item 15). The 2004 Base O&M incentive will be capped for sharing purposes at \$ 1 million, and there will be no sharing mechanism relating to Base Capital Expenditures (Settlement Item 9).

2004 Revenue Requirements

March 3, 2004

5.1 Final Adjustment to 2002 Revenue Requirements

Schedule A Statement of Adjustments – 2002 Final

	2002 Target Cost	Actual (000's)	Variance	Customer Shared Percentage	Adjustment to Rates (000's)
SHARED COMPONENTS					
OPERATING EXPENSES					
1 O&M	\$ 27,709	\$ 29,299	\$ 1,590		
2 Software Development Expensed	-	2,075	2,075		
3 Integration Costs		2,200	2,200		
4 Other income	(3,494)	(5,841)	(2,347)		
FINANCING COSTS					
5 Cost of Capital (Base Capital Expenditures) (Volume variance)	700	734	34		
6 PRELIMINARY SHARED ADJUSTMENT	\$ 24,915	\$ 28,467	\$ 3,552	50%	\$ 1,776
FLOW-THROUGH COMPONENTS					
OPERATING EXPENSES					
7 Extraordinary O&M	\$ 686	\$ 715	\$ 29		
8 Extraordinary Other Income	(75)	(75)	-		
9 Capitalized Overhead	(1,951)	(2,195)	(244)		
10 Wheeling	4,089	3,996	(93)		
11 Water fees	7,210	7,120	(90)		
FINANCING COSTS					
12 Cost of Capital (Base Capital Expenditures) (Rate Variance)	734	739	4		
13 Amortization expense	13,729	14,344	615		
14 AFUDC	(2,434)	(2,451)	(17)		
TAXES					
15 Income tax	7,388	5,892	(1,496)		
16 Property tax	9,720	9,024	(696)		
17 B.C. capital tax	660	569	(91)		
18 PRELIMINARY FLOW-THROUGH ADJUSTMENT	\$ 39,756	\$ 37,678	\$ (2,079)	100%	\$ (2,079)
19 FINAL 2002 ADJUSTMENT					\$ (303)
20 LESS PRELIMINARY ADJUSTMENT TO 2003 RATES					\$ (132)
21 REDUCTION TO 2004 RATES					\$ (171)

Schedule B Financing Cost Adjustments – 2002 Final

	Target Cost	Actual	Variance
1 Base Capital Expenditures	\$ 17,033	\$ 17,866	\$ 833
2 Average Rate Base Increase	\$ 8,517	\$ 8,933	\$ 417
3 Return on Capital	8.22%	8.27%	-0.05%
4 Earned Return	\$ 700	\$ 739	\$ 39
5 Volume Variance	\$ 700	\$ 734	\$ 34
6 Rate Variance	\$ 734	\$ 739	\$ 4
7 Total Variance			\$ 39

2004 Revenue Requirements

March 3, 2004

5.2 Adjustment to 2003 Revenue Requirements

Schedule C Statement of Adjustments – 2003

	2003 Target	Actual	Variance	Customer Shared Percentage	Adjustment to Rates	
	(000's)				(000's)	
SHARED COMPONENTS						
OPERATING EXPENSES						
1	O&M	\$ 28,564	\$ 31,848		\$ 3,284	
2	Software Development Expensed	-	-	-		
3	Other income	(3,661)	(4,979)	(1,318)		
FINANCING COSTS						
4	Cost of Capital (Base Capital Expenditures) (Volume variance)	768	726	(42)		
5	SHARED ADJUSTMENT	\$ 25,671	\$ 27,595	\$ 1,924	50%	\$ 962

	2003 Target	Actual	Variance	Customer Shared Percentage	Adjustment to Rates	
FLOW-THROUGH COMPONENTS						
OPERATING EXPENSES						
6	Extraordinary O&M	\$ 1,072	\$ 1,028	\$ (44)		
7	Extraordinary Other Income	(75)	(271)	(196)		
8	Capitalized Overhead	(2,214)	(2,815)	(601)		
9	Wheeling	3,715	3,727	12		
10	Water fees	7,470	7,369	(101)		
FINANCING COSTS						
11	Cost of Capital (Base Capital Expenditures) (Rate Variance)	726	716	(10)		
12	Amortization expense	15,145	14,637	(508)		
13	AFUDC	(3,001)	(3,370)	(369)		
TAXES						
14	Income tax	7,929	7,578	(351)		
15	Property tax	9,572	9,115	(457)		
16	B.C. capital tax	-	-	-		
17	FLOW-THROUGH ADJUSTMENT	\$ 40,340	\$ 37,714	\$ (2,626)	100%	\$ (2,626)
18	2003 ADJUSTMENT					\$ (1,663)

Schedule D Financing Cost Adjustments – 2003

	Target Cost	Current Estimate	Variance
1 Base Capital Expenditures	\$ 17,895	\$ 16,926	\$ (969)
2 Average Rate Base Increase	\$ 8,948	\$ 8,463	\$ (485)
3 Return on Capital	8.58%	8.46%	0.12%
4 Earned Return	\$ 768	\$ 716	\$ (52)
5 Volume Variance	\$ 768	\$ 726	\$ (42)
6 Rate Variance	\$ 726	\$ 716	\$ (10)
7 Total Variance			\$ (52)

2004 Revenue Requirements

March 3, 2004

Schedule E Return on Capitalization

	Actual 2002	Actual 2003	Forecast 2004
		(000s)	
1 EARNED RETURN			
2 Interest Expense	\$ 16,959	\$ 19,871	\$ 22,157
3 Cost of Equity	14,486	17,209	19,638
4	<u>\$ 31,444</u>	<u>\$ 37,080</u>	<u>\$ 41,795</u>
5 CAPITALIZATION			
6 Weighted average debt	227,999	262,890	308,454
7 Average shareholders' equity	151,999	175,242	205,636
9	<u>\$ 379,998</u>	<u>\$ 438,131</u>	<u>\$ 514,090</u>
10 RETURN ON CAPITALIZATION	<u>8.27%</u>	<u>8.46%</u>	<u>8.13%</u>

5.3 Adjustments to Power Purchase Costs

Schedule F Power Purchase Incentive Adjustment – 2002 Final

	Target Cost	Actual	Power Purchase Variance "PPV"	Aquila Share of Market Incentive	Adjustment to Rates
			(000's)		
1 FORECAST POWER PURCHASE EXPENSE "FPPE"	\$ 53,673				
2					
3 ADJUSTED POWER PURCHASE EXPENSE "APPE"	\$ 52,272	\$ 51,760	\$ (512)		
4					
5					
6 <u>SHARED COMPONENT</u>					
7 On first \$1 million			(512)	(179)	(333)
8 Over \$ 1 million			-	-	-
9					
10 FINAL 2002 INCENTIVE			(512)	(179)	\$ (333)
11 LESS PRELIMINARY ADJUSTMENT TO 2003 RATES					\$ (242)
12 ADJUSTMENT TO 2004 RATES					<u>\$ (91)</u>

Schedule G Power Purchase Incentive Adjustment – 2003

	Target Cost	Actual	Power Purchase Variance "PPV"	Aquila Share of Market Incentive	Adjustment to Rates
			(000's)		
1 FORECAST POWER PURCHASE EXPENSE "FPPE"	\$ 60,630				
2					
3 ADJUSTED POWER PURCHASE EXPENSE "APPE"	\$ 60,532	\$ 58,926	\$ (1,606)		
4					
5					
6 <u>SHARED COMPONENT</u>					
7 On first \$1 million			(1,000)	(350)	(650)
8 Over \$ 1 million			(606)	(152)	(455)
9					
10 2003 Incentive			(1,606)	(502)	\$ (1,105)

2004 Revenue Requirements

March 3, 2004

6. Revenue Forecast Summary

Load and revenue forecasts for 2004 are unchanged from the February 12 Update (Settlement Item 1).

Table 6-A Sales Load (GW.h)

		Normalized	Normalized	Forecast
		2002	2003	2004
CUSTOMER CLASS				
1	Residential	998	1,024	1,042
2	General Service	521	529	549
3	Industrial	347	337	338
4	Wholesale	874	890	906
5	Other	57	62	55
6	TOTAL SALES LOAD	2,797	2,841	2,890

Table 6-A Revenue from Sale of Electricity

		Normalized	Forecast Normalized	Forecast
		2002	2003	2004
CUSTOMER CLASS				
1	Residential	\$ 61,847	\$ 67,991	\$ 69,051
2	General Service	32,420	35,355	36,279
3	Industrial	16,138	16,936	16,985
4	Wholesale	34,855	37,046	37,545
5	Other	3,471	3,455	3,455
6	TOTAL SALES REVENUE	\$ 148,731	\$ 160,783	\$ 163,315

Note: Revenues are forecast at rates effective January 1, 2003.

2004 Revenue Requirements

March 3, 2004

7. Capital Expenditures

2004 Base Capital Expenditures have been calculated in accordance with the existing formulas (Settlement Items 3 and 4). Extraordinary Capital Expenditures are unchanged from the February 12 Update, with the addition of the Generating Unit Brake Replacement (Settlement Items 5 and 8.4). DSM Expenditures in Table 7-B include the DSM Incentive for 2003 (Settlement Item 2).

Table 7-A Base Capital Expenditures

			Target	Actual	Target	Actual	Target
			2002	2002	2003	2003	2004
			(\$ 000s)				
1 Generation							
2	Cost Driver	Generating Plants	4		4		4
3	Base Cost	(\$ 1998)	1,275		1,275		1,275
4	Base Cost Escalator	CPI Canada (Cumulative)	1.096		1.126		1.143
5	Productivity Improvement Factor (Cumulative)		0.94		0.93		0.93
6			<u>1,315</u>	<u>912</u>	<u>1,338</u>	<u>1,247</u>	<u>1,358</u>
7 Transmission and Distribution Upgrade							
8	Cost Driver	Peak MW (Normalized) <i>Note 1.</i>	659		643		678
9	Base Cost	(\$ 1998)	14,224		14,224		14,224
10	Base Cost Escalator	CPI Canada (Cumulative)	1.096		1.126		1.143
11	Productivity Improvement Factor (Cumulative)		0.94		0.93		0.93
14			<u>9,667</u>	<u>12,168</u>	<u>9,597</u>	<u>9,611</u>	<u>10,271</u>
15 Distribution Extensions							
16	Cost Driver	Number of New customers	1,496		2,035		1,262
17	Base Cost	(\$ 1998)	1,325		1,325		1,325
18	Base Cost Escalator	CPI Canada (Cumulative)	1.096		1.126		1.143
19	Productivity Improvement Factor (Cumulative)		0.94		0.93		0.93
22			<u>2,044</u>	<u>2,842</u>	<u>2,829</u>	<u>4,973</u>	<u>1,781</u>
23 General Plant							
24	Cost Driver	Direct Customers	89,970		91,736		93,384
25	Base Cost	(\$ 1998)	44.14		44.14		44.14
26	Base Cost Escalator	CPI BC (Cumulative)	1.072		1.095		1.113
27	Productivity Improvement Factor (Cumulative)		0.94		0.93		0.93
28			<u>4,006</u>	<u>1,944</u>	<u>4,130</u>	<u>1,093</u>	<u>4,274</u>
29 Total Base Capital Expenditures			<u>\$ 17,033</u>	<u>\$ 17,866</u>	<u>\$ 17,895</u>	<u>\$ 16,926</u>	<u>\$ 17,684</u>

Note 1. Peak Load for Transmission and Distribution Upgrades reduced for Celgar load.

2004 Revenue Requirements

March 3, 2004

Table 7-B Aggregate Capital Expenditures

	Actual 2002	Actual 2003 (000s)	Forecast 2004
<u>Previously Approved:</u>			
1 Upper Bonnington Unit 5 ULE/ Dam Rehabilitation	\$ 903	\$ 5,263	\$ 5,195
2 Upper Bonnington Unit 5 Headgate Rebuild		226	587
3 Upper Bonnington Powerhouse Crane	157	1	
4 South Slocan Unit 2 Upgrade/Life Extension	(211)		
5 Kootenay 230kV System Development	43,628	20,319	13,362
6 South Okanagan Supply Reinforcement	1,127	3,152	35,308
7 CSP Transformer Replacement	199		
8 Vernon Capacitors	42		
9 44 Line Easement	495	3	
10 Lambert Substation Upgrade		1,288	3,000
11 Slocan City Substation Redevelopment	377	447	250
12 Joe Rich Reconductoring	425	786	105
13 Kootenay Area Voltage Conversions	1,473	1,194	800
14 Kelowna Operations Center	3,293	507	
15 Trail District Facilities Upgrade	159	3,063	
16 Intergraph AM/FM System	1,116	(10)	
17 Integrated Resource Management System (SAP)	6,981	5	
<u>To be Approved:</u>			
18 Upper Bonnington Unit 6 ULE		53	11,373
19 Upper Bonnington Unit 6 Headgate Rebuild			813
20 Lower Bonnington Unit 1 ULE			11,520
21 Lower Bonnington Unit 1 Headgate Rebuild			300
22 Kelowna Area Capacity and Reliability Upgrade			5,507
23 Joe Rich Reconductoring			1,600
24 Creston Distribution Improvements			483
25 Midway Substation Rehabilitation			1,451
26 Naramata Substation Rehabilitation			250
27 Whitewater Substation			250
28 Substation Metering/Automation			200
29 Glenmerry Underground Rebuild			300
30 Warfield-Okanagan Fibre Optic Communications			200
31 Narrow-Spectrum Conversion			500
32 PCB Program			452
33 Asbestos Abatement and Management Program			702
	60,164	36,294	94,507
<u>Demand Side Management</u>			
34 Demand Side Management	1,623	1,775	1,814
35 DSM Income Tax Adjustment	(594)	(592)	(646)
	1,029	1,183	1,168
36 Total Extraordinary Capital Expenditures	61,193	37,477	95,675
37 Total Base Capital Expenditures	17,866	16,926	17,684
38 Total Capital Expenditures	\$ 79,059	\$ 54,403	\$ 113,359

2004 Revenue Requirements

March 3, 2004

8. Calculation of Rate Increase Effective April 1, 2004

BCUC Order No. G-91-03 approved an interim rate increase of 3.6% effective January 1, 2004. In order to give effect to the 4.0% increase resulting from the February 25, 2004 Settlement Agreement, a further 0.62% is required, effective April 1, 2004. If the effective date of the rate increase changes, the incremental increase required to ensure cost recovery will be adjusted.

Table 8-A Calculation of Incremental Rate Increase

	Revenue at 2003 Rates	Revenue from 3.6% Increase
	(000s)	
Revenue January to March	\$ 46,189	\$ 1,663
A Revenue April to December	117,126	4,217
B Total Revenue at 2003 Rates and at Interim Rates Page 2, Line 27	163,315	<u>5,879</u>
C Revenue Deficiency Update T2 P4 Line 16 - Line 17		<u>6,611</u>
C-B Deficiency to Be Recovered April Through December		732
(C-B)/A Additional Rate Increase April 1		0.62%
Total Increase Effective April 1		4.22%

Note: Revenue for January to March does not include actuals.

2004 Revenue Requirements

March 3, 2004

Update to Tab 6 Demand Side Management

The following table has been updated to include the 2002 and 2003 DSM incentives, and an accrual for 2003 DSM expenditures not booked until 2004.

Schedule 1 - DSM Expenditures and Amortization, 2002 – 2004

										Forecast							
										Additions/		NBV					
										(Amortization)		NBV					
										Dec 31/01		Dec 31/02		Dec 31/03		Dec 31/04	

I.M.E.U.

Interior Municipal Electrical Utilities

Cities of Kelowna, Penticton, Grand Forks, District of Summerland, Nelson Hydro, Princeton Light & Power

BCUC Log # 5737
RECEIVED

March 17, 2004

MAR 17 2004

Mr. Barry McKinlay
Manager, Rates and Finance
British Columbia Utilities Commission
Sixth Floor, 900 Howe Street, Box 250
Vancouver, British Columbia
V6Z 2N3

Routing _____

"CONFIDENTIAL"

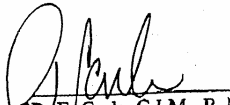
Dear Mr. McKinlay:

*Re: Aquila Networks Canada (British Columbia) Ltd.
2003 Annual Review and 2004 Revenue Requirements Application*

The Interior Municipal Electrical Utilities (IMEU) from the Cities of Kelowna, Grand Forks, Penticton, District of Summerland, Nelson Hydro and Princeton Light & Power are jointly endorsing the Settlement Agreement achieved with respect to the Aquila Networks Canada (British Columbia) Ltd. Application for Approval of the 2003 Annual Review and the 2004 Revenue Requirement Application.

The IMEU fully supports the Negotiated Settlement Process and recommends the conclusions arrived at on February 24-25, 2004 be forwarded for review by the B.C. Utilities Commission.

Respectfully submitted,



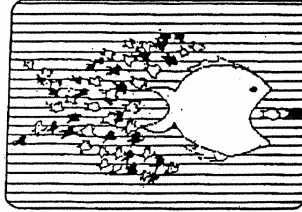
R. E. Carle, C.I.M., P. Mgr.
Electrical Manager, City of Kelowna
IMEU Chairman

cc

Director of Works & Utilities
IMEU

**The
British Columbia
Public Interest
Advocacy Centre**

815-815 West Hastings Street
Vancouver, BC V6C 1B4
Tel: (604) 687-3063 Fax: (604) 682-7896
email: bcpiac@bcpiac.com
<http://www.bcpiac.com>



Richard J. Gathercole	687-3006
Sarah Khan	687-4134
Patricia MacDonald	687-3017
Jess Hadley (articled student)	687-3044
Barristers & Solicitors	

March 18, 2004

VIA FAX: 604-660-1102

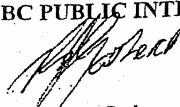
Barry McKinlay
Manager
Rates and Finance
British Columbia Utilities Commission
6th Floor – 900 Howe Street
Vancouver, BC V6Z 2N3

**Re: Aquila Networks Canada (British Columbia) Ltd. - 2003 Annual Review and 2004
Revenue Requirements Application Negotiated Settlement**

This will confirm BCOAPO et al's acceptance of the Negotiated Settlement Agreement in this matter.

Yours sincerely,

BC PUBLIC INTEREST ADVOCACY CENTRE


Richard J. Gathercole
Executive Director

RJG/ar

NATURAL RESOURCE INDUSTRIES

Box 19, Hedley, B.C., V0X 1K0
Fax / Phone (250)292-8692

BC Fishing Resorts and Outfitters Assn.
Council of Tourist Associations of BC
Guide Outfitting Association of BC
BC Trapping Association
National Farmers Union
Certified Organic Associations of BC
BC Wildcrafters Association

Whitewater Kayaking Association
BC Wildlife Federation
Recreational Canoeists Association
BC Federation of Fly Fishers
Steelhead Society
Outdoor Recreation Council of BC
Commercial Fishing Industry Council

March 22, 2004

BCUC Log # 5783
RECEIVED

Mr. Barry McKinlay
BC Utilities Commission
900 Howe Street
Vancouver, BC, V6Z 2N3

MAR 22 2004

Routing _____

Via Fax: (604) 660-1102

Dear Mr. McKinlay,

**Re: Aquila Networks Canada (BC) Ltd. 2003 Annual Review and 2004
Revenue Requirements Application**

Natural Resource Industries was a participant in the Negotiated Settlement Process for the above named application. We hereby confirm our acceptance of the settlement, as presented in your letter of March 16, 2004.

We would also like to make the following comments on the recent review and on the plans for the anticipated three year application at the end of 2004. NRI was very concerned by statements from management that they had not been doing all the system maintenance work that was required. The reason for deferring this work was to remain within the financial target set by the PBR mechanism.

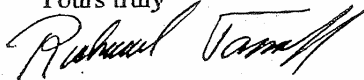
For water utilities, such as Hedley Improvement District, reliability is of utmost importance, since an extended power outage could lead to contaminated water and illness amongst vulnerable customers such as the elderly and children. It appears to us from the statements made and from common sense, that there is a built in incentive in the current PBR mechanism

for the utility to defer prudent maintenance work, if it means they will incur a penalty. In theory, the performance tests are supposed to protect customers from inadequate service, but they are quite crude measurements and the effects of deferred work might not show up for a few years.

Certainly, there are problems inherent in traditional cost of service based rate-making. The utility may not have an incentive to operate as cost-effectively as possible. However, we believe that given the opportunity most managers will operate in a professional manner. We also believe it is the job of the Commission and the stakeholders to evaluate the company's expenditures and when required insist they be justified.

For these reasons, we would like to see Aguila return to a cost of service basis for their next application. We intend to provide expert evidence for this position at the hearing.

Yours truly

A handwritten signature in black ink, appearing to read "Richard Tarnoff", written in a cursive style.

Richard Tarnoff

Alan Wait
Box 2663
Grand Forks, B.C.
V0H 1H0
alwait@telus.net
Mar.22, 2004

Mr. Barry McKinlay, Manager
Rates & Finance
British Columbia Utilities Commission
Sixth Floor,
900 Howe St., Box 250,
Vancouver, B.C.
V6Z 2N3

Re: Aquila Networks Canada (BC) Ltd.
2003 Annual Review and 2004 Revenue Requirements Application

Dear Sir:

This is to confirm that I accept the Negotiated Settlement Agreement for the 2003 Annual Review and 2004 Revenue Requirements as finalized in Penticton Feb. 25, 2004 with Aquila Networks.

Sincerely yours,

Alan Wait

2004 Revenue Requirements Negotiated Settlement

Page 1 of 1

McKinlay, Barry BCUC:EX

From: Isherwood, George [George.Isherwood@aquila.com]
Sent: Monday, March 22, 2004 3:47 PM
To: McKinlay, Barry BCUC:EX
Cc: Curtis, Bryan; Humphrey, Lavern; Debiene, Don; Martin, Joyce; Pawluk, Ken
Subject: 2004 Revenue Requirements Negotiated Settlement

Aquila Networks Canada (British Columbia) Ltd. hereby endorses without qualification the Negotiated Settlement for 2004 Revenue Requirements as circulated March 16, 2004.

3/22/2004