operational costs. However, in lieu of passing on the cost of servicing debt, they include an amount sufficient to give them an approved return on their rate base.

The rate base is composed of the mid-year average of the net book value of their fixed assets, plus an amount calculated for working capital requirements. The earnings of the private utilities will improve in any year the rate base is increased through additions exceeding booked depreciation, or when the regulatory authority allows a higher rate of return. The private utilities are in the business of investing money, and not solely in the business of recovering their costs and earning a fee for services provided.

In the two territories, the rate of return on rate base received by the private utilities is based not on their own capital structure, but on that of their parent companies. This is logical because the utilities operate as divisions and the parent companies raise the funds. Because the private utilities operating in the North are small compared to their parents, their financing requirements have only a minor effect on rates. Therefore, the rate of return they seek represents, in large part, the rate required to finance operations elsewhere in Canada, mainly in Alberta. To the extent that this rate of return is higher than historical costs of government borrowing, the private utilities pass on an added cost to consumers of electrical power.

The private utilities have one other cost that the NCPC does not incur. To the extent that their rate base is not financed by debt instruments, they must pay income taxes on the earnings applicable to their shareholders' equity. Such taxes are included as an expense to be recovered in their rates, but under the Public Utilities Income Tax Transfer Act, 95% of taxes paid are refunded to the territorial governments. The Government of Yukon has generally used this income to subsidize the electrical power costs of consumers in the higher cost areas of the territory. The Government of NWT returns this income to the private utilities, who in turn pass it on to their customers in Yellowknife, Hay River and the other communities they serve. Unless the federal government, as has been proposed, reduces this rebate from 95% to 50%, the net effect is to leave the territories in approximately the same position as if non-taxable public utilities were providing the power.

Both the NCPC and the private utilities set rates sufficient to cover estimated operating costs, including the costs of financing. If the NCPC recovers more or less than its actual costs, consumers benefit or suffer in future years. When private utilities earn more or less than the approved amount, this has no effect on future electrical rates because excesses or shortfalls in earnings are absorbed by their shareholders. Thus, while the NCPC has no direct incentive to control costs, the private utilities continually seek to improve their efficiency and reduce costs from those projected.

Although private utility operations may help contain the costs of providing electrical power in the North, the subcommittee recognizes that they cannot finance capital facilities in locations where electrical power rates would be beyond the ability of the northern consumers to pay. Private financing might lighten the Government of Canada's borrowing