

**NEWFOUNDLAND AND LABRADOR HYDRO
GENERAL RATE APPLICATION 2001**

OPENING STATEMENT

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SEPTEMBER 24, 2001

Newfoundland and Labrador Hydro has not appeared before the Public Utilities Board on a General Rate Application since 1992. Since then Hydro's performance has been consistent with its mandate to provide reliable electrical power and energy at least-cost. Hydro's customers have had the benefit of stable electricity rates, stable or declining real costs, and the benefits of a substantially improved system resulting from millions of dollars in capital expenditures. This has resulted in increased efficiencies in production and system improvements in transmission and distribution. Hydro's principal customer, Newfoundland Power, has not been subject to a rate increase since 1990 and our industrial customers currently have the benefit of the lowest industrial rates in Atlantic Canada.

The decade of the '90's has been a difficult and challenging economic period. Restraint, cost cutting, and reorganization have been a constant throughout most of the decade. As well, Hydro has had to deal with the challenges resulting from the impact of technological change and the emergence of new public attitudes and expectations, related to issues such as the reliability of service and environmental performance.

The issues pertinent to this Application arise from a number of factors including: the fluctuation in fuel prices on a global scale, legislative requirements, Public Utilities Board inquiries and studies, and the normal application of regulatory

requirements. The issues may be broadly divided into categories: costs, and as well the transfer of costs and the allocation of costs respecting the rural deficit; rate issues per se, including preferential rates and rate classes, for example the Labrador interconnected system; Hydro's revenue requirement and the determination of the rate base and the appropriate return on rate base; and Hydro's capital program for 2002, the test year.

There is one overriding fact with respect to costs in operating the Island system and that is the price of No. 6 fuel. Fuel costs are the principle driver of the rate increases proposed by Hydro. The Holyrood Thermal Plant, dependent upon variations in hydrology and consumption, may consume between 1,500,000 and 5,000,000 barrels of oil in a year to meet system requirements, the forecast for 2002 is 3,500,000 barrels. Hydro's rates are currently based on a price of \$12.50 per barrel, the reality over the past year and a half have been prices in excess of \$30.00 per barrel. The forecast price for fuel even in the most optimistic case is mid to high \$20's. Since the events of September 11th, any forecast with respect to fuel prices is inherently problematic.

No one should have any difficulty in accepting the fact that a more realistic fuel price for No. 6 fuel should be embedded in Hydro's base rates. The price of \$12.50 per barrel for No. 6 fuel currently in Hydro's rates is less than half the current price. The difference between the prices paid and what is charged in Hydro's rates is deferred to the Rate Stabilization Plan which is forecast to exceed, before the end of this year, the \$50 million cap set by the Board with respect to Newfoundland Power.

The Rate Stabilization Plan has worked effectively since its inception in stabilizing customers' bills and in reducing the immediate impact of variations in fuel prices. We have been fortunate in past years in having higher than average inflows to Hydro's reservoirs which assisted in reducing the amounts charged to the Rate Stabilization Plan. I should also note that approximately two years ago,

the price of fuel dipped below \$12.00 per barrel for one brief period, and the generally lower prices at that time had a very positive influence on the balances outstanding in the Rate Stabilization Plan for both Newfoundland Power and our industrial customers.

The Rate Stabilization Plan can not operate effectively as it was designed to do, when there are huge differences between the prices actually paid for No. 6 fuel and the price set in the base rates. In the current situation and in order to reduce the impact on customers' rates, Hydro is proposing a two-pronged approach. First of all, increasing the fuel price in Hydro's rates allows the Plan to work more effectively as it was originally designed to do in decreasing the variations in customers' bills as a result of the variability in fuel prices. Second, increasing the cap from \$50 million to \$100 million assists in partially offsetting the immediate impact of higher costs for ratepayers. I urge caution in any approach that would change the concept of the Plan or any move to dispense with it.

The fact is, that on the island portion of the province, our dependence on thermal power is a reality that must be accepted. It now accounts for approximately 30% of our energy production on an annual basis. The costs related to our Holyrood Thermal Plant relate almost totally to the price for and the consumption of No. 6 fuel. It is also a fact that on the island portion of this province that our competitive rates within the Canadian and North American context are being eroded by the impact of rising fuel prices and the costs associated with the provision of additional capacity to meet the system demand. Additional low cost hydro power on the island is just not available to meet future requirements.

The rate increases proposed by Hydro as a result of this Application are as low as they could reasonably be in the current circumstances, and they should be assessed from two aspects: first, the beneficial results to ratepayers over the past ten years; and second, the reality of the current cost requirements of the system. In that context, the 6.7% increase proposed for Newfoundland Power

and the resultant 3.7% increase to end consumers are really modest increases which offset the cost of fuel and transfer a portion of the cost from the Rate Stabilization Plan to Hydro's rates. Industrial customers will have their rates increased by approximately 10.4%. Should Hydro's proposal be accepted by the Board, the rate reductions that our industrial customers have received since 1992 result in their actually having to pay approximately 3.5% more for their power and energy received from Hydro in 2002, than they did in 1992.

There has been comment that the increases proposed in Hydro's rates are in addition to the approximately 6% - 7% increase in rates which will result from the application of the Rate Stabilization Plan in 2002. The outstanding balances in the Rate Stabilization Plan confirm the fact that the real issue with respect to the costs incurred in the system and the resulting impact on the rates is the high cost of No. 6 fuel.

Hydro has no control over fuel prices but it can be justifiably proud of the management of the system which has ensured that generation requirements were met with the least amount of fuel consumption possible. The increase in rates proposed by Hydro and the proposal with respect to an increase in the cap in the Rate Stabilization Plan, as well as the balances that will be outstanding in the Rate Stabilization Plan as of December 31st this year, all relate to one factor - the increased costs of No. 6 fuel.

Hydro's approach to the rate issues is to reduce the impact of rate increases on customers while laying a foundation for rate equity amongst all ratepayers. With some patience, perseverance and good fortune, we may be able to absorb the shock of continuing higher oil prices within the system and allow for a period of adjustment for all rate payers to accommodate their particular rate increases.

Hydro provides an essential service to all Newfoundlanders and Labradorians. It is important that Hydro be regarded as a commercial entity and that it be kept on

a sound financial footing in its own right. During the course of this hearing, we will be examining its capital structure, and operating requirements. Again, you will find Hydro proposing innovative means to provide a solid foundation for the future while minimizing the impact on rate payers. In order to reduce the rate impact on its customers, Hydro is proposing in the short-term a nominal return on equity, or rate base, provided that the normal and appropriate return on equity for Hydro is clearly expressed by the Board in its final decision. It is important that everyone understand the basis upon which Hydro's capital structure and financial operations will be founded in the longer-term. In the provision of an essential service, predictability is all important and to the extent that the situation is governable, we should ensure the removal of uncertainties.

The regulatory process, in the absence of competition, is intended to ensure that Hydro is held accountable for the actions that it undertakes in pursuit of its mandate. Unfortunately, the overriding issue affecting the rate increases proposed in this Application relate to those matters over which Hydro has no control, or at least very little control. In matters over which Hydro does have control, it is to be expected that we will be subject to a critical review, the result of which should better enable Hydro to meet its mandate and commitment to provide reliable least-cost power.

One cannot embark on this process without commenting on the cost of the process and the process itself. This hearing is expected to continue for months - not weeks. Hydro has answered all the requests for information and stands ready to facilitate the process in any way it can, to better enable an understanding by all of the concerned parties of the facts underlying the provision of electrical services in this province and, Hydro's role in that endeavour. It is recognized that intervenors, customers and the people, have a right to be heard. However, there is a challenge for everyone involved to do the right thing to assist the Board in bringing these proceedings to a timely conclusion. As part of the regulatory process, this hearing will cost millions of dollars, a significant amount

of money related to the size of the jurisdiction. That is why it is so important that everyone involved be conscious of the fact that the object of the exercise is to ensure least-cost rates to consumers.

Finally, the Board has to make its decisions based on the facts and merits of the case. It must apply regulatory principles and practices to the fact situation. The Applicant, as well as the Intervenors, to a certain extent represent vested interests and not necessarily the interests of the whole of the power system of the province. The Board will take the larger view of the total system and weigh the overall benefits against any particular perceived disadvantage.

On behalf of all of Hydro's dedicated employees and our witnesses at this hearing, I pledge our total commitment to this process and that everyone involved will be dealt with in an open, honest and forthright manner to the best of our ability.