

IN THE MATTER OF the *Electrical Power Control Act, 1994* (the “EPCA”) and the *Public Utilities Act, R.S.N., 1990, c. P-47* (the “Act”) And their subordinate regulations;

AND IN THE MATTER OF an Application by Newfoundland and Labrador Hydro (“Hydro”) for approvals of (1) Under Section 70 of the Act, changes in the rates to be charged for the supply of power and energy to its Retail Customer, Newfoundland Power, its Rural Customers and its Industrial Customers; (2) Under Section 71 of the Act, its Rules and Regulations applicable to the supply of electricity to its Rural Customers; (3) Under Section 71 of the Act, the contracts setting out the terms and conditions applicable to the supply of electricity to its Industrial Customers; and (4) Under Section 41 of the Act, its 2002 Capital Budget

FINAL SUBMISSION OF THE CONSUMER ADVOCATE

INTRODUCTION

1. On the 31st of May, 2001, the Board of Commissioners of Public Utilities (the “Board”) received an Application from Newfoundland and Labrador Hydro (“Hydro”) requesting an Order of the Board pursuant to the *Public Utilities Act* (the “Act”) for approval of rates to be charged to all customers of Hydro and for approval of their 2002 Capital Budget.
2. In particular, Hydro requested an Order of the Board relating to the following:
 - (1) **Fixing and determining the 2002 rate base of Hydro at \$1,370,471,000;**
 - (2) **Determining a just and reasonable rate of return for 2002 on average rate base at 7.4%;**
 - (3) **Approving, pursuant to Section 70 of the Act, the rate of 48.0 mills/kWh to be charged NF Power;**
 - (4) **Increasing the Rate Stabilization Plan (“RSP”) cap for NF Power to \$100 million;**

- (5) **Approving, pursuant to Section 70 of the Act, the rate of \$7.01 per kW per month demand charge and an energy charge of 23.09 mills per kWh to be charged Island Industrial Customers for firm power and energy, plus the annual specifically assigned charge as follows:**

Abitibi-Consolidated Inc. (Grand Falls)	\$107,549
Abitibi-Consolidated Inc. (Stephenville)	83,691
Corner Brook Pulp and Paper Limited	73,444
North Atlantic Refining Limited	154,097

- (6) **Approving, pursuant to Section 70 of the Act, the rate for non-firm service to Industrial Customers;**
- (7) **Approving, pursuant to Section 70 of the Act, the rate of 6.95 mills per kWh as a wheeling fee to be charged Abitibi-Consolidated Inc.;**
- (8) **Approving, pursuant to Section 70 of the Act, the firming up charge of 8.76 mills per kWh for secondary energy supplied by Corner Brook Pulp and Paper Limited to Hydro and delivered as firm power and energy to NF Power;**
- (9) **Approving, pursuant to Section 70 of the Act, the continuation of the existing policy for setting rates charged Island Interconnected Rural and L'Anse au Loup System Customers;**
- (10) **Approving, pursuant to Section 70 of the Act, the continuation of the existing policy for setting the rates charged Isolated Rural System Customers, with the exception of Government Departments and Agencies;**
- (11) **Approving, pursuant to Section 70 of the Act, the rates for Government Departments and Agencies;**
- (12) **Approving the rates for street and area lighting in Rural Isolated and Rural Interconnected Systems;**
- (13) **Approving, pursuant to Section 70 of the Act, the rates for Labrador Interconnected System Customers;**
- (14) **Approving, pursuant to Section 70 of the Act, the Rules and Regulations applicable to providing service to Rural Customers;**
- (15) **Approving, pursuant to Section 71 of the Act, the contracts with Industrial Customers;**
- (16) **Approving, pursuant to Section 41 (3) (a) of the Act, the construction or purchase of improvements of \$48,037,000 as set out in Section A of the 2002 Capital Budget Application;**

- (17) **Approving, pursuant to Section 41 (3) (b) of the Act, the leases for 2002 of \$ 1,795,564 as set out in Section D of the 2002 Capital Budget Application;**
 - (18) **Approving the changes proposed in Hydro's depreciation policies;**
 - (19) **Determining the disposition of the Wabush surplus;**
 - (20) **Consolidating this Application with the Application related to Industrial Rates in which Order No. P.U. 25 (2000-2001) was issued; and**
 - (21) **Granting such alternative, additional or further relief as the Board shall consider fit and proper in the circumstances.**
3. By Order-in-Council dated the 8th of June, 2001, and under authority of Section 117 of the Act, the Lieutenant Governor-in-Council appointed the Consumer Advocate to represent the interests of domestic and general service consumers at the aforesaid hearing.
4. At the conclusion of the hearing, the Board ordered the parties to file a written submission. The Consumer Advocate's submission follows.

RATE OF RETURN ON COMMON EQUITY

The Application

5. In the Application of Hydro, paragraph 14(9), Hydro made the following request regarding its capital structure and rate of return on equity:

14. The Applicant proposes:

- (9) that the following financial targets, based on current market conditions, be set by the Board as appropriate.**

Long Term:

Return on Equity (ROE)	-	11% - 11.5%
Debt / Equity Ratio	-	60:40
Return on Rate Base	-	9.5%

And that for the interim for this application, the Board allow an R.O.E. of 3%, which results in a return on rate base of 7.4%;

6. The Consumer Advocate submits that Hydro's Application, insofar as it requests that the Board "allow" a rate of return of 3%, is flawed, as the Board cannot make an order setting any particular rate of return on common equity (hereinafter referred to as "R.O.E.")
7. This principle is clearly set forth in Re: Newfoundland (Board of Commissioners of Public Utilities) 164 Nfld. & P.E.I.R. 60 (NF CA) (hereinafter referred to as the "Stated Case").
- (Tab B)
8. In the Stated Case, Green, J., as he then was, explained the proper procedure the Board must follow (and indeed has followed in previous decisions) when considering the appropriate R.O.E. for a regulated utility. In the Stated Case, the Newfoundland Court of Appeal had been asked, *inter alia*, to answer the following question:

Question No. One

1. **Does the Board have jurisdiction, pursuant to the Act, to set out and fix the rate of return which a public utility may earn annually upon:**
- ii) **the investment which the Board has determined has been made in the public utility by the holders of common shares.**
9. In the Stated Case, the Board was considering, *inter alia*, Section 80 of the Public Utilities Act which states as follows:
- 80(1) A public utility is entitled to earn annually a just a reasonable return as determined by the Board on the rate base as fixed and determined by the Board for each type or kind of service applied by the public utility but where the board by order requires a public utility to set aside annually a sum for, or towards, an amortization fund or special reserve in respect of service supplied, and does not in the order or in subsequent order authorize a sum or a part of it to be charged as an operating expense in connection with the service, the sum or part of it shall be deducted from the amount which otherwise under this section the public utility would be entitled to earn in respect of the service, and the net earnings from this service shall be reduced accordingly.**

10. In considering the aforesaid section of the Act in context of the question asked (as referred to in paragraph 4), the Court of Appeal found as follows:

Subsection 80(1) makes no reference at all to determining, let alone setting and fixing, the rate of return on common equity. The calculation of an appropriate rate of return on a common equity is truly a mere component in the overall process of determining a just and reasonable return on the rate base. Furthermore, there is nothing in the purpose of the Act or the policies which the Board is to implement which would lead inexorably to the conclusion that the Board ought to have the power to prescribe a rate of return on common equity as a component of an overall return or rate base, anymore than it ought to have a power to prescribe a return on any other component. ... I therefore conclude that the power “to determine” a just and reasonable return on rate base, as contained in subsection 80(1) does not include within it a power to “set and fix a rate of return on common equity” but it obviously does contemplate that the analysis of an appropriate rate of return on common equity will be undertaken and factored into the conclusion as to what is a just and reasonable return on rate base.

11. The Consumer Advocate therefore submits that Hydro’s request for an allowed rate of return on common equity of 3%, as set out in Section 14(9) of its present Application, is inappropriate, as the Board cannot determine, or “set and fix”, Hydro’s rate of return in this manner.
12. Rather, Hydro should have requested that it be allowed a rate of return on common equity in a “range” as in the method approved by the Newfoundland Court of Appeal in the Stated Case. At page 19, paragraph 64, of the Stated Case, the Court of Appeal found as follows:

“It has also been pointed out that the cost of common equity is often difficult to estimate with precision. The best that experts are often able to do is estimate rates within a reasonable range. Inasmuch as the cost of common equity is weighted into the overall rate of return on rate base, that range would also have to be reflected in the ultimate rate of return on rate base, as determined by the Board ... Realistically, the balance can only be struck within a reasonable range. It is for that reason that the Courts have on subsequent appeal or applications for judicial review, generally deferred to the determination of boards in this regard provided the determination is not arbitrary or capricious and can be said to fall within a reasonable range. As indicated in the earlier decisions, in the United States the notion of a “zone of reasonableness” as a “area rather than a pinpoint” has been recognized.

13. Based on the foregoing, the Consumer Advocate submits that the Board should follow its past practice, and not fix any particular rate of return for Hydro, but rather determine an appropriate range of R.O.E.
14. The Consumer Advocate acknowledges that Hydro has also expressed its request for a rate of return on common equity as a “range” between 11% and 11.5%, however, this request is anomalous, as it is not fixed in any particular timeframe, other than a request that it be imposed in the “long term”. (Section 14(9) Hydro Application)
15. The Consumer Advocate submits that Hydro’s request in this regard appears to be a request for the Board to perform a theoretical exercise to determine what Hydro’s normal R.O.E. on common equity would be, but for their request for a 3% return in the test year.
16. Further, it is arguable that Hydro’s request has been modified by the oral evidence of Hydro’s cost of capital expert, Ms. Kathleen McShane, on August 31, 2001. Upon questioning from the Board, Ms. McShane stated:

I would say that the cost of capital, the cost of equity in particular, is somewhat lower than it was before, that if I were preparing this testimony today that I would likely recommend a full return on equity of 11% instead of 11-11.5%.

(Source: Transcript, October 31, 2001, page 9, line 33)

17. Furthermore, Hydro’s cost of capital expert restated that Hydro was not looking for a “range” of a rate of return on common equity in the test year, but rather that Hydro’s request was as stated in Hydro’s application, being 3%.
18. Hydro’s cost of capital expert testified that she did not think that a “range” of return on common equity was necessary, given the fact that Hydro was only seeking a 3% R.O.E. for the test year.

(Source: Transcript, October 31, 2001, page 12, line 35)

19. The Consumer Advocate submits that the opinion of Hydro's cost of capital expert that a "range" of R.O.E. is unnecessary for the test year, should be disregarded. This is so since not only does this opinion run contrary to the past practice of the Board, and indeed the Court of Appeal's decision in the Stated Case, but implicit in the opinion is the absence of any cap or restraint on Hydro's ability to earn a R.O.E. in the test year.
20. Without a cap, or stated end of the range, the Board would have no reference available to it to decide whether Hydro has experienced excess earnings on its R.O.E. over and above a reasonable rate of return.
21. Such a determination is required since, should Hydro experience excess earnings, the Board has several options available to deal with these revenues.
22. The Stated Case gives direction to the Board as to how it may treat a utility's excess earnings. The Court of Appeal ruled that the Board could order that these earnings be used for Revenue Reduction, as a Reserve Fund, or as a Rebate to the consumers.

(Source: Stated Case, page 26, paragraph 102)
23. The Court of Appeal has referred to these three options as "enforcement mechanisms" which the Board may employ to ensure that the utility does not benefit from any windfall profits resulting from earnings in excess of the just and reasonable return to which it is entitled.

(Source: Stated Case, page 21, paragraph 75)
24. If no range of R.O.E. is set by the Board, then it would arguably be difficult for the Board to identify a case of over earning by a utility and thus the enforcement mechanisms referred to in the Court of Appeal could never be employed.
25. The Consumer Advocate therefore submits that when the Board determines Hydro's R.O.E. for the test year, that the R.O.E. be expressed in terms of a "range".

But For Hydro's Application For a 3% R.O.E., What Range of R.O.E. Could a Utility Like Hydro Expect for the Test Year?

26. The Board heard expert evidence from several cost of capital experts at the hearing, including Kathleen McShane (called by Hydro), John T. Browne (called by Newfoundland Light and Power), Dr. Michael Vilbert (called by the Industrial Customers), and Dr. Basil Kalymon (called by the Consumer Advocate).
27. In her pre-filed evidence dated May 31, 2001, Hydro's cost of capital expert, Kathleen McShane, presented the Board with her opinion that, but for Hydro's request for a 3% R.O.E. in the test year, Hydro would ordinarily be entitled to an R.O.E. in the range of 11% - 11.5%. As noted above, Ms. McShane restated her evidence on October 31st, indicating that she would reduce this estimate to 11% due to the then current market trend.
28. Ms. McShane arrived at these above figures by applying certain recognized tests, measuring expected R.O.E.s, in particular, the equity risk premium test, the discounted cash flow test, and the comparable earnings test.
29. Following are the results Ms. McShane presented in her pre-filed evidence, arising from the application of the aforementioned tests:

Equity Risk Premium	10.5 – 10.75%
Discounted Cash Flow	11.0 – 11.25%
Comparable Earnings	12.5 – 12.75%
Based on these results a fair return for Hydro would be 11.0 to 11.5%	

30. The Consumer Advocate's expert, Dr. Basil Kalymon applied similar tests. In his pre-filed evidence dated August 10, 2001, Dr. Kalymon arrived at the following results:

Risk Premium	8.20% - 8.70%
Comparable Earnings:	
- Low Risk Industrials	8.65% - 10.45%
- Utility Sample	7.49% - 8.99%
D.C.F.	
- Low Risk Industrial	9.05% - 10.56%
- Utility Sample	7.39% - 8.64%

31. Dr. Kalymon concluded that a reasonable range for a return on common equity for Hydro in the test year would be 8.75% to 9.25% based on the foregoing. **However, due to changes in market conditions, Dr. Kalymon revised this estimate in his update to the Board on November 9, 2001, and gave his opinion that an appropriate R.O.E. for Hydro in the test year would be in the range of 8.5% to 9.0%.** (See: BK1)
32. The Consumer Advocate submits that the Board should prefer the evidence of Dr. Kalymon over Ms. McShane on the issue of Hydro's R.O.E. for the following reasons:
- i. Ms. McShane has admitted that her results are based in part on the application of the comparable earnings test. By applying this test, Ms. McShane arrived at an R.O.E. figure of 12.5% to 12.75%.
 - ii. However, Ms. McShane has not adjusted the samples she used in applying this test for market-to-book ratios.
 - iii. Ms. McShane has admitted (See: CA-132) that most regulators in Canada have "overlooked" the comparable earnings test, when not adjusted for market-to-book ratios.

(Source: Transcript, October 30, page 16, line 64)
 - iv. It is obvious that by applying the comparable earnings test, without an adjustment for market-to-book ratios, the resultant range of R.O.E. for the sample companies are overstated (12.5%-12.75%).
 - v. Dr. Kalymon's evidence is that the use of the comparable earnings test, unadjusted for market-to-book ratios, should be rejected.

(Source: Pre-filed Evidence - Basil Kalymon,
August 10, 2001, page 29, line 14)

- vi. Thus, insofar as Ms. McShane's analysis relied upon the comparable earnings test unadjusted for market-to-book ratios, it should be rejected when the Board is considering an appropriate range of R.O.E. for Hydro.
- vii. As regards the risk premium test, Ms. McShane relies heavily on American comparables, which are not readily applicable to the Canadian market experience, as the American equity markets have consistently out-performed the Canadian equity markets. (Source: Transcript, October 30, 2001, page 17, line 34) This reliance results in an overstating of investor expectations when comparing the U.S. equity markets to Canadian utilities. Again, it is submitted that Ms. McShane's selection process causes an overstatement of the R.O.E.s she arrived at by applying this test.
- viii. As regards the discounted cash flow tests employed by Ms. McShane, Ms. McShane has admitted that these tests, based on financial analyst forecasts, tend to be optimistic and there is a recognized upward bias implicit in applying them.
(Source: Transcript, October 30, 2001, page 20, line 24)
- ix. Finally, in a general sense, the response to CA-134 illustrates that while Ms. McShane has testified before numerous regulatory bodies in the past, on average her recommendations regarding a reasonable R.O.E. have been 1.4 percentage points higher than the returns ultimately awarded by these same regulators.

33. For the foregoing reasons therefore, *inter alia*, the Consumer Advocate submits that Dr. Kalymon's evidence regarding this issue should be preferred.

Conclusion

How does the Board reconcile Hydro's request for an R.O.E. of 3% in the test year with the expert evidence presented?

34. As stated above, the Board is restricted in its ability to "fix and determine" that the R.O.E. for Hydro should be 3%. Any determination that the Board makes regarding Hydro's R.O.E. for

the test year should not deviate from the Board's past practice, and thus should be expressed in terms of a "range" of R.O.E.

35. The Consumer Advocate submits that the Board should interpret Hydro's request for a 3% R.O.E. as representing the upper limit of a range, between say 2.5% and 3%, and make an Order accordingly, setting the mid-point of the range at 2.75%.
36. The Consumer Advocate further submits that the Board can then "theoretically" analyze the opinions of the cost of capital experts to arrive at a normalized R.O.E. for Hydro for the test year. The Consumer Advocate further submits that based on the foregoing the Board should prefer the evidence of Dr. Basil Kalymon in this regard and allow an R.O.E. in the range of 8.5% to 9.0%.

THE COST OF NO. 6 FUEL

37. The cost of No. 6 fuel has been described by Hydro's C.E.O. William Wells as one of the three "pillars" of Hydro's revenue requirement in any given year, representing approximately one-third of Hydro's annual operating expenses.

(Source: Transcript, September 24, 2001, page 26, line 35)

38. Although in September of 2001, William Wells had described the cost of No. 6 fuel in the test year as a "\$100 million item", in fact by December of 2001 the forecast cost of No. 6 fuel for the test year was revised to approximately \$92.1 million.

(Source: Mr. Henderson's Supplementary Evidence, December 12, 2001)

39. As regards this forecast amount of \$92.1 million, the Consumer Advocate notes that this substantial figure is really based upon the evidence of a third party, as Hydro relied on the PIRA Group for its oil price forecast. At the hearing, Hydro, for reasons best known to itself, failed to disclose the actual PIRA report regarding this forecasting. The Consumer Advocate submits that at future hearings, having regard to the importance of the cost of oil as a component of Hydro's revenue requirement, full disclosure of PIRA's forecast be presented.

Further, the Consumer Advocate submits that in the future Hydro should be required to present forecasts from several internationally recognized forecasting companies, allowing the Board to select an average of their forecasts for the purpose of determining the reasonableness of Hydro's oil revenue requirements.

40. In his opening statement, William Wells made the following comment regarding the cost of No. 6 fuel:

There is one overriding fact with respect to the 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 on variations on 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. (Emphasis added)

(Source: Transcript, September 24, 2001, line 14, page 20)

41. It is apparent therefore that Hydro itself has identified the cost of No. 6 fuel as representing one of its primary operating costs.
42. The Consumer Advocate submits that despite this fact, the evidence shows that Hydro has not adopted any clear oil purchasing strategy aimed at reducing this substantial annual cost.

Hydro's Oil Purchasing Process

43. The Consumer Advocate also submits that there remains some uncertainty as to which department at Hydro is ultimately responsible for the strategic purchasing of No. 6 fuel, to ensure that the lowest possible price is obtained.
44. Mr. Henderson, Manager of Systems Operations with Hydro, gave evidence that he was responsible for the fuel budgets for all inter-connected system plants.

(Source: Pre-filed Evidence of Mr. Henderson dated May 31, 2001, page 1)

45. When asked under cross-examination if he was responsible for the Bunker C that's purchased, Mr. Henderson replied, "That's correct".

(Source: Transcript, October 11, 2001, page 10, line 84)

46. However, upon further cross-examination, it appears that Mr. Henderson's role in the purchase of No. 6 fuel, from a financial perspective, was limited.

47. In response to a question regarding his role in the purchase of No. 6 fuel, Mr. Henderson qualified his role as follows:

A. I'm kept apprised of the price. I know what the price is. We will have discussions and there would be a number of people within Hydro that will get together to discuss maybe opportunities to take advantage of low prices when they are, when they present themselves, so that we can take advantage and lower the cost, and I'm involved with these discussions, but it's not a ... it's not my decision per se ... The price that will be set on this is when you actually receive the fuel, and therefore, you know, that type of decision that I wouldn't be making. That would be a decision made by, involving higher levels of management. (Emphasis added)

(Source: Transcript, October 11, 2001, page 16, line 18)

48. In the subsequent testimony of Mr. Derek Osmond, Chief Financial Officer of Hydro, Mr. Henderson's role in the purchasing of No. 6 fuel was described as follows:

Q: Okay, but as I understand it, what we just spoke about, Mr. Henderson ... his responsibility is limited to defining what Hydro's need is when it comes to No. 6.

A: (Inaudible)

Q: Okay, but he is not directly involved in the purchasing of fuel itself.

A: No, the actual purchasing itself is coordinated through the materials management department. They do the actual ordering.

(Source: Transcript, November 20, 2001, page 34, lines 85-95)

49. It is the Consumer Advocate's submission that this foregoing exchange reveals that there remains some ambiguity regarding Hydro's oil purchasing process, and the extent to which Hydro may or may not be adopting oil purchasing strategies to reduce costs.
50. The Consumer Advocate further submits that if in fact Mr. Henderson, as Manager of Systems Operations, is the person ultimately responsible for the purchase of No. 6 fuel, it must be remembered that Mr. Henderson's duty as Manager of Systems Operations is to ensure the production of electricity through the power system controlled by the E.M.C. Hydro did not lead any evidence to indicate that the Manager of Systems Operations' responsibilities would include the strategic purchasing of oil to ensure its lowest acquisition price. (Emphasis added)

Possible Oil Purchasing Strategies

(a) Oil Hedging

51. Hydro has not adopted any oil hedging policy, and in fact has indicated that it has no intention to implement such a policy in the near future.
(Source: Pre-filed Evidence of Derek Osmond, page 18, line 14)
52. The Board's cost of service expert, Dr. John Wilson, identified this as an area where Hydro has not provided enough information for the Board to determine the reasonableness of their decision in this regard.
(Source: Dr. Wilson's Pre-filed Evidence dated July 31, 2001, page 34)
53. Furthermore, it appears from UH No. 31 (Hydro's oil hedging commentary) that, had Hydro implemented a conservative hedging strategy as of September 1998, savings of approximately \$1.2 million could have been realized to date.
54. The Consumer Advocate therefore submits that the Board should require Hydro to either implement an oil hedging program or provide a detailed explanation why such a program cannot be justified.

55. From UH No. 31 it appears that Hydro's position is that they do not need a oil hedging program since the R.S.P. provides protection to its customers from adverse, unexpected and random price fluctuations.
56. The Consumer Advocate submits that this position taken by Hydro reveals a certain indifference by Hydro as to the price of No. 6 fuel, since in their view, the impact on consumers of any sharp increase in oil prices is softened by "financing" such an increase over a three year period through the R.S.P.
57. The Consumer Advocate submits that this hardly amounts to a protection for consumers against sharp increases in oil prices, as the consumer ultimately pays for these sharp increases, with interest, albeit over time.
58. The Consumer Advocate submits that if Hydro implemented an oil hedging plan in the first place, these sharp increases in No. 6 oil prices could be checked, or "hedged", at the point of purchase, thus ensuring the cost of the oil that Hydro then passes into the R.S.P. (if still in existence) has already gone through a stabilizing process, where an attempt has been made to obtain the oil at the most favourable price possible.

(b) Increasing Oil Storage

59. Hydro has indicated that its expected annual consumption of No. 6 oil can be anywhere between 1,500,000 to 5,000,000 barrels of oil.
(Source: Transcript, September 24, 2001, page 20, line 14)
60. Hydro's Bunker C oil storage maximum capacity is approximately 840,000 barrels.
(Source: Transcript, October 11, 2001, page 15, line 90)

61. Hydro's C.F.O. indicated that on some occasions Hydro may make a decision to purchase extra amounts of Bunker C when the market price is down. On this point Mr. Osmond stated as follows:

... I mean the actual prices detailed by the contract and the market price at the time that the shipments are received, so we don't dictate the price. The only thing, if he is referring to the upper level of management then on the odd occasion we may see the price down very, very low and we may top up our tanks. That would be decided by the next level of management.

(Source: Transcript, November 20, 2001, page 35, lines 7-13)

62. Hydro's Bunker C fuel requirement is forecast to be approximately 3.5 million barrels in the test year.

(Source: William Wells' Opening Statement)

63. If this is the case, then Hydro would really only have approximately three months' storage capacity for Bunker C oil. Indeed, if in any year, Hydro forecast that it would require 5,000,000 barrels of oil (as indicated in the opening statement of Mr. Wells), then Hydro would really only have capacity for two months storage.

64. The Consumer Advocate submits that it is useful to compare Hydro's oil purchasing strategy and storage capacity with Abitibi-Consolidated's approach on these issues.

65. It is submitted that Abitibi-Consolidated, being a private industry, adopts a much more stringent approach to this area of operating expense.

66. Mr. Melvin Dean, giving evidence on behalf of Abitibi-Consolidated Inc., made the following comments regarding these issues:

Mr. Browne, Q.C.: **In terms of the open market, can you give us some description as to how you go about a purchase?** (Referring to Bunker C oil)

Mr. Dean: **I was responsible for this in 1995, 1997. I am not now but let me think for a second here. We of course monitor the tank**

levels, we take a look at the prices, whether the prices are going up, going down. We do have a lot of storage at the mill, like about nine months storage capability, and then we take a look, as I say, at the prices, go out on the open market and take a look at the best price that we can get for it and bring it in. The payment for it, the cost is actually as the date we place the order. I think that's important.

Mr. Browne, Q.C.: The date you ... how does that compare with what you have heard Hydro is doing?

Mr. Dean: Well, what I heard, first I had heard that it was when they receive the shipment, but I believe that was revised to an average if you have more than one shipment a month. I think there was some differences there.

Mr. Browne, Q.C.: But you pay for it as you buy it on the open market.

Mr. Dean: The price is booked at that date.

Mr. Browne, Q.C.: The price is booked at that date. Would you have difficulty doing it the other way, doing it, paying the price, buying the fuel but paying whatever price it is when it arrives at your dock in Stephenville.

Mr. Dean: If there hasn't been a price change we wouldn't have a problem, but I guess that's a risk we're avoiding by doing it that way.

(Source: Transcript, January 1, 2001)

67. Later in the same transcript, upon further examination of this area, the following exchange occurred between Mr. Dean and the Consumer Advocate:

Mr. Browne, Q.C.: How does that work, can you .. generally,

Mr. Dean: I think I used the term open market. Spot market, that's where we look at what's available. We keep a running tab on what it is out there in terms of Bunker C purchases and if there are ships someplace that have a good price, we will take it.

Mr. Browne, Q.C.: Have you gotten bargains that way in the past?

Mr. Dean: In the past we have found that that's better then for us than having a firm contract. Tied into that is the fact that we do have a lot of storage capability.

Mr. Browne, Q.C.: How does your storage capability compare with Hydro's from what you have heard in this hearing?

Mr. Dean: Significantly higher. We actually have about nine months supply that we can put in storage. I don't recall exactly what Hydro is but ours is considerably higher.

Mr. Browne, Q.C.: And what advantage is there in that in having a greater storage capacity?

Mr. Dean: The advantage is the advantage of pre-buying. If the price is low you can buy extra. That only works if you are reasonably sure that the price of oil is going to go up but that's what we attempt to do.

68. The Consumer Advocate submits that while Hydro has indicated an intention to take advantage of dips in the world market price for No. 6 oil, in fact their ability to take advantage of these situations is limited by their relatively modest storage capacity compared with Abitibi-Consolidated, which has a more substantial capacity.
69. If indeed Hydro expects its need for Bunker C to range between 3,500,000 barrels to 5,000,000 barrels annually (which seems to be a marked departure from its average past annual consumption)*, and if Hydro is sincere in its expressed intention that it will attempt to take advantage of dips in the market price for No. 6 fuel by pre-buying same, then the Consumer Advocate submits that it is incumbent on Hydro to demonstrate to the Board that its oil storage capacity is comparable with other enterprises of similar scale and with similar proportionate levels of oil consumption as Hydro. Otherwise, the Consumer Advocate submits that there is

* This increased forecast consumption is partly related to Hydro's hydrology forecasts. The Consumer Advocate has some concerns about the reliability of hydrology data prior to 1970. A number of the Applicant's hydro generating stations were not yet in service at that time, and it is not clear what impact the addition of these stations has had on hydrology data. Likewise, it is not clear how accurate the water flow measurement devices were prior to 1970. As pointed out in Mr. Brockman's Supplemental Testimony dated September 2001 (page 3, lines 10-12), using a 30-year moving average of hydrology data would reduce the revenue requirement by approximately \$6.6 million. The Consumer Advocate recommends that the Board direct the Applicant to base its revenue requirement on a 30-year moving average of hydrology data. The Applicant can address the appropriateness of the hydrology data to be used in rate setting at its next rate hearing scheduled for 2003.

an appearance that Hydro really has limited ability to pre-buy oil and thus take advantage of dips in the market as claimed.

CONSERVATION

70. Conservation is an important principle in rate design. Dr. Wilson testified:

The complementary goals of conservation, efficiency and equity emerged as the hallmark of modern electric utility rate design.

(Source: Transcript, December 7, 2001, page 2, line 96)

71. The conservation efforts of the utilities were summarized in correspondence from Newfoundland Hydro's President to the President of Newfoundland Power. Newfoundland Hydro's (hereinafter "Hydro") initiatives include:

- Employee education through Seneca College
- Partnership with Newfoundland and Labrador Conservation Corps
- Natural Resources Canada Energy Efficiency Publications
- Customer Assistance Database (Records & Monitors customer requests for assistance to ensure timely responses)
- Customer Newsletter
- Hot 2000 Program for Estimating Electricity Consumption for New Homes
- Communications Center with toll free service
- In house expertise in "House as a System"

(Source: U Hydro 6)

72. Newfoundland Power's (hereinafter "Power") initiatives include:

Customer Programs and Services

- Wrap Up for Savings
- Energy Efficient Water Heater
- Thermostat Program
- R-2000 Upgrade Financing
- Key Customer Program
- In-person energy efficiency and conservation consultation services are available through Newfoundland Power's Customer Service Specialists.
- Newfoundland Power's Customer Call Centre representatives are also trained to assist customers with questions on energy use and efficiency.

Residential Customer Information, Brochures and Worksheets ...

Commercial Customer Information ...
Bill Inserts
Newsletters ...
Website Information ...
Energy Efficiency Partnerships...

(Source: U Hydro 6)

73. Barbara Mullally-Pauly (representing the office of Energy Efficiency at Natural Resources Canada) has been involved in energy efficiency programs since 1976. Ms. Mullally-Pauly testified:

And one thing I'd like to say right now is that if publications worked, if printing material worked ... I could swear for the amount of paper we've produced and the amount of information that we, and the public utilities, and the provincial governments, and the oil suppliers, and everybody else has produced in the last 25 years, we could have insulated every single home in Canada to such an extent that none of our programs would be necessary today. But the truth is just producing information doesn't work.

(Source: Transcript, October 26, 2001, page 12, line 99)

74. Barbara Mullally-Pauly testified:

...people are ready, willing, and able to accept detailed technical information, they want this kind of information. So we knew that there was a desire for information.

Secondly, people are looking for impartial information. ... I think most consumers are very weary and recognize that if you have a stake in the product you sell the advice might be somehow less trustworthy to the customer ... So we wanted a way of getting out impartial information.

And thirdly, we took a look at ways to deliver programming.

(Source: Transcript, October 26, 2001, page 13, line 18)

75. Barbara Mullally-Pauly testified:

We know now that, for example, a successful bill stuffer campaign is one where out of every 100,000 fliers you send out, perhaps 2000 people bother to look at it, and they give you a phone call that might lead them to order a publication, but the

actual amount of activity they do gets smaller and smaller. So we have learned that, for example, national advertising ... major advertising, although some help to provide awareness, ... advertising does not lead to action. The key is to actually get out there within the community and have someone offer the service. So you need to support it with promotions, and I'm really very grateful to those utilities that have supported our activities through bill stuffers and through promoting it in their own literature and on their own web sites. I mean, this is all necessary, but just as we put the information on our web site, that's only our very first in making people aware that they're even, that there are services out there and there are ways that they can achieve (inaudible).

(Source: Transcript, October 26, 2001, page 14, line 45)

The Conservation Corps

76. Both Power and Hydro claim partnership with the Conservation Corps.
77. However, that partnership appears token:

... Newfoundland Power provided \$3,000 approximately for the purchase of a blower door; \$1,000 approximately for the purchase of the metrobus ad; and approximately \$3,000 for the purchase of 50 to 60 assessments, and that there was a bill insert which would have been an in-house cost ... that would be a total of \$7,000.

(Source: Transcript, October 26, 2001, pages 28-29, line 104)

There is evidence that Power purchased another 50 or 60 assessments for about \$3,000, for a total provided to the Conservation Corps of \$10,000.

Hydro, according to the evidence, paid the Conservation Corps \$18,000 for services rendered.

These amounts, \$10,000 provided by Power and \$18,000 provided by Hydro, pale in comparison to the \$130,000 provided to the Conservation Corps by Petro Canada and is less than the amount provided by municipalities.

(Source: Transcript, October 26, 2001, page 24, line 74)

78. The Federal Ener-Guide Program has signed a contract over the next two years with the Conservation Corps for \$125,000 worth of services.

(Source: Transcript, October 26, 2001, page 13, line 89)

79. Barbara Mullally-Pauly stated:

With the Conservation Corps, the model of the Conservation Corps and the green communities, has proven to us to be the most effective type of delivery mechanism.

(Source: Transcript, October 26, 2001, page 14, line 21)

80. Barbara Mullally-Pauly said:

With the Conservation Corps, like I said, seven out of ten home owners undertake their work and we know that they're spending on average somewhere around \$1,300 on materials and labour.

(Source: Transcript, October 26, 2001, page 14, line 63)

81. Barbara Mullally-Pauly testified:

... we're prepared to continue to support this group. We feel that they are doing excellent work, and we feel that we now have a demand side management model and energy conservation programming model that works really well for the existing housing sector.

(Source: Transcript, October 26, 2001, page 15, line 51)

82. The evidence reveals that in this province the Conservation Corps assessed 380 households which would have consumed 9,920,039 kilowatt hours of electricity. After the intervention of the Conservation Corps there was a saving of 1.56 million kilowatt hours for these 380 homes.

(Source: Transcript, October 26, 2001, page 22, lines 41-63)

83. According to the evidence, Natural Resources Canada pays Ener-Guide for assessors \$150 per call completed to reduce customer costs and the cost of delivery. This program has been

renewed for five years by the Government of Canada in the Federal Budget of 2000. A Conservation Corps customer in this province pays \$100 for the service rendered. The \$100 may be a barrier for potential customers who require conservation. Ms. Mullally-Pauly testified that in Ontario a gas utility provides \$50 by way of a coupon toward the Ener-Guide cost for a customer. Here there is no such subsidy provided by Hydro or Power.

(Source: October 26, 2001, transcript, page 25, line 68)

84. Barbara Mullally-Pauly's evidence is:

Natural Resources Canada will fully subsidize the second after visit because it is less costly, so we pay for that. We pay the full \$150 cost for the second visit, provided people have undertaken at least half of the upgrades.

(Source: Transcript, October 26, 2001, page 33, line 97)

85. It is the proposal of the Conservation Corps that the \$100 fee for their services be underwritten by the two utilities by at least \$50.

(Source: Transcript, October 26, 2001, page 26, line 43)

86. Finally, Ms. Mullally-Pauly questioned the entire process of using oil to heat homes with electricity:

I'm not an engineer ... but the one thing I can tell you is whenever you transform energy there are losses, so burning oil at whatever efficiency, we're burning it at that point for generation, and I don't know the efficiency of generating but it's probably, what, in the 60 or 70 percent range to produce electricity. Electricity itself inherently we always calculate at 100 percent efficiency, but on the other hand, if you had to burn another fuel and use part of that fuel to just simply fire the plant you, it's a very low grade way of producing electricity. Hydro electricity is always, will be a lot more efficient, so the less you have to use thermal generation the better off you are. Now you don't have the option here right now of switching to a higher efficiency fuel to generate electricity so it makes sense to go after as many savings as you can and try to reduce those costs. It's far more efficient, for example, to burn oil in a house, to heat the house, and use electricity for what it does best, provide light and power appliances. It just makes common sense. ...

(Source: Transcript, October 26, 2001, page 23, line 89)

87. The Consumer Advocate recommends that the two utilities, in the interest of conservation, undertake to support the work of the Conservation Corps by providing coupons to assist in the \$100 fee for the services rendered.

Conservation – Industrial Customers

88. The Industrial Customers have experienced the benefits of conservation. In the early 1990s there was an energy audit in which the two paper mills owned by Abitibi-Consolidated and Hydro participated. That energy audit was available to all of Hydro's Industrial Customers. Participation was out of necessity. According to the evidence of Jay Backus:

In Stephenville's case, the cost of energy represents twenty percent of the cost of manufacturing a tonne of newsprint.

(Source: Transcript, January 10, 2002, page 11, line 73)

89. Melvin Dean testified:

The energy per wrapped tonne of newsprint has decreased slightly since 1992. In 1992, we used 3003 kWh/wrapped tonne. Year/2/date/2001 we have used 2970 kWh/wrapped tonne.

(Source: Pre-filed Evidence, December 13, 2001, page 5)

90. In short, Hydro is capable of working with its customers to promote conservation measures when required.

DEMAND SIDE MANAGEMENT

91. Demand side management ("D.S.M.") is a term used by electric utilities to refer to actions utilities take in an attempt to control the timing or amount of electricity used by customers. In other words, actions taken to influence customers' demand for electricity. This is accomplished through the planning, development and implementation of programs that affect

customers' daily consumption so as to maximize the efficiency of electricity production and system performance.

(Source: Energy Wise, Newfoundland and Labrador Hydro, Fall 1994, CA-106)

At least until 1994 D.S.M. programs were being implemented throughout Canada by major electrical utilities.

92. D.S.M. programs benefit both the customer and the utility. Benefits to customers include reduced costs, reduced consumption, and better use of electricity. Benefits to Hydro include reduced costs and capital requirements, increased system utilization, and reduced fuel consumption. The benefits to Hydro are also indirect benefit to customers, since reduced costs assist Hydro in holding the line on electricity rates. D.S.M. also provides Hydro with an opportunity to provide better service.

(Source: Energy Wise, Newfoundland and Labrador Hydro, Fall 1994, CA-106)

93. All D.S.M. initiatives appear to originate from the April 13, 1992, report issued by the Board of Commissioners of Public Utilities where the Board directed that Hydro prepare annually a joint report with Newfoundland Power on the progress of demand side management for the year there ended. To date no joint report was ever prepared.

(Source: Transcript, November 9, 2001, page 5, line 26)

94. The Consumer Advocate recommends that there be joint reporting on the progress both utilities are making working together on demand side management, as required by the original Order of April 13, 1992.
95. In the past, Hydro has undertaken conservation pilot projects in some communities on the Island and in communities along coastal Labrador, and in Labrador City.

Good news from Hydro! We have a number of ways to help our diesel customers use less electricity – and that means lower monthly bills. For example, we have lighting products which consume only 25% as much electricity as regular light bulbs. That means you can save up to 75% on your lighting costs. If you have an

electric water heater, our insulation blanket will trim 10% off your hot water costs. Our faucet aerators and high efficiency shower heads will help you save on hot water energy costs as well as conserve water. All together, such conservation measures could save up to \$100-\$150 per year on your electricity bill.

It is in everyone's interest to save electricity. Charlottetown and Pinsent's Arm are served by a diesel-electric system which is an expensive way of generating electricity. Helping you lower your electricity consumption through the use of energy saving products provides savings for your and savings for Hydro.

(Source: CA-106, Energy Wise, October, 1993)

96. In Hydro's Charlottetown pilot project the initial results were good. As indicated in Table 2, 110 customers participated in the pilot program. This level of participation is estimated to result in savings of 25 kW during the winter peak and 157,800 kWh per year.

(Source: CA-106, March 11, 1994, p. 18)

97. The Charlottetown D.S.M. pilot project evaluation states at p. 22:

The evaluation of the Charlottetown D.S.M. pilot project demonstrates that delivering energy efficiency services to its customers in isolated diesel systems does have a direct impact on reducing system demand and energy requirements. The energy savings represent about 75% of pre-program estimates as prepared by Barakat & Chamberlin. Demand savings are deemed to be higher than the consultants' previous estimates due to the added element of diversity which D.S.M. brings to small domestic driven loads which in the first place are very undiversified. Such conclusions are based on a review of billing and demand data covering the first six months following the community D.S.M. effort. Impact evaluation will be undertaken again after one year.

(Source: CA-106, December 1994, page 22)

98. The experts concluded:

Conservation is more cost effective than producing energy. D.S.M. costs less than fuel and therefore costs less than all further marginal cost configurations.

(Source: CA-106, December 1994, page 20)

99. The efforts of Hydro to place D.S.M. measures into Charlottetown appear sporadic. Melita Paul, Town Clerk/Manager of the Town of Charlottetown, testified that the program was “quite a number of years ago”. It is apparent from her evidence that there has been no follow-up:

Not in the last couple of years but a few years ago there was some hot water tank blankets and some fluorescent lights and I think insulation for pipes. That was a few years ago.

According to the evidence of Ms. Paul, consumers are paying for basic utilities for an average household in excess of \$200 per month and this does not include electric heat.

(Source: Transcript, October 19, 2001, page 28)

100. In December 2000 there was an economic analysis of consideration of conservation and load management for Norman Bay, Labrador. Norman Bay has fifteen domestic customer accounts and five general service accounts. After the D.S.M. assessment the analysts concluded:

- a. So long as the short run marginal costs and marginal revenue structure prevails, it is more economic for Hydro to cause electricity to be conserved in Norman Bay rather than produced. This entails ongoing re-installation of energy conserving equipment as it decays, customer education regarding appliance efficiency, etc. ...**

The overall recommendation:

Hydro proceed to develop a D.S.M. implementation program in Norman Bay utilizing the corporate resources of T.R.O. customer services and system planning.

(Source: CA-106, December 2000 Report, page)

101. In the past, Hydro was offering cash back to electric heat customers on the purchase and installation of insulating materials in homes in which electricity is the primary source of heat. We note as well that Hydro was offering a \$500 coupon by way of rebate towards the purchase and installation cost of an oil fired hot water heater. In that program there appeared to be collaboration with Irving Oil, Ultramar Canada and Esso.

(Source: CA-106)

102. In reference to the “Wrap Up for Savings” plan, Mr. Budgell testified:

I believe we still have it on the books but there is very little activities or requests for it.

(Source: November 9, 2001, transcript, page 5, line 85)

103. The Consumer Advocate recommends, based on the foregoing, that Hydro immediately reactivate all D.S.M. measures and renew its efforts in D.S.M. and work in coordination with the Conservation Corps and that results be forwarded to the Board on a regular basis.

DUPLICATION

104. Duplication of operations and services between the two utilities has emerged as an issue, which this Board has a statutory responsibility to settle. As is stated in Board of Commissioners of Public Utilities Order P.U. 16 (1998-99) at p.104:

“The Board has a responsibility under the *Electrical Power Control Act, 1994*, to implement the Power Policy of the Province which requires that the power sources and facilities are managed and operated in a manner:

“that would result in power being delivered to consumers in the Province at the lowest possible costs consistent with reliable service”. [*Electrical Power Control Act, 1994, Sec. 3(b)(iii)*]

105. The Board’s financial advisor testified on the issue of duplication between the utilities:

I see the merit and it was not explored or reviewed in any detail by us in the past year. ... but I do acknowledge and see that where there is opportunity to share resources that benefits ratepayers and there is no impediment, you know whether it be a legal or physical impediment to doing so, then I think it should be encouraged ... everyone should work to that objective.

(Source: Transcript, January 9, 2002, page 5, line 89)

106. The Board also has the opinion of one of its industrial customers. Melvin Dean testified, **“it is a concern that there may there be some efficiencies gained in some areas by avoiding a duplication”**.

(Source: Transcript, January 10, 2002, page 17, line 31)

107. It therefore falls incumbent upon the Board to ensure that ratepayers are not paying for the duplication enjoyed by the two utilities.
108. The evidence is that in 1997 the Presidents of Hydro and Newfoundland Power initiated a process to deal with issues of duplication. John Evans, a Vice-President of Newfoundland Power at the time, and David Reeves, Vice-President of Transmission and Rural Operations for Hydro, formed a part of the Steering Committee. There were eighteen task groups (fifteen working groups and three sub-groups). The evidence is that there were thirty-six meetings of the Steering Committee alone in the period between March 5, 1997, and May 10, 1999.
(Source: Transcript, October 2, 2001, page 36, line 2)
109. Draft No. 20 was the latest version of the final report of the Coordination Steering Committee between the utilities because no final report was complete. That draft contains a summary and discussion of findings. (Source: CA-201(a))

Working Group No. 1 – Sharing of Specialized Services and Equipment

110. This Working Group's recommendations included that both utilities define the areas that should provide the maximum gains in the sharing process. The Steering Committee agreed with the working group's recommendations but cautioned a simple method of tracking loaned items which does not entail any major software development.

Working Group No. 2 – PCB Facility

111. In page 10 of its report, Working Group No. 2 – PCB Facilities stated in part, "... the unit cost for destruction of one drum of lighting ballast can be approximately \$1,450 or less if transported along with a "full load". However, this cost could be in the \$1,800 - \$2,500 per drum range if transported in a partial load. If the utilities coordinate to maximum the number of full trucks as opposed to partial trucks, then a savings of up to \$1,000/drum may be realized."
112. Mr. Reeves in his evidence was unable to quantify what amounts, if any, had been realized as a result of this recommendation, stating as follows:

Yes there has been a number of occasions when there has been coordination between the two utilities. I guess, dating back to 1998. The first one, I guess, Hydro offered Newfoundland Power the opportunity to take advantage of the small space that we had left on one of our trailers that we were shipping a load on, and at that time, it wasn't advantageous for them to do it. Since then, Newfoundland Power has offered us on three occasion a similar offering; two of these were similar to the one that we made to Newfoundland. There wasn't a lot of space available so we did not take advantage of those ... We are going to be disposing of 51 of our drums ... so we anticipate that there will be savings and that cost savings will be shared between the two utilities in that we are not going with a full load ... we anticipate ... this particular one that's happening right now will give savings to both utilities.

(Source: Transcript, October 4, 2001, page 12, line 7)

There was no evidence filed to indicate what savings, if any, had been realized or if these shipments occurred.

Working Group No. 3 – Customer Inquires 1-800 Number

113. According to the report of Working Group No. 3 – Customer Inquiries, "... it was originally concluded that there were benefits to both utilities in having a single account for 1-800 number services". However, this objective does not appear to have been realized. Draft No. 20, January 4, 2001, Working Group No. 3, page 13, has a note "Can this be reviewed? Now with same carrier, it may be possible".

114. According to the evidence of Mr. Reeves, "**The end result is that ... Newfoundland Power has its call center and we have our call center with different numbers**".

(Source: Transcript, October 2, 2001, page 37, lines 96-98)

Working Group No. 4 – Printing Services

115. The Steering Committee agreed with recommendations including:

- Newfoundland and Labrador Hydro will contact Newfoundland Power for a quote on all work

- Newfoundland Power will be able to look after Newfoundland and Labrador Hydro's needs more than 90% of the time. Based on work that has been quoted and performed by outside suppliers, Newfoundland Power estimates that it can offer similar services and quality at an overall cost savings of 32% to Newfoundland and Labrador Hydro.

There was no evidence to suggest that any savings had been realized to date through the coordination of printing services.

Working Group No. 5 – Storage Space

116. The Steering Committee's evaluation stated in part:

The working group has reviewed many areas for coordination and in general, new opportunities were discovered for the practical use of storage space in one utility by the other. With very little overlap of territories, the facilities of one utility are not conveniently sited for the other's use.

(Source: CA-201(a), Draft 20, page 17)

117. However, we know from the evidence that Newfoundland Power has a facility in Whitbourne, and nearby in Blaketown, Hydro has a facility. In Central Newfoundland, Hydro has a facility in Bishops Falls and Newfoundland Power has a facility in Grand Falls. Both companies have facilities on the west coast. It is interesting to note that this working group stated:

Savings would normally be associated with the reduction in handling, storage costs, labour costs, security costs, etc.

(Source: CA-201(a), Draft 20, page 16)

118. It is incumbent upon the Board to investigate and make a determination if there is a duplication in facilities and if savings can be realized for consumers by addressing that issue.

Working Group No. 6 – Emergency Spill Response

119. In reference to Working Group No. 6 – Emergency Spill Response, it is interesting to note that it is only recently that the working group is recommending that both utilities provide each other with the names of contact personnel for spill response and both utilities inform each other of training plans in order to allow the other utility an opportunity to participate.

Working Group No. 7 – Protective Test Facilities

120. Page 22 of the January 4, 2001, report of Working Group No. 7 – Protective Test Facilities states:

John Evans feels that even greater savings might be possible if both utilities encourage the establishment of a local outside test facility and this option should be explored.

The Steering Committee recommended that prior to either company replacing test equipment the recommendations be re-visited.

Working Group No. 8 – Distribution and Maintenance

121. The scope of Working Group No. 8 was to review rural operations where Hydro and Power operated adjacent to each other to establish the most effective means of operation to enhance customer service at the lowest possible cost. In the Baie Verte, Springdale and White Bay areas both utilities continued their existing arrangement. According to the evidence of Mr. Reeves, this task force could not reach a consensus. The only agreement the parties appear to have reached is to deal with emergencies is a memorandum of understanding.

(Source: Transcript, October 2, 2001, page 41, line 94)

Working Group No. 9 - Switching

122. The purpose of Working Group No. 9 was to review the coordination of switching between the utilities with a view to enhanced customer service. The recommendations of the working group, however, were not unanimous due to bargaining unit concerns.

(Source: CA-201(a), page 28)

Working Group No. 10 – The VHF Mobile Radio System

123. In reference to the VHF Mobile Radio System, Mr. Reeves testified:

What the committee found when they did their review is that the two systems while providing the same service had limited capabilities of being tied technically together but there was some of that done and what the conclusion of the committee was is that once one of the utilities decide to replace its VHF it would discuss with the other one the likelihood of a possible coordination.

(Source: Transcript, October 2, 2001, page 44, line 46)

124. The Steering Committee's evaluation was:

The Steering Committee agrees with the analysis completed by the working group and agrees that at the time of the replacement of one of the systems a full review of both system requirements will be completed to determine if there are benefits to going with one system.

(Source: CA-201(a), Working Group No. 10, January 4, 2001, p. 31)

125. The VHF system falls under Information Systems and Control and Hubert Budgell testified on behalf of Hydro in reference to the same (although this item of \$8,600,000 was not within his jurisdiction). The evidence reveals some dispute between Newfoundland Power and Newfoundland Hydro philosophically:

John cited examples where cooperation agreed to did not seem to exist and a significant philosophical difference between the organization. An example was in the telecommunications area where despite the agreement, NP learned of Hydro's

plans to build a major VHF radio network through an NLH filing with the PUB. Philosophically NP views the telecommunications companies as the experts in their field, while Hydro seems to take the position that they can do the job better than the telecommunications company.

(Source: Transcript, November 8, 2001, page 34, line 50)

126. The evidence is that Hydro intended to replace its VHF radio in 2003/2004 but has moved this up to 2002/2003. The evidence reveals little by way of explanation as to why the VHF radio acquisition was moved up a year.

(Source: Transcript, November 8, 2001, page 35)

127. The evidence further reveals that the Department of Works, Services and Transportation intends to participate in the funding and usage of the proposed new Hydro mobile radio system, although, according to the evidence, the degree of participation and funding process remains to be decided.

(Source: U Hydro 22)

128. According to revised estimates, the VHF radio system will now cost \$8,721,000.

(Source: U Hydro 14)

129. Given the fact that the two utilities have yet to work out any suitable arrangement, and the degree of participation in funding from the Department of Works, Services and Transportation has yet to be worked out, it is our recommendation that no funding be allowed for this particular item.

Working Group No. 11 – Inventories and Common Spares

130. The Inventories and Common Spares Committee determined there was no cost benefit in doing a pilot study on combining facilities in Whitbourne, Stephenville and Grand Falls/ Bishop Falls as according to the Committee there was not sufficient space at this time in either Whitbourne or Stephenville. The Group also recommended that Hydro move to change its method of scrap metal disposal to be more in line with the methodology utilized by Power. This would provide Hydro with a higher return on its scrap metal sales. It is interesting to note that Power was

receiving more by way of compensation for the sale of scrap metals than Hydro was receiving. The reason, according to Mr. Reeves, is:

Originally we would collect our material, which is scrap, and we would package it in such a way that all of the material would be auctioned off, and that would mean that we'd have some more valuable, some less valuable stuff together into a package for auctioning.

(Source: Transcript, October 4, 2001, page 6, line 75)

This is one positive result of the collaborative efforts but does not auger well for Hydro who would appear to have been losing money the way copper and aluminum was sold previously.

Working Group No. 12 – 138 kV Transmission Line Maintenance

131. Working Group No. 12 dealt with 138 kV transmission line maintenance for Central. The purpose of that Committee, according to the evidence, was to review the maintenance of the 138 kV transmission lines in Central Newfoundland in order to minimize duplication of service and to better deploy current resources. There was no unanimous consent regarding changes, even though, according to the evidence:

NLH staff feel that because they specialize in transmission line work and have the equipment available to do this work, there may also be an opportunity to maintain Newfoundland Power's 138 kV lines more cost effectively. Newfoundland Power would also be relieved from the burden of additional or future purchases of capital equipment that would be under-utilized in their day-to-day operation, or the renting of equipment in a forced outage situation when specialized equipment may not be readily available.

There was no result and the duplication continues.

(Source: Transcript, October 2, 2001, page 46)

Working Group No. 13 – Common Equipment and Engineering Standards

132. The scope of this group's work was to review material and construction equipment specifications, design standards, construction standards, and work methods for both utilities

with the purpose of identifying potential cost reduction opportunities that may be derived through standardization. As of January 4, 2001, there was no indication that the working group's recommendations had been completed.

(Source: CA-201(a), Working Group No. 13, page 39)

133. In reference to substation design standards and practices, that working group found that opportunities exist for common training activities and maintenance standards. The working group recommended working together to reach common practice over time and acknowledged that it was through common materials, designs and practices that further savings can be achieved.

(Source: CA-201(a), Working Group No. 13, page 42)

134. In reference to line maintenance construction, the committee noted that in the long term significant savings are possible.

(Source: CA-201(a), Working Group No. 13, page 43)

Working Group No. 14 – Joint Meter Shop Review

135. The committee met and recognized that \$175,000 per year could be saved if both utilities used one accredited shop. Subsequently, Power decided that using an outside contractor was more cost effective.
136. Now, according to the evidence, Hydro intends to approach Power to see if, instead of contracting out, this work could be undertaken in Hydro's shop. The testimony of Mr. Reeves:

I would say that there has been savings, I'm not able to quantify them to you right now but where we are right now, like, it was only this year that we became fully accredited and my intention, as we have an accredited shop now, is to go to Newfoundland Power and to, which I have already asked, to see if they, instead of contracting out their meters, if they could have their meters tested in our shop, but those discussions, the real discussion of that particular thing has not been finalized yet.

(Source: Transcript, October 3, page 2, line 19)

Working Group No. 15 – Technical Training

137. This group worked on (1) training programs offered by manufacturers of equipment used by both companies, (2) communications and information technology training programs and (3) trades and technology training including skills upgrading. The Steering Committee agreed that there were savings in the issue of joint training and using the other utility's facilities where practical. The group also recommended that both utilities make a two-year commitment to examine the possible overall cost savings of joint training efforts. The two-year study could be a cost tracking period. It would allow both utilities to see the impact of joint training efforts and make a longer term projection of cost savings.

(Source: CA-201(a), Working Group 15,
January 4, 2001, page 48)

138. There does not appear to be any quantification in terms of the savings realized and Mr. Reeves, in his evidence, could not say whether or not anything had been done in reference to some recommendations made.

(Source: Transcript, October 3, 2001, page 2, line 96)

Duplication Issues Not Addressed by Committees

139. Of interest to consumers is what was not discussed during the meetings of the Steering Committees or Working Groups. These would include:

- Discussions re the benefits of purchasing or leasing or sharing vehicles.
- Discussions re the benefits of purchasing and leasing of equipment including computers.
- Discussions re the benefits of joint purchasing efforts in reference to these major ticket items.
- Discussions re the benefits of joint purchases of supplies.

(Source: Transcript, October 2, 2001, pages 34-35)

140. Mr. Reeves testified in reference to a question concerning leasing versus purchasing:

... We have not explored in a lot of detail other than, as I explained, our Asset Manager over the last number of years since he has been in the job, he is part of a users' group from across Canada for again vehicles, transportations and what he has gleaned from that interaction is that not a lot of similar utilities as ourselves actually lease out their vehicles for the number of reasons I gave the other day but next to endeavour to ensure that that is the right decision then we are going to attempt to during our purchase next to put the option in our tender bids for the possible leasing. (Emphasis added)

(Source: Transcript, October 5, 2001, page 10, line 47)

Conclusion – Duplication Committees

141. And were there savings in reference to the efforts to reduce duplication? According to Mr. Reeves the answer is no and Mr. Reeves stated that the committees have not met for the last couple of years.

(Source: Transcript, October 5, 2001, page 15, lines 48-68)

142. Of concern is a minute in meeting number 25 of the Joint Coordinating Steering Committee which states:

John vented his frustration regarding the lack of progress by all parties in this endeavour. To significantly reduce costs requires tough decisions by all.

(Source: Transcript, November 8, 2001, page 34, line 41)

CAPITAL BUDGET

143. Because the two utilities were unable to reach a final agreement to address issues of duplication and costs, it is incumbent upon the Board to ensure that ratepayers are not paying for the duplication displayed by the two utilities. Because the Board has a legislative mandate to provide to consumers electricity at the lowest possible costs, consistent with reliable services, the Board has a duty to ensure that the utilities are working together to avoid duplication. Only

by determining that there is no duplication prior to approving a capital budget item will ratepayers be assured of obtaining the lowest possible cost for electricity.

144. The Consumer Advocate recommends that the Board develop a test to determine if there is duplication prior to approving either utility's capital budget. The Board should develop standards common private industry for justification of any expenditure. As stated by Mr. Backus of Abitibi-Consolidated:

... I couldn't submit a project without a cost benefit study, unless it involved something like the roof falling down ...

145. By way of example, B-59 in the 2002 Capital Budget Projects Over \$50,000 Hydro has an item for the purchase of meters and equipment – TRO system – for an amount of \$172,000. There are five lines given to the Board with this request for approval.
146. In B-60 – Acquired Document Management and Imaging System – a \$104,000 item in the 2002 Capital Budget Projects Over \$50,000, Hydro provides the Board with a seven line request and the last line states that there will be requests for the approval of additional phases in future submissions to the P.U.B. This item is unreasonable because we do not know what future amounts will be requested.
147. B-63 involves the replacement of printers for an amount of \$130,000 in the 2002 Capital Budget Projects Over \$50,000. There was no formal cost benefit study required. We do not know if these printers are for individual use or if they are networked and how many employees are utilizing one particular printer. Without such information how can there be a commitment for funding. Mr. Dean offered in his evidence that his printer is used by five people at Abitibi-Consolidated.

(Source: Transcript, January 10, 2002, page 16, line31)

148. B-23 – Replace Two Air Compressors – Buchans (\$65,000) provides six lines in seeking in seeking the approval. Mr. Dean in his evidence stated:

There is not a lot of detail there so we are assuming here that the two compressors, one is a backup for the other, and if that is, in fact, correct, which is standard in our industry, we tend to replace one and then run that new one as your main, keep the other one as a backup and probably get several more years service out of the second one. In short, there was little information given to the Board for this expenditure.

149. In B-74 Hydro is proposing to replace vehicles for an amount of \$1,897,000. There was no formal cost benefit study required. According to Mr. Reeves when asked concerning leasing versus purchasing options re vehicles, Hydro admitted having not done much exploring of the leasing option. So this request for approval comes at a time in which Hydro appears to be examining the leasing versus purchasing option.

(Source: Transcript, October 5, 2001, page 10, line 47)

150. In reference to B-57 – Upgrade Diesel Plant - Harbour Deep (previous \$35,000; \$515,000), Hydro should be required to review that proposed expenditure and determine a cost effective way of dealing with this issue until the Harbour Deep relocation is resolved.
151. In reference to B-66 - the replacement of the VHF mobile radio system, as stated in the 2002 Capital Budget Project Over \$50,000, we note that this item, which is nearly \$8,750,000 did not require a formal cost benefit study. Previously, there were indications that both utilities should be sharing in one VHF mobile radio system. Until this issue is resolved, no money should be provided for a VHF mobile radio system.
152. The Consumer Advocate recommends that both utilities should appear before the Public Utilities Board back-to-back on capital budget applications each year. One utility should be required to attend the capital budget hearing of the other. Neither capital budget of should be approved until issues of duplication are dealt with in these applications.

PRODUCTIVITY ALLOWANCE

153. In the 1996 hearing in the matter of an Application of Newfoundland Light and Power Company Limited for an Order (P.U. 7 (1996-1997)), the Board saw fit, after reviewing all of

the evidence, to implement a productivity allowance to reduce expenses for the test year. The Consumer Advocate recommends that the Board implement a similar productivity allowance in this instance.

154. In the evidence of Grant Thornton filed on December 13, 2001, the Board's financial advisors suggested that a fair way to deal with these expenses, in a "macro" sense, was to employ a productivity allowance for Hydro in reference to controllable operating and maintenance costs.
155. This approach would allow Hydro's management to be flexible in cost saving initiatives, without undue interference from the regulators. While Grant Thornton suggested a productivity allowance in the range of 1%-1.5%, Mr. Brushett of Grant Thornton agreed that a 2% productivity allowance could be appropriate, depending upon the Board's view of the matter.

(Source: Transcript, January 9, 2002, page 2, line 95)

BILL DESIGN

156. Both utilities should have a common format for their statements of account to consumers. Hydro's statement provides information to consumers re kilowatt usage. (See: CA-1) There is nothing similar on Power's bill. When asked whether the itemization for Hydro of kilowatt hours usage for appliances is worthwhile, Barbara Mullally-Pauly stated:

Definitely we find that when people get direct feedback and understand how much they are spending its very effective.

(Source: Transcript, October 26, 2001, page 28, lines 29)

And Barbara Mullally-Pauly also testified that there is room for improvement in what is provided to consumers in these statements:

... but I find one of the most compelling things is when you say to somebody, this is typical and this is what you are doing because people would like to be better than

typical so its nice to start up at typical ... the bill could be really improved by using typical going to ... typical use and this actual use.

(Source: Transcript, October 26, 2001, page 28, lines 27-37)

157. Transparency demands that consumers be informed on their monthly bills as to what is owing in the R.S.P. account. There should be a computation of what each consumer's liability is in reference to that account in the monthly statements. The RSP should no longer be hidden from consumers.

MONTHLY METER READINGS

158. Hydro appears to be able to complete monthly meter readings. Power does not. There should be consistency across the Province. Utilities should be reminded by the Board that monthly meter readings are mandatory in this Province barring exigent circumstances. There should be no confusion for consumers in reference to the monthly meter reading issue.

NOTICE

159. There was evidence in the hearing that Hydro's 35,000 customers were not provided with notice of Hydro's intention to seek a rate increase. Regulations should ensure that the utility is required to provide notice to every ratepayer when that utility appears before the Public Utilities Board for the purpose of seeking a rate increase. In this instance, because consumers were not aware of the amount Hydro was seeking by way of increase, Hydro was requested to fax to community councils in Labrador this information.

(Source: Transcript, October 31)

160. The Consumer Advocate is recommending that the regulations change not only to ensure that notice be provided to all consumers of proposals for rate increases through an insert in their bill but that consumers be provided with a synopsis of meetings held between the Public Utilities Board and representatives of the utilities from time to time so that process is transparent.

PREFERENTIAL RATES

161. All preferential rates provided to the Federal Government should be discontinued immediately. Preferential rates affecting the Provincial Government, schools and churches should be phased out with notice.

CORPORATE SURVEYS

162. Both utilities have embarked upon processes of engaging pollsters to conduct surveys from time to time. The value of conducting these surveys, from a consumer's perspective, has never been explained. A rationale should be developed before any further expenditures are permitted from regulated funds.

INCENTIVE PLANS

163. U-Hydro No. 12 reveals that during 2000 the Compensation Committee of the Board of Directors of Newfoundland and Labrador Hydro considered the introduction of a performance based incentive for members of the Executive and Senior Management. The four standards adopted related to performance objective are financial performance, system reliability, safety and strategic planning. If the utilities could work collectively to reduce the amount of purchased oil, to implement successful conservation programs, and to reduce costs for consumers generally, consumers could very well endorse incentive plans. The criteria for implementing an incentive plan requires further review but the performance threshold appears to be low in this particular instance.

BILLING PAYMENT OPTIONS

164. The Consumer Advocate recommends that the Board direct Hydro to implement an equalized billing payment option for consumers. This will help to address consumer concerns about billing stability, is consistent with what is currently offered by Newfoundland Power to its

customers and is more easily implemented by Hydro with the addition of its new customer service system.

RULES AND REGULATIONS

165. The Consumer Advocate recommends that the Board direct Hydro to make certain changes to wording in its Rules and Regulations as follows. These changes will reduce confusion and potential claims of discrimination. Mr. Bowman discusses these wording changes in detail on pages 17 and 18 of his Pre-filed Evidence. None of the experts raised any objections to Mr. Bowman's recommended wording changes.

- (i) Revise Clause 4 to state that a customer's security deposit will be refunded once a good credit history has been established, generally after two years;
- (ii) Revise the wording in Clause 10 (c) to state that Hydro *will* charge an interest rate of prime plus five percent on delinquent accounts; and
- (iii) Revise Clause 10 (g) to state that Hydro will collect the full amount of any under-billings.

COST OF SERVICE AND RATE DESIGN

Cost of Service

166. Hydro has done a reasonable job of interpreting and reflecting the basic principles set out in the Board's 1993 Report on Cost of Service Methodology, and has applied the principles on a reasonably consistent basis. However, the Board should direct Hydro to make two changes to the cost of service study in order to ensure a more fair and cost-reflective allocation of the revenue requirement to consumers.

167. First, the Board should direct Hydro to allocate generation demand costs on the Island Interconnected System on the basis of a single coincident peak (1CP) allocator rather than a two coincident peak (2 CP) allocator as proposed by Hydro. A 1CP allocator is consistent with what Hydro has proposed for its other systems and better reflects cost causation. Mr. Budgell

testified that Hydro plans its generation to meet an 18.5 % reserve margin at time of system peak (page 7, line 2, November 6, 2001 transcript). He goes on to say that the change in models from LOLE to LOLH should have no impact on the need for additional capacity (page 12, lines 41 to 43, November 6, 2001 transcript). Therefore, a 1CP allocator is appropriate. Mr. Osler (page 17, line 25 of his Pre-filed Supplementary Testimony) and Mr. Bowman (page 2, paragraph 1 of CA-6) favor use of a 1CP allocator. Under cross-examination, Mr. Brickhill (page 6, lines 59 to 70, November 28, 2001 transcript) indicated that 1CP is the appropriate allocator given Mr. Budgell's evidence discussed above.

168. Secondly, distribution equipment is sized to meet local peak load as opposed to system peak load, so the Board should direct Hydro to allocate distribution demand costs on the basis of non-coincident peak rather than coincident peak as proposed by Hydro. All cost of service experts agree that utilities generally size their distribution systems to meet local peak loads including Mr. Brickhill (page 6, lines 87 to 90, November 28, 2001 transcript), Dr. Wilson (page 8, lines 10 to 12 of his Pre-filed Evidence), Mr. Brockman (CA-213), Mr. Osler (CA-215), and Mr. Bowman (page 3, lines 17 to 18 of his Pre-filed Evidence). Although Mr. Brickhill believes that Hydro's distribution plant investment decisions are more appropriately reflected by a coincident peak allocator, his logic is not supported by any of the other experts. Mr. Brockman testified that Newfoundland Power allocates distribution demand costs on the basis of a non-coincident peak allocator (page 22, lines 49 to 60, December 4, 2001 transcript). Hydro should allocate distribution demand costs on the basis of non-coincident peak to be consistent with Newfoundland Power.

Rate Design

169. The Consumer Advocate recommends that the Board hire an independent consultant to review and recommend rate designs for electricity consumers in Newfoundland, and table the independent consultant's report for review at a public hearing. The Consumer Advocate makes this recommendation because in spite of the Board's efforts over the years, Hydro's proposed rates fail to meet its design criteria, particularly with regard to market efficiency and cost-based rates. The Consumer Advocate bases this recommendation on the following:

- (i) Hydro has not submitted for the Board’s review a revised wholesale rate design for sales to Newfoundland Power in spite of the Board’s order to do so as far back as 1992. As stated by Mr. Bowman in CA-6 (page 3, last paragraph), every rate design expert involved in this hearing (or in Mr. Brickhill’s case, a rate design expert from his company), has recommended before this Board that a more complex wholesale rate with demand and energy charges be implemented – Mr. Osler (page 30, lines 27 to 29 of his Pre-filed Supplementary Testimony), Dr. Wilson (page 7, lines 19 to 20 and page 8, lines 1 to 2 of his Pre-filed Evidence), Mr. Hamilton on behalf of Newfoundland Power at the 1992 hearing (pages 7 and 8, November 29, 2001 transcript), Dr. Sarikas, representing Mr. Brickhill’s firm, Foster & Associates at the 1992 Hearing (IC-2 and page 25, November 27, 2001 transcript), and Mr. Brockman (page 43, December 3, 2001 transcript). As Newfoundland Power’s rate design expert, Mr. Brockman stated that it is widely accepted practice, consistent with the principle of ensuring rates reflect costs, to signal costs separately in customer, energy and demand charges where practical to do so (page 43, lines 38 to 41, December 3, 2001 transcript). Mr. Brockman states on page 4, lines 16 to 17 of his Supplemental Testimony for this hearing that the size of Newfoundland Power’s load “means demand meters can clearly be afforded”. Therefore, a more complex wholesale rate structure will better reflect cost causation and fairness, and is likely to be cost effective.
- (ii) Secondly, Hydro has not performed an analysis of time of day and seasonal rates since 1990 (page 3 of 5, lines 19 and 20, IC-205), and refers to a marginal cost study conducted in 1984 when it designed the rate for the Non-Utility Generators (page 3, lines 26 to 28, IC-208). Without updated studies of marginal costs and time of use rates, Hydro is missing an opportunity to better meet its rate design criteria related to market efficiency and cost based rates, and to improve customer service by offering rate options, and providing customers a level of control over their bills. Whether or not consumers can, or choose, to respond to time-of-use rates is immaterial. Cost causation and fairness, and the benefit/cost ratio are the only issues that matter. As testified by Mr. Bowman, technology is making it easier for customers to respond to time-of-use rates without changes in lifestyle (page 5, last paragraph, CA-6). Mr. Bowman related

his own experience with a time-of-use rate in Virginia where he was able to reduce his electricity costs without changing his lifestyle.

- (iii) Thirdly, Hydro has made no progress in reducing the excessive levels of cross-subsidization in its rate structure in spite of the Board's recommendation in its 1996 Report. There is cross-subsidization among customer classes (CA-70), taxpayers are subsidizing electricity consumers (page 9, lines 24 to 31 of Mr. D.G. Hall's Evidence), future customers are subsidizing current customers through the RSP (page 6, lines 4 to 6 of Mr. Bowman's Pre-filed Evidence and page 35 of Dr. Wilson's Pre-filed Evidence), and because rates are averaged over the year and do not reflect seasonal variations in costs, electric heating customers are being subsidized by non-electric heating customers (Mr. Bowman, page 6, paragraph 1, of CA-6). Hydro's attempt at subsidy reduction (proposed 20% increase for Government institutions on Isolated Systems) indicates that subsidy reduction is simply not one of its priorities.

170. In summary, Hydro falls far short of meeting its rate design objectives. Hydro has failed to provide the information necessary to adequately address the shortcomings identified above. For this reason, the Consumer Advocate recommends that the Board hire an independent consultant to work with Hydro to design such rate structures. By having a public review of the Consultant's report, all stakeholders will have the opportunity to provide their input. Tabling the consultant's report at the 2003 hearing proposed by Hydro (LC-5) would provide an ideal forum for such a review.

Regulatory Mechanism

171. Mr. Bowman provides a description of performance-based regulatory mechanisms and their benefits on pages 8 and 9 of CA-6. The current regulatory mechanism known as cost of service, or rate of return, regulation is not only slow, cumbersome and expensive, but also not focus on what customers want, and does not provide the utility adequate incentive to continue to improve its performance. Where performance and incentive-based regulatory mechanisms have been put in place elsewhere, consumers have derived significant benefits. The Consumer

Advocate recommends that the Board make known its views on alternative regulatory mechanisms in a report to the Attorney-General pursuant to Section 83 of the Act.

RSP

172. In spite of testimony by Mr. Bowman (page 5, lines 21 to 22 and page 6, lines 1 to 12 of his Pre-filed Evidence) and Dr. Wilson (page 9, lines 6 to 9 of his Pre-filed Evidence) that the Board should consider elimination of the RSP, Hydro has filed no alternatives. In addition, Hydro refused to consider Mr. Bowman's proposal (page 16, paragraph 2 of CA-6) that Hydro, Newfoundland Power, the Industrial Customers and the Consumer Advocate meet in an effort to negotiate a solution to the RSP dilemma. As evidence has not been filed upon which to design a replacement for the current Rate Stabilization Plan (RSP), the Consumer Advocate recommends that the Board eliminate the current RSP and establish Hydro's revenue requirement for 2002 on the basis of forecast system load, hydraulic production and fuel prices. The Consumer Advocate recommends that the Board direct Hydro to recover the outstanding RSP balance over a period of 15 years in order to spread the rate impact over time. In addition, the Board should direct Hydro to file a fuel adjustment clause with its next rate application in 2003 taking into account the incentive mechanisms outlined by Mr. Bowman on pages 13 to 15 of CA-6. The RSP is forecast to be \$86.3 million in arrears in 2002, so it is vital that the Board take immediate action to eliminate the plan.
173. The RSP has two principal components: a fuel adjustment charge and a balancing, or holding, account. The fuel adjustment charge component accounts for differences between actual and forecast fuel costs. Fuel costs are impacted primarily by load, hydraulic production and the price of fuel. The differences between actual and forecast fuel costs are accumulated in the balancing, or holding, account component of the RSP and one third of the balance in the account is passed through to consumers each year.
174. As testified by Mr. Bowman (page 10, paragraph 2 of CA-6) and Mr. Brickhill (page 2, lines 13 to 15 of November 28, 2001 transcript), no other utility in North America has an RSP charge like that used in this province – that is, a fuel adjustment clause combined with a multi-year

balancing account. Mr. Bowman lists a number of reasons why utilities do not use multi-year balancing accounts with their fuel adjustment clauses (pages 10 to 13 of CA-6). It distorts price signals, it causes cross-subsidization in that past consumers are being subsidized by current consumers, it provides little incentive for the utility to better manage its fuel supply costs and improve its forecasting techniques, it is difficult for consumers to understand, and as Newfoundland Power states on page 51 of the Board's *1992 Report on Proposed Rates to be Charged to Newfoundland Light and Power Company* "NLP submitted that cost deferrals are against generally accepted utility practice of matching rates to costs in the period in which they occur and that cost deferrals should not be made especially when they can be reasonably avoided." The RSP balancing account, by deferring costs to future periods, violates this basic principal as agreed by Mr. Hamilton under cross-examination (page 14, lines 30 to 42, November 29, 2001 Transcript).

175. As the cost of capital experts testified, the fuel adjustment component of the RSP offers protection from variations in forecast load, generation mix and fuel prices, and so reduces risk, and Hydro's required rate of return. In her list of key business risk elements that would determine a reasonable capital structure for Hydro, Ms. McShane, Hydro's cost of capital expert witness, includes the RSP in her list of strengths, stating the "RSP offers protection from variations in forecast load, generation mix and fuel prices". However, she also includes the RSP in her list of challenges, stating the "RSP defers recovery of actual costs" (page 17, lines 9 to 23, her pre-filed Evidence). In effect, the fuel cost component of the RSP enables a reduction in the rate of return required by Hydro, but the balancing account component of the RSP actually increases risk, and the rate of return required by Hydro.
176. Both Hydro and Newfoundland Power support the RSP on the basis that customers demanded the RSP back in 1985. However, in addition to the fact that this information is out-of-date, being 16 years old, it is very much exaggerated. As pointed out by Mr. Bowman on pages 12 and 13 of CA-6, none of the documentation submitted by Hydro in its response to CA-179 indicates that consumers in 1985 were complaining about unstable year-over-year prices. In fact, the newspaper articles and transcript excerpts are clear that customers were not satisfied that the RSP addressed their concerns. The New Labrador Action Committee stated that the

averaging plan was only a whitewash, and demanded a full inquiry into why electricity bills were so high. In the transcript, Mrs. Peddle stated “we reject this proposal in so far as we can understand it”. There is not a single article in CA-179 indicating that customers wanted the rate stabilization plan.

177. Balancing the fuel adjustment account on an annual basis rather than a monthly basis, and an equalized billing option would have addressed customer concerns about billing stability in 1985. As testified by Mr. Bowman (page 10, paragraph 2 of CA-6), the National Regulatory Research Institute (NRRI) indicates that where fuel adjustment clauses are in use, all but one state balances the fuel adjustment account either annually, or semi-annually. Only Connecticut uses a monthly balancing mechanism similar to the fuel adjustment clause that preceded Newfoundland’s RSP. According to NRRI, no state utilizes a fuel adjustment clause that balances over a period greater than one year. Under cross-examination, Mr. Brockman indicated that when he worked for the Florida Commission, they had a regular schedule for fuel adjustment hearings where utilities could appeal to the Board to re-base the price of oil or gas included in the fuel adjustment clause. They would have mini-hearings on that issue alone (page 19, lines 15 to 31, December 4, 2001 Transcript). Mr. Brockman goes on to say “I’m not adverse to having a fuel adjustment hearing every year” (page 19, lines 71 to 72, December 4, 2001 Transcript).

Lifeline Block / Domestic Customers / Isolated Rural Systems in Labrador and on the Island

178. Hydro’s rate policies are listed on pages 7 and 8 of Mr. Osmond’s Pre-filed Evidence. The third policy included in the list states that Domestic customers in Isolated Rural Systems should pay the Island Interconnected Domestic rate for their lifeline block of energy shown as 700 kWh per month. The principal upon which the 700 kWh figure is based is that it reflects the amount of energy consumed by a typical domestic customer with electric hot water, but without electric heat.

179. According to Hydro's own bill (See: CA # 1), it will take more than 700 kWh for a lifeline. In reference to their lifeline rate, Hubert Budgell stated:

I think the 700 kWh doesn't represent any particular group. It's a mix. Like the lifeline requirements for Labrador are very different than the lifeline requirements for the island, I'll give you that.

180. Hubert Budgell also says, on November 9, 2001, page 9, line 8:

I see it as a problem because the customers are indicating it's a problem and I know that the customers' bills do in the winter, based on our analysis, do go above the 700. The issue on the other side of raising the lifeline block is the issue of subsidization ...

181. The Consumer Advocate believes that 700 kWh per month falls short of typical consumption levels of Domestic consumers on Isolated Systems. This causes significant financial hardship for domestic consumers in Isolated Systems who are least able to afford it. In this regard, the Consumer Advocate recommends that the Board address the issue now but direct Hydro to undertake a study to determine an appropriate lifeline block size, and report back on the results at the next rate hearing scheduled for 2003 (LC-5).

RECOMMENDATIONS

The Consumer Advocate's recommendations include:

- 1. The Board direct Hydro to allocate generation demand costs on the island interconnected system on the basis of a single coincident peak (1 CP) allocator rather than a two coincident peak (2 CP) allocator as proposed by Hydro.**
- 2. The Board direct Hydro to allocate distribution demand costs on the basis of non-coincident peak rather than coincident peak as proposed by Hydro.**

3. **The Board hire an independent consultant to review and recommend rate designs for electricity consumers in the province and table the independent consultant's report for review at a public hearing.**
4. **That the Board make known its views on alternative regulatory mechanisms in a report to the Attorney General pursuant to Section 83 of the Act.**
5. **The Board allow Hydro to earn an R.O.E. in the range of 2.5% to 3.0% in the test year, while recognizing that, theoretically, but for Hydro's request for a 3% R.O.E., Hydro would be entitled to 8.5% and 9% for the test year.**
6. **At future hearings, Hydro should fully disclose its oil forecasting opinion from third parties, and further Hydro should present the Board with oil forecasting reports from at least two other internationally recognized oil forecasters for comparison purposes.**
7. **The Board require Hydro to either implement an oil hedging program or provide a detailed explanation from third party experts why such a program cannot be justified.**
8. **The Board direct Hydro to use a 30 year moving average of hydrology data.**
9. **The Board eliminate the current rate stabilization plan and establish the Applicant's revenue requirement for 2002 on the basis of forecast system load, hydraulic production and fuel prices.**
10. **The Board direct the Applicant to recover the outstanding RSP balance over a period of 15 years in order to spread the rate impact over time.**
11. **The Board direct Hydro to file a fuel adjustment clause with its next rate application in 2003, taking into account the incentive mechanisms outlined by Mr. Bowman on pages 13 to 15 of CA-6.**

12. **The Board direct Hydro to implement an equalized billing payment option for customers.**
13. **The Board direct Hydro to make certain changes to wording in its Rules and Regulations as follows:**
 - (i) **Revise Clause 4 to state that a customer's security deposit will be refunded once a good credit history has been established, generally after two years;**
 - (ii) **Revise the wording in Clause 10 (c) to state that Hydro will charge an interest rate of prime plus five percent on delinquent accounts; and**
 - (iii) **Revise Clause 10 (g) to state that Hydro will collect the full amount of any under-billings.**
14. **The Board direct Hydro to undertake a study to determine an appropriate lifeline block size and report back on the results at the next rate hearing. Because of the evidence from from the coast of Labrador and other evidence, it appears an interim measure to increase the lifeline block to at least 900 kWh would be in order.**
15. **That the utilities work with the Conservation Corps in the implementation of D.S.M. programs and contribute to the \$100 fee for services provided to ratepayers by the Conservation Corps.**
16. **That Hydro implement consistent and persistent D.S.M. programs for customers.**
17. **That all conservation programs adopted by Hydro be according to standards suggested in the evidence of Barbara Mullally-Pauly.**
18. **That the Board devise a standard to deal with duplication of operations and services between the two utilities in order to ensure that consumers in the province receive electricity at the lowest possible costs consistent with reliable service.**

19. That the Board commission a third party report dealing with the cost of duplication and that a report with appropriate recommendations be filed prior to the next rate hearing.
20. That the utilities be required to present their capital budgets back-to-back so that the Board and the utilities may address duplication issues with the objective of cost savings prior to either utility having its capital budget approved.
21. That capital budgets in the 2002 Capital Budget Projects, which lack complete justification, such as B-59, B60, B-63, and B-23, be rejected.
22. That the replacement of the VHF mobile radio systems (B-66) be rejected and that B-57 and B-74 be examined in detail.
23. That a productivity allowance of 2% be imposed.
24. That the utilities format a common bill design which provides useful information to consumers concerning kilowatt usage for various appliances.
25. That consumers' monthly bills include an accounting as to what is owing in the R.S.P. account and a computation of what each consumer's liability is in reference to the R.S.P.
26. That there be a consistent policy developed by the Board re monthly meter readings across the province.
27. That all utilities be required to provide notice to individual consumers prior to appearing before the Board for a rate increase.
28. That individual consumers be provided with an update as to the results of meetings which occur from time to time between the representatives of the utilities and representatives of the Public Utilities Board to ensure transparency.

29. That all preferential rates provided to the Federal Government be discontinued immediately.
30. That preferential rates affecting Provincial Government, schools and churches be phased out with notice.
31. That a rationale be developed before any further expenditures are permitted from regulated funds for corporate surveys.
32. That criteria for implementing a corporate incentive plan for Hydro be reviewed and the performance threshold for an incentive plan include such items as the reduction in the amount of purchased oil and the implementation of a successful conservation program, and a reduction for costs to consumers generally.
33. That Hydro be directed to review its policies for the replacement of appliances destroyed through power surges, particularly along the coast of Labrador.

DATED AT St. John's, Newfoundland, this 21st day of January, A.D., 2002.

Dennis M. Browne, Q.C., Consumer Advocate

TO: Board of Commissioners of Public Utilities
120 Torbay Road, P.O. Box 21040
St. John's, Newfoundland
A1A 5B2

Attention: Cheryl Blundon

TO: Newfoundland and Labrador Hydro
Hydro Place, Columbus Drive
P.O. Box 12400
St. John's, Newfoundland
A1B 4K7

Attention: Maureen P. Greene, Q.C.

TO: Newfoundland Power Inc.
55 Kenmount Road
P.O. Box 8910
St. John's, Newfoundland
A1B 3P6

Attention: Gillian Butler, Q.C. / Peter Alteen

TO: Stewart McKelvey Stirling Scales
Cabot Place, 100 New Gower Street
P.O. Box 5038
St. John's, Newfoundland
A1C 5V3

Attention: Janet Henley-Andrews

TO: Poole Althouse Thompson & Thomas
P.O. Box 812, 49-51 Park Street
Corner Brook, Newfoundland
A2H 6H7

Attention: Joseph S. Hutchings

TO: Miller & Hearn
450 Avalon Drive
P.O. Box 129
Labrador City, NF
A2V 2K3

Attention: Edward M. Hearn, Q.C.

TO: Town of Happy Valley-Goose Bay
P.O. Box 40, Station B
Happy Valley, Goose Bay
Labrador, NF
A0P 1E0

Attention: Dennis Peck