1**IN THE MATTER OF** the *Electrical Power Control Act, 1994* (the “EPCA”) and the *Public Utilities Act*, R.S.N. 1990, Chapter 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.

SUBMISSION TO THE BOARD OF COMMISSIONERS
OF PUBLIC UTILITIES
BY
TOWNS OF LABRADOR CITY AND WABUSH

MILLER & HEARN
P.O. Box 129
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Per: Edward M. Hearn, Q.C.

INTRODUCTION

1. In the present hearing, Newfoundland and Labrador Hydro (Hydro) is proposing to consolidate the three separate sets of Labrador Interconnected rates into one set.

Ref: Evidence of Derek Osmond

2. The initial step proposed for Public Utilities Board (P.U.B.) approval in this hearing is a net increase in rates for Labrador West (Labrador City and Wabush) customers.

Ref: Evidence of Derek Osmond

3. Hydro proposes at its next rate application to submit a rate plan outlining alterations in rates over a maximum of five years in order to complete the implementation of a Labrador Interconnected rate structure.

Ref: Evidence of Derek Osmond

4. The issue of increasing rates for Labrador West customers is raised in the context of a General Rate Application by Hydro that deals largely with issues related to the operation of the Island system.

5. As eloquently expressed by William E. Wells, President and C.E.O. of Hydro in his opening statement, the Public Utilities Board is required, as an independent regulatory

body, to make its decision based on the facts and merits of the case and to the application of appropriate regulatory principles and practices to the fact situation.

6. The electrical customers of Labrador West submit that Hydro has not presented sufficient evidence or shown that appropriate regulatory principles warrant a net increase in electricity rates for Labrador West customers at this time.

7. The electrical customers of Labrador West further submit that Hydro has not presented sufficient, or any evidence, to warrant a finding that rates between Happy Valley-Goose Bay and Labrador West ought to be equalized over a period of five years, or at all.

8. Since Hydro contemplates, in any event, a further rate hearing to deal with the issue of future rates within the Labrador Interconnected System, all issues of future rates within that system should be determined at that hearing.

SUMMARY OF ARGUMENTS TO P.U.B.

1. Cash working capital (CWC) requirements should be adjusted to reflect revenues received in advance of payment.

2. There is no evidence to warrant an increase in revenues from Labrador West at present. Rate issues in relation to the Labrador Interconnected System should be left to a future focused hearing that is required in any event.

3. The proposed allocation of the rural deficit is inappropriate and ought to be collected as a tax on the entire electrical production base of the Province, including electrical production exported from Churchill Falls.

ARGUMENT I

CASH WORKING CAPITAL (CWC) SHOULD BE ADJUSTED TO REFLECT REVENUES RECEIVED IN ADVANCE OF PAYMENT

1. Hydro's working capital is based on the net lag in recovery of operating expenses and does not adequately reflect the fact that the net lag in operation and maintenance expenses is offset in part by the net lead in the recovery of HST and the recovery of the cost of debt advanced to the time that the payment is made by Hydro. In other words, Hydro's analysis does not adequately reflect the fact that the net lag in the recovery of operating expenses is offset by the net lead on the recovery of financial costs.

Ref: Evidence of Mark Drazen

2. It is acknowledged that, for some expenses, there is not always a net lag in the recovery of expenses and that some expenses are paid after the corresponding revenue has been received from customers, thereby actually providing additional working capital which Hydro has recognized to some extent in its calculations.

Ref: Evidence of Mark Drazen

3. The calculation of cash working capital by Newfoundland and Labrador Hydro (Hydro) is based on the net lag in the recovery of operating expenses. This is a positive amount (addition to rate base) because operating expenses are generally incurred prior to the time the revenue to pay those expenses is received from customers. The net lag in operation

and maintenance expenses is offset in part by a net lead (or negative net lag) in the recovery of HST. Likewise, revenue from customers also recovers Hydro's financial cost, primarily the cost of debt. On average, this revenue is recovered in advance of the time that the payment is made by Hydro. Thus, this net lead on the recovery of financial costs gives rise to an additional negative cash working capital (deduction from rate base).

Ref: Evidence of Mark Drazen

4. Cash working capital (CWC) can be viewed as the amount of capital required to bridge the time gap between a period the Company pays out money in order to provide service and the time when that money is collected from customers. This is usually determined by a leading/lag study, which measures when revenue is received and when expenses are incurred relative to the average service date.

Ref: Evidence of Mark Drazen

5. To illustrate, consider the month of June. Assuming that service to customers is provided evenly throughout the month, the "average" date is the middle of the month, or at the end of June 15. For simplicity, assume that all meters are read at the end of the month, bills rendered 7 days later and payment received (on average) 12 days after billing. In this case, the average date for receipt of payment would be 19 days (= 7 day billing lag + 12

day payment lag) after the end of the month, or 34 days after the average date of service. This is the *revenue lag*.

Ref: Evidence of Mark Drazen

6. Next, assume that all employees are paid twice a month, once in the middle and once at the end. In this case, the average date of payment would be 22.5 days into the month (half at day 15 and half at day 30), giving an expense lag of 7.5 days (22.5 days – 15 days). Thus, the *net lag* in the recovery of salary and wage expense would be 26.6 days (= 34 day revenue lag – 7.5 day expense lag). Different expenses are paid at different times, so a weighted average operating expense lag is used.

Ref: Evidence of Mark Drazen

7. There is not always a net lag in the recovery of the expenses. Some expenses are paid after the corresponding revenue has been received from customers. This “negative” lag actually provides working capital that the Company uses. In fact, Newfoundland and Labrador Hydro has recognized this to some extent in its calculation.

Ref: Evidence of Mark Drazen

8. The effect of usage taxes (HST) is a *negative* component of cash working capital. This is because usage taxes are collected on average from customers *before* they are paid to the

governments (details are given in NLH Evidence of J.C. Roberts, Schedule VI). This reduces the CWC requirement by $2,437,000 as shown on Schedules III and VI of the Roberts evidence.

Ref: Evidence of Mark Drazen

9. As with the usage taxes, interest payments provide the utility with cash working capital, which reduces the CWC requirement.

For bonds with semi-annual payments, on average the expense is incurred with a lag of one-quarter of a year, or 91.25 days. The Company collects revenues in order to pay the interest cost throughout the year, which on average is before it must actually pay the interest. Accordingly, this represents a source of working capital or a negative CWC requirement. Schedule 1 provides some of the regulatory precedents for this. The negative net lag on interest payments provides cash working capital as shown in Table II-2:

Table II-2

Effect of Debt on CWC

Category	**Annual Cost (000)**	**Lag Days**	**(1x(2)/365 (000)**
Revenue lag		39.46	
Interest expense lag		91.25	
Net lag		(51.79)	
Interest cost	$93,584		
CWC requirement			($13,279)

Source: Interest form Evidence of J.C. Roberts, Schedule I, Line 40, Column (i).

Combining this with NLH's calculation gives a net working capital requirement of *negative* $10,183,000.00

Table II-3

CWC Requirement Adjusted
For Effect of Interest Expense

	CWC Amount (000)
Operating expenses and power purchases	$ 5,535
HST	(2,439)
Interest	(13,279)
Total	($ 10,183)

Ref: Evidence of Mark Drazen

10. It is therefore respectfully submitted that the P.U.B. should include the offset to cash working capital provided by collection of interest expense prior to it being paid by Hydro.

ARGUMENT II

THERE IS NO EVIDENCE TO WARRANT AN INCREASE IN REVENUES FROM LABRADOR WEST AT PRESENT. RATE ISSUES IN RELATION TO THE LABRADOR INTERCONNECTED SYSTEM SHOULD BE LEFT TO A FUTURE FOCUSED HEARING THAT IS REQUIRED IN ANY EVENT

11. In this proceeding before the Public Utilities Board, Hydro is proposing to consolidate three separate sets of Labrador Interconnected rates into one set, with the initial step being a net increase in rates for Labrador West.

Ref: Evidence of Derek Osmond
Evidence of William Wells

12. Hydro further proposes a rate plan to be presented at a subsequent hearing outlining alterations to the rates over a period of some five years, with a view to equalizing rates within the Labrador Interconnected System.

13. While consumers situate in Labrador City and Wabush do not object in principle to the same rate structure applicable in the Labrador West area, this does not mean that an increase in revenue from Labrador West is warranted at present.

14. It is submitted that the un-contradicted evidence before the Public Utilities Board clearly demonstrates that the Labrador West area is presently not only paying appropriate costs but also generating a substantial surplus so that no net increase in rates is warranted at this time.

Ref: Pre-filed evidence of Mark Drazen
See also evidence of Mark Drazen, December 12, 2001

15. It is also the position of the Towns of Labrador City and Wabush that Hydro has presented no evidence to justify any phase-in period, whether of five years or otherwise and, further, that Hydro, in any event, contemplates a further rate hearing to deal with this issue.

16. Given the paucity of evidence presented at the present proceeding and the requirement for a further hearing in any event, the question of future rates and whether any increase or any phase-in of any increases is warranted should be left to be determined at the subsequent hearing.

17. The evidence presented in this proceeding reflects the factual circumstances: that the Labrador Interconnected System consists of two discrete systems, one in the Happy Valley-Goose Bay area and the other in the Labrador West area, with respective systems having different histories, dealing in different economies and different cost bases. The two separate systems are approximately four hundred kilometers apart.

Ref: Submissions of the Towns of Labrador City/Wabush
See also evidence of Derek Osmond and Mark Drazen

GENERATION

18. It is acknowledged that the systems in Happy Valley-Goose Bay and Labrador West have common generation costs in that energy for each system is generated by CFLCo at Churchill Falls.

19. In the Happy Valley-Goose Bay area there is also a gas turbine and a diesel plant for peaking power or back-up power.

20. The gas turbine and diesel plant at Happy Valley-Goose Bay have little relevance for Labrador West since the supply from Churchill Falls is sufficiently reliable so that additional peaking power or back-up power is not required.

Ref: Evidence of Mark Drazen, December 12, 2001, at p. 10

TRANSMISSION

21. The Labrador West area receives its energy by way of a transmission line from Churchill Falls to Wabush, which line is owned and maintained by Twin Falls Power Corporation Limited; Twin Falls Power Corporation Limited wheels to Hydro at the Wabush terminal station the domestic energy supplied to the Towns of Labrador City and Wabush.

> For the record, I'll confirm the lines are owned by Twin Falls Power Corporation Limited from Churchill to the Wabush terminal station and Twin wheels, at no charge, owe those lines to supply energy to Hydro at the terminal station.

Ref: November 21, 2001 Transcript, per Ms. Greene, Q.C., p. 27

22. In contrast, Happy Valley-Goose Bay receives the bulk of its energy from Churchill Falls over a separate line, which is owned and maintained by Hydro at Hydro's expense.

Ref: Evidence of Derek Osmond

23. Thus, there is no common transmission or transmission cost between the Labrador West area and the Happy Valley-Goose Bay area.

DISTRIBUTION

24. The evidence is clear that the Labrador West area and the Happy Valley-Goose Bay area actually represent two distinct, discrete distributional systems with no functional overlap.

25. The distribution facilities in Labrador West serve that area alone; the distribution facilities in Happy Valley-Goose Bay serve that area alone.

26. These two areas, as separate and distinct systems, quite obviously have their own separate distribution costs which should be reflected in rates.

> MR. HEARN, Q.C.: Mr. Osmond in his testimony has suggested that all customers in the same class and served from the same system should pay the same rates. Is this a fundamental public utility principle or simply a matter of policy?
>
> MR. DRAZEN: I would say a policy issue and my feeling is that one can make a policy decision that everybody served from a system should pay the same rate. One of the

things I've observed over time is that there's fundamental regulatory principle, at least as applied by utilities, which says that things are the same unless they're different, and the corollary is that things are different unless they're the same and often it's up to the utility to decide whether they are the same or different, so what appears here is that not having looked for any difference in cost amongst the subsystems in the Labrador interconnected system, naturally Hydro didn't find any difference, but when you look for the cost difference they're there. Then as a policy decision the Board has to decide do you equalize the rates or do you not. My view is that a policy decision like that should be informed by technical analysis. If the costs are not much different then the policy decision to equalize the rates is much easier than if the costs are significantly different, as I think they are here.

Ref: December 12, 2001 Transcript, at p. 3

… the distribution costs are different and it's common to have different rates because of different distribution cost among customer classes, in this case because the Lab City customers or the Lab West customers could be considered a different class from the Happy Valley-Goose Bay customers, the difference in distribution costs should be recognized and, or (inaudible) that in total the Lab West rates should be left at the current level, although the equalization between Wabush and Lab City does have some merit. That's it.

Ref: December 12, 2001 Transcript, per Mark Drazen, at p. 4

The principle is that rates should reflect the cost. The judgment comes in … when you say if the costs are close, then does it make sense to have a small differential or should you just merge the two? I mean, in this case, given the fact that the rates are similar right now, not the same but similar between Lab City and Wabush and the geographic proximity and it'd make more sense to consolidate those two than it does to consolidate those two and Happy Valley-Goose Bay.

Ref: December 12, 2001 Transcript, per Mark Drazen, at p. 5

27. As is clear from the evidence of Mr. Drazen, differences in distribution costs provide a rationale for having different rate classes and different rates.

28. In the present rates for Wabush, which rates were approved by the Public Utilities Board in 1989, Hydro receives not only its costs of service but also, on an annual basis, a substantial surplus. The surplus for the past several years amounts to approximately $300,000.00 annually. This surplus, which is calculated after including certain corporate overheads for Hydro, amounts to approximately thirty per cent (30%) of the annual revenue collected from the residents of Wabush.

Ref: Originally filed evidence of Derek Osmond, at p. 16
See also Schedule 1 to Derek Osmond's pre-filed evidence
See also November 26, 2001 Transcript, per Derek Osmond, at p. 2

29. It is noteworthy that the rates set by the Public Utilities Board for the Town of Wabush in 1989 were only set after hearing submissions from Hydro as to the appropriate rates.

30. It is further noteworthy that, from 1989 to the present, Hydro has not seen fit to apply to the Public Utilities Board to vary the rates for the Town of Wabush.

31. Furthermore, it is our understanding from the evidence submitted by Hydro that Hydro does not take issue with the fact that Hydro has collected from Wabush customers an accumulated surplus of approximately $3,000,000.00, which surplus has been generated since 1989; indeed, Hydro proposes to refund this amount to Wabush customers.

> At this time, Hydro is proposing to refund the surplus accumulated for the years 1989 to 2001 of $2.9 million to Wabush customers in 2002, based on each customer's proportionate share of the 2001 revenues, unless Hydro is otherwise directed by the Board.

Ref: Pre-filed evidence of Derek Osmond, p. 17

32. Thus, the clear and un-contradicted evidence is that electrical consumers in Wabush are already paying an amount that is acknowledged to be excessive in utility terms.

33. While Hydro proposes to add other costs to the electrical consumers in Wabush, there is no evidence to indicate that present rates are insufficient to cover the relevant additional costs.

Ref: Evidence of Mark Drazen, December 12, 2001

34. Similarly, the un-contradicted evidence is that the ratepayers in Labrador City at present rates provide sufficient revenues to pay Hydro's costs and to generate an annual surplus is in the range of approximately $500,000.00.

Ref: December 12, 2001 Transcript, per Mark Drazen, at p. 2 and attached Schedule 1

35. While Hydro now suggests that there was some doubt as to the validity of the Wabush surplus information, Hydro has provided no evidence to guide us on this point.

> MR. YOUNG: Hydro has made comments both in its testimony and also in response to some of the information requests indicating that, you know, what it's provided to determine the Wabush surplus is not a cost of service kind of analysis, and I believe you probably would confirm that that's the case this morning. I'm just working if you draw a distinction between the sort of process you went through this morning and the sort of process that a utility would normally go to, go to to find the answers as to costs for an area.
>
> MR. DRAZEN: The problem is that the process that Hydro went through is nothing.
>
> …
>
> MR. YOUNG: If there are … if there was some doubt as to the validity of the Wabush surplus information, because you've used that as a scale for the Lab City and sort of them made some conclusions from them, I suggest to you if the Wabush surplus information, has some doubt about it, there may be some concern about the outcome of your study, would you accept that, using it for what the purposes are here in your evidence, determining that there is in fact excess revenues that have a basis for continuing their difference in rate treatment?
>
> MR. DRAZEN: I think I recall Hydro is proposing to refund something in excess of $2 million to the customers in Wabush. That's a lot of money to have some doubt about, so I think it's, if it's good enough for their purpose, it's good enough as a basis for assessing, at least in this first instance, whether the Lab City rates are adequate.

Ref: December 12, 2001 Transcript, p. 7

36. Thus, the un-contradicted evidence is that the rates in Labrador City and in Wabush are more than adequate at present levels.

37. Given that a further rate hearing is contemplated by Hydro in any event, and given the lack of evidence presented at the present hearing, it is submitted that the rates in the Labrador West area should not be altered at present and that Hydro ought to be required at the next rate hearing to present the necessary evidence to justify any reallocation of rates within the system and to justify any proposed equalization of rates between the two distinct areas of Labrador West and Happy Valley-Goose Bay.

38. There has been no regulatory authority cited to show that a policy of having common rates in the two separate geographic areas of Happy Valley-Goose Bay and Labrador West is warranted, given the differences in transmission costs and distribution costs between the two distinct areas.

ARGUMENT III

THE PROPOSED ALLOCATION OF THE RURAL DEFICIT IS INAPPROPRIATE AND OUGHT TO BE COLLECTED AS A TAX ON THE ENTIRE ELECTRICAL PRODUCTION BASE OF THE PROVINCE, INCLUDING ELECTRICAL PRODUCTION EXPORTED FROM CHURCHILL FALLS

39. Hydro's proposals include applying a rural rate subsidy to retail electrical customers on the Island Interconnected System and on the Labrador Interconnected System.

40. By compelling some electrical consumers to pay the rural rate subsidy, these electrical consumers are forced to pay what is effectively a social tax that is added to their rate base.

Ref: Evidence of Douglas Bowman, at p.27

41. Section 92A of the Canadian *Constitution Act* is relevant to this discussion. S. 92A(4) reads as follows:

> In each province, the legislature may make laws in relation to the raising of money by any mode or system of taxation in respect of
>
> (a) non-renewable natural resources and forestry resources in the province and the primary production therefrom, and
>
> (b) sites and facilities in the province for the generation of electrical energy and the production therefrom,
>
> whether or not such production is exported in whole or in part form the province, but such laws may not authorize or

> provide for taxation that differentiates between production exported to another part of Canada and production not exported from the province.

Ref: *Constitution Act*, 1982, being Schedule B to the *Canada Act*, 1982 (U.K.), 1982. c. 11

42. In an article entitled *Newfoundland Resources*: *the Supreme Court Strikes Again* by William D. Moull, Associate Professor of Osgoode Hall Law School of York University, Professor Moull made the following pertinent comment:

> Section 94A(4) now authorizes the province to impose indirect taxation on sights and facilities in the province for the generation of electrical energy and the production therefrom and this indirect taxation may be imposed whether or not such production is exported in whole or in part from the province so long as the tax regime adopted does not differentiate between production exported to another part of Canada and production not exported from the province.

Ref: [1985] 7 Supreme Court L.R., 419 at 435

43. The authority of the province to enact such a tax has been confirmed by the Supreme Court of Canada in <u>Ontario Hydro</u> v. <u>Ontario (Labour Relations Board) et al</u>, per La Forest, J.:

> It was to respond to this insecurity about provincial jurisdiction over resources – one of the mainstays of provincial power – that s. 92A was enacted. Section 92A reassures by restating this [page 377] jurisdiction in contemporary terms, and the following provisions go on, for the first time, to authorize the provinces to legislate for

> the export of resources to other provinces subject to Parliament's paramount legislative power in the area, as well as to permit indirect taxation in respect of resources so long as such taxes do not discriminate against other provinces.

Ref: [1993] 3 S.C.R. 327

44. Under Section 92A, the authority of the province to impose a tax upon electrical production, including production exported from the province, is subject to the reasonable proviso that such taxation be of a non-discriminatory nature and not differentiate between production exported to another part of Canada and production not exported from the Province.

Ref: The *Constitution Act*, supra, at para. 41

45. Ironically, the imposition of the rural rate subsidy on certain electrical consumers in the province, while exempting others and exempting production exported, is in effect discriminating against those customers in the province upon whom the burden of the rural rate subsidy is imposed.

46. It is submitted that the Public Utilities Board is established as an independent regulatory authority, and its role is not limited to simply proving or disproving the proposal before it.

> [2] The Board of Commissioners of Public Utilities ("the Board") is a quasi-judicial tribunal constituted under the **Public Utilities Act**.
>
> [3] … It was therefore decided by Government to appoint a committee for the purpose of assessing the role of the Public Utilities Board and to conduct an organizational review. That committee reported to Government in January 1989 and the following recommendations were made:
>
> 1. The need for a strong independent Public Utilities Board exists given its current legislative mandate.

Ref: <u>Wells</u> v. <u>Newfoundland and Board of Commissioners of Public Utilities</u> (1997), 156 Nfld. & P.E.I.R. 271, p.p. 274-275

47. Rather, the Board itself may recommend the necessary course of action, including legislation, that best ensures appropriate and fair utility rates.

Ref: *Public Utilities Act*, R.S.N. 1990, c. P-47, s. 83

48. It is worthy of emphasis that the level of taxation required to recover the amount equivalent to the rural rate subsidy would be less than one mil for kilowatt hour on an annual basis if the appropriate tax was applied to all electrical production of the Province, whether such production is exported or not.

49. In contrast, the effect of applying the burden of the rural rate subsidy only to retail electrical consumers on the Island and those on the Labrador Interconnected System is to

add, on an annual basis, a much larger amount to the electrical rates paid by those consumers.

50. It is submitted that the Board would be in serious dereliction of its obligations to electrical consumers if it imposed the rural rate subsidy as requested by Hydro rather than recommending legislation to include a much wider base on which to impose the burden of such subsidy. It is submitted that the appropriate base is all electrical production for the Province, including that exported from the Province.

RELIEF REQUESTED

51. The following relief is respectfully requested:

(a) THAT Hydro's Application for a present increase in rates for Labrador West customers be denied;

(b) THAT Hydro's request for approval in principle of a future rate plan authorizing the implementation of equalized rates between Happy Valley-Goose Bay and Labrador West at a future hearing be denied; and

(c) THAT this intervener shall be entitled to the costs of this intervention.

ALL OF WHICH IS RESPECTFULLY SUBMITTED ON BEHALF OF THE TOWNS OF LABRADOR CITY AND WABUSH

DATED at Labrador City, in the Province of Newfoundland and Labrador this ______ day of ____________, A.D. 2002.

EDWARD M. HEARN, Q.C.
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LIST OF AUTHORITIES

	TAB
LEGISLATION	
Constitution Act, 1982, being Schedule B to the *Canada Act*, 1982 (U.K.), 1982, c. 11	1
Public Utilities Act, R.S.N. 1990, c. P-47	2
CASE LAW	
Ontario Hydro v. Ontario (Labour Relations Board) et al [1993] 3 S.C.R. 327.	3
Wells v. Newfoundland and Board of Commissioners of Public Utilities (1997), 156 Nfld. & P.E.I.R. 271	4
SECONDARY MATERIALS	
William D. Moull, “Newfoundland Resources: The Supreme Court Strikes Again” (1985) 7 Supreme Court L.R. 419	5