

September 22, 2003

G. Cheryl Blundon  
Board Secretary  
Board of Commissioners of Public Utilities  
Suite E210, Prince Charles Building  
120 Torbay Road, P.O. Box 21040  
St. John's, NL A1A 5B2

Dear Ms. Blundon:

**Re: Newfoundland & Labrador Hydro's 2003 General Rate Application**

Please find enclosed the original plus ten (10) copies of Newfoundland and Labrador Hydro's response to the issues on which the parties disagree in the Mediator's Revised Issues List on Cost of Service and Rate Design Matters.

Yours truly,

Newfoundland and Labrador Hydro

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**IN THE MATTER OF** the Public  
Utilities Act, (R.S.N. 1990,  
Chapter P-47 (the “Act”)), and

**IN THE MATTER OF** a General Rate Application  
(the “Application”) by Newfoundland and Labrador  
Hydro for approvals of, under Section 70 of the Act,  
changes in the rates to be charged for the supply of  
power and energy to Newfoundland Power, Rural  
Customers and Industrial Customers; and under  
Section 71 of the Act, changes in the Rules and  
Regulations applicable to the supply of electricity to  
Rural Customers.

**Hydro’s Response to the Issues on which**  
**the Parties Disagree in the**  
**Mediator’s Revised Issues List on**  
**Cost of Service and Rate Design Matters**

Hydro’s position on the issues on which the parties disagree is as follows:

- j. Should Municipal Taxes and Board Assessments be allocated based on revenues? IC believes that the allocation of Board Assessments, in particular, needs to be explored.

**Hydro’s Response:**

Hydro continues to believe that Municipal Taxes and Board Assessments should both be allocated based on revenue since (i) they are derived based on Hydro’s revenues and (ii) it is common practice to allocate them

on this basis.

- k. Should Hydro's wholesale rates to NP include both demand and energy charges or should they remain an energy-only rate? NP supports an energy only rate. Other parties favour separate demand and energy charges.

**Hydro's Response:**

As Hydro has stated on page 3 of the Rates and Customer Services Evidence. "This report recommends that an energy and demand structure be implemented once a number of important issues are resolved including: the degree of risk to be assumed by Hydro; an appropriate weather normalization methodology; the treatment of Newfoundland Power generation; and appropriate costing and billing determinants. Subject to resolution of these issues, Hydro recommends that such a rate be implemented instead of the energy only rate outlined above." Hydro continues to recommend this approach.

- l. Should Burin Peninsula transmission assets be assigned to common as Hydro proposes? IC opposes this assignment, contending that except for the interconnection of Paradise River generation to the grid there is insufficient benefit to the grid to justify assignments to common.

**Hydro's Response:**

Hydro continues to believe that the Burin Peninsula transmission assets should remain common as has been the case in all previous referrals for the reasons set out in the evidence of J.R Haynes page 43. The facilities serve more than one customer and connect significant generation, which benefits the planning and operations of the grid as described in JRH-3.

- m. Should GNP generation assets be assigned to common as Hydro proposes? IC opposes this assignment, contending that these assets do not benefit the common system and questioning their prudence.

**Hydro's Response:**

The interconnection of the St. Anthony / Roddickton system was prudent as is evidenced by the cost effectiveness analysis completed supporting the interconnection and presented by Hydro to the Board during the 2001 referral. The Board approved recovery of the costs of the interconnection in approving the rates in Order No P.U. 21 (2002-2003). Further, as described in JRH-3 the generation assets on the GNP have since 1997 served as a portion of the system's required reserve capacity and benefits the grid in generation expansion planning by assisting in deferring future generation and in the operations of the grid by providing standby emergency generation.

- n. Should the Interruptible B Program offering to Abitibi Stephenville be terminated as proposed by Hydro or continued as proposed by IC with consideration for expanded availability to other industrial customers? IC contends that (1) Hydro's proposed termination of the Interruptible B Program raises questions regarding the prudence of Hydro's own more costly peak generation resources which Hydro proposes to retain in rate base, and (2) consumers would benefit by retaining (and possibly expanding) the Interruptible B Program offering and removing Hydro's own more costly peaking alternatives from the cost of service.

**Hydro's Response:**

The interruptible B contract with Abitibi Stephenville expired in March of 2003 and Hydro has not renewed it, as there is no requirement for

additional capacity on the system at this time. Hydro's combustion turbine and diesel capacity provide a range of services. In addition to the planning and operational benefits described in JRH-3, these facilities are strategically located on the system to provide necessary year round reserve capacity, transmission voltage support where required and emergency generation to radial fed customers. The interruptible B contract did not and cannot provide these services. Hydro would require these generation facilities irrespective of any interruptible B capacity and to renew the contract would only impose unnecessary additional costs to all customers.

- o. What is the appropriate treatment of NP Generation in Hydro's COS and rates charged to NP (e.g., NP Generation Credit)? IC proposes to limit NP's Generation Credit to hydraulic capacity.

**Hydro's Response:**

As a part of the Newfoundland Power Rate Review three different alternatives for the treatment of NP's generation were evaluated. As recommended in section 4.1 of that report, continuation of the current treatment for NP's generation is the most appropriate. Hydro however is willing to discuss other treatments for NP's generation.

- p. Should the load variation component of the new RSP be eliminated as proposed by IC?

**Hydro's Response:**

Hydro continues to believe that the load variation component of the RSP provides Hydro with an element of earnings stability related to forecast test year sales and the RSP contributes to rate stability for customers.

Earnings stability is also an issue regarding implementation of a demand energy rate structure currently being considered for Newfoundland Power. As part of the mediation process, Hydro is willing to consider various alternatives involving both of these related items.

- q. Should the hydraulic production and fuel cost variation components of the RSP be separate funds with different timing of passthrough as proposed by IC?

**Hydro's Response:**

Hydro believes that having two separate funds with different timing adds unnecessary complexity and administrative effort.

- r. What is the appropriate data stream for use in projecting hydraulic production? IC recommends that the hydraulic variation component of the RSP be treated as a long term stabilization mechanism, designed with sufficiently long term hydraulic generation forecasts and a sufficiently high balance trigger that there would be no expected need for hydro production variation rate adjustments.

**Hydro's Response:**

The appropriate data stream for use in estimating the hydraulic production in the RSP or a "Hydraulic Production Variation Fund" should be the same. Hydro believes that the recommendations of the Acres Island Hydrology Review Study should be implemented including the use of the full historic inflow record.

- s. Assuming that the load variation component of the RSP is eliminated, should all riders for the fuel cost and hydraulic funds be applied on an

equal KWh basis to all customers as proposed by IC?

**Hydro's Response:**

Hydro believes there is merit in pursuing this option.

- t. What interest rate should be used with respect to RSP balances? IC proposes the use of short-term debt rates rather than Hydro's weighted average cost of capital.

**Hydro's Response:**

Hydro believes that the weighted average cost of capital is the most appropriate rate to apply to RSP balances. Hydro believes that all of its assets are financed proportionately with the elements of its capital structure and that it is inappropriate to suggest that any piece of debt was incurred exclusively to finance any particular asset.

- u. Should there be demand charges for interruptible power above the Power on Order for industrial customers? IC agrees with Hydro's proposed non-firm energy rates but opposes the non-firm demand charges.

**Hydro's Response:**

Hydro continues to believe that there should be a demand component to the non-firm rate. As stated in response to CA-68 NLH the rate for the demand portion of the non-firm service "is a charge to reflect some value of the assets in place to provide the non-firm service".

- v. Are the load forecasts used to allocate Hydro's demand costs reasonable? IC contends that while IC has a strong incentive to provide accurate



forecasts (because of demand charges and firm power requirements), NP has an incentive to underforecast to gain a cost allocation advantage.

**Hydro's Response:**

Hydro believes the load forecasts provided to allocate demand costs are reasonable. Further, the proposed implementation of a demand energy rate structure for NP will provide a similar incentive to NP as exists for IC.

- w. Should industrial customer demand charges for firm power be changed to reflect the greater of the customer's actual monthly peak or 80% of the customer's seasonal peak during the previous winter as proposed by IC?

**Hydro's Response:**

Hydro does not support a change in the manner in which the Industrial Customers demand charge is determined. The following summarizes some of the more significant concerns:

1. It adds greater volatility to Hydro's earnings;
2. In order to protect Hydro's revenue requirement Hydro will require a close review of Hydro's demand rate design;
3. It may require elimination of the current non-firm rate options as the proposed firm demand is established based on the maximum monthly demand with no limit;
4. It adds unnecessary complexity for high load factor customers; and
5. The current arrangement is part of the Industrial Contracts which were subject to negotiation in 2001 and was approved by the Board in its decision on the 2001 General Rate Application.

- x. Should Hydro be required to undertake a marginal cost study, as proposed by CA, and file a report with the Board on how its rates can be

redesigned to better incorporate marginal cost principles, offer rate options for customers, and promote market efficiency?

**Hydro's Response:**

As stated in response to IC-186 NLH Hydro is prepared to assess the need for further study of time of use rates and thus an updated marginal cost study after the issues arising from this current application are addressed.

- y. Should Hydro's current three block Domestic Diesel rate structure be replaced with a two block structure, as proposed by CA, with the first block set at the Alternative Lifeline (see CA-13 NLH) and priced at the rate charged by NP to Domestic Customers, and the second block priced to maintain revenue neutrality (i.e., no increase in the rural subsidy implicit in Hydro's Application)?

**Hydro's Response:**

Hydro believes there is merit in pursuing this option which results in no increase in the rural deficit.

- z. Should Hydro be required to undertake a customer survey, as proposed by CA, to determine customer valuation of service upgrades and the optimal capital and maintenance expenditure balance in view of this valuation?

**Hydro's Response:**

Hydro does not believe there is merit in pursuing the customer survey as recommended. There would be significant challenges to actually determine the "value of service" point at which customers are (or should

be) willing to accept less reliability for lower prices for electricity since it is likely to vary significantly by customer class (i.e. residential vs. general service e.g. hospitals) and by type (electric heat residences versus lighting only). These challenges are further compounded in Hydro's rural isolated systems, for example, since the majority of these customers' rates are heavily subsidized and thus expenditures for greater reliability would not materially affect rates. Hydro currently surveys all rural customers on a regular basis on a variety of factors, including the value of reliability, and uses reliability metrics related to the frequency and duration of outages in managing its rural operations.

- aa. Should Hydro be required to propose a peer group of utilities and measures upon which to compare its performance as proposed by CA, and (upon approval thereof) report key statistical information relative to the peer group at regular intervals?

**Hydro's Response:**

Hydro is prepared to investigate whether there is a peer group of utilities whose operations, structure and service territory can be considered as comparable to Hydro's. Performance amongst utilities in the group can only be considered as meaningful if real comparability exists, otherwise, comparison of key statistical information can be misleading.

- bb. Should Hydro be required to commission an independent study of the merits of creating a separate department responsible for service to Isolated Systems, as proposed by CA?

**Hydro's Response:**

Hydro believes that its current structure, wherein functions such as

management, engineering and other services support the Isolated Systems as part of Hydro's overall integrated Corporate structure is the most efficient and cost-effective approach.

- cc. Should the Board be asked to conduct a review and hearing on the merits of Performance Based Regulation ("PBR") and file a Report thereon with the government as proposed by CA?

**Hydro's Response:**

Hydro supports the need to investigate new forms of regulation including PBR. However, with the Government of Newfoundland & Labrador pursuing its electricity policy review, as recently reported in the media, Hydro believes a study of new forms of regulation at this time would be ill advised.

- dd. What, if any, corresponding rate adjustments are appropriate in view of Hydro's anticipated revenue increase from phase-in of the revenue credit for secondary energy sales to CFB Goose Bay to the rural deficit, as suggested by NP?

**Hydro's Response:**

Hydro has included forecast secondary energy sales from 5 Wing Goose Bay which reduces the proposed 2004 rates on the Labrador Interconnected System. Hydro's actual financial return for 2004 is at risk if the full level of these sales do not materialize. However if Hydro's proposal is accepted regarding the phase in of rates on the Labrador Interconnected system, Hydro believes there is merit in pursuing the option that these additional forecast revenues form part of the Rural Rate Alteration component of the RSP.