**<u>IN THE MATTER OF</u>** 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.

# WRITTEN ARGUMENT OF THE INDUSTRIAL CUSTOMERS

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#### PART 1

#### INTRODUCTION

The Industrial Customers are comprised of Abitibi-Consolidated Company of Canada ("ACCC"), Corner Brook Pulp and Paper Company Limited ("CBPPL"), North Atlantic Refining Limited ("NARL") and Voisey's Bay Nickel Company Limited ("VBNC"). ACCC owns and operates pulp and paper mills located at Stephenville ("ACCC Stephenville") and at Grand Falls-Windsor. CBPPL owns and operates a pulp and paper mill at Corner Brook. NARL owns and operates an oil refinery at Come-by-Chance. These four operations substantially make up the industrial base of the island of Newfoundland, and each of these operations is a major consumer of power purchased from Hydro. VBNC has joined the Industrial Customers group for the present hearing by reason of its intended industrial operations in the Province and its anticipated significant future power demands. Power costs are (or, in the case of VBNC, will be) a significant element in the costs of the industrial processes of the Industrial Customers' operations.

In its 2003 Application, Newfoundland and Labrador Hydro ("Hydro") seeks substantial rate increases from its customers. The aggregate rate increase being sought by Hydro from the Industrial Customers is 22.6%,<sup>1</sup> comprised of the proposed base rate increase and the increase related to the recovery of balances in Hydro's rate stabilization plan ("RSP"). The impact of Hydro's proposals is even greater for ACCC Stephenville. Hydro's discontinuance of its

<sup>&</sup>lt;sup>1</sup> Banfield November 21, 2003 Supplementary Evidence, p. 7.

Interruptible B power program translates into an additional rate increase impact of approximately 7% for ACCC Stephenville.<sup>2</sup>

Collectively, the Industrial Customers represent over 20% of the Island Interconnected System of Hydro's annual energy sales.<sup>3</sup> They employ in the range of 3,000 Newfoundlanders and their combined annual payroll is in the vicinity of \$150 million. They are being asked, in 2004, to pay total costs in excess of \$62 million (including RSP amounts). ACCC Stephenville, in particular, would see total 2004 power costs of \$25.6 million, representing an increase of \$5.7 million over 2003. According to the testimony of Messrs Guillot and Dean, this would have the effect of worsening the already-challenging position of ACCC Stephenville as the highest cost mill in the ACCC system worldwide.

The present proposed rate increases and associated impacts need also to be seen in the context of Hydro's 2001 general rate application. Implementation of the rate increase proposed by Hydro in the present application would result in an aggregate rate increase over the past three years of approximately 40% to the Industrial Customers as a class, and 47% to ACCC Stephenville.<sup>4</sup> The magnitude of such increases is shocking, and the Industrial Customers take particular exception to that part of the requested rate increase which is attributable to Hydro's proposal to more then triple its return on equity from 3% to 9.75%.

<sup>&</sup>lt;sup>2</sup> Banfield testimony, December 2, 2003, page 144; Mel Dean testimony, December 12, 2003, pp.14-15.

<sup>&</sup>lt;sup>3</sup> Exhibit RDG-1 Rev. 2, p. 32 of 107, line 15 of column 4 reflects the Industrial Customers' energy consumption in the cost of service study to be 20.51%.

<sup>&</sup>lt;sup>4</sup> Pre-Filed Evidence of Jean Francois Guillot and Mel Dean dated September 2, 2003, as amended on December 12, 2003, p.9.

The Industrial Customers are businesses. They sell their products in international markets in which they cannot, either individually or collectively, affect the prices at which their products sell. They also compete within their own corporate families for work and for capital dollars. Their ability to continue to create economic activity in this Province depends upon their ability to produce products at costs which will allow them to be competitive in world markets. If the gap between their costs and the prices dictated by the market does not produce a sufficient return on the investment by the shareholders of these companies, they will not be able to continue to operate. All of Hydro's Industrial Customers are bottom-line operations.

The issues before the Board can be classified into three categories:

- 1. revenue requirement issues;
- 2. cost of service issues; and
- 3. rate issues.

In addition, there is an issue as to whether the Industrial Customers should, like every other major participant in this hearing, be entitled to recover their taxed costs.

#### **LEGISLATIVE FRAMEWORK**

The principal relevant pieces of legislation governing the Board's consideration of Hydro's Application are the *Electrical Power Control Act, 1994*<sup>5</sup> ("EPCA 1994") and the *Public Utilities* 

<sup>&</sup>lt;sup>5</sup> Electrical Power Control Act, 1994 S.N.L. 1994, c. E-5.1.

*Act.*<sup>6</sup> Pursuant to the EPCA 1994, the Board acquired full authority to determine Hydro's rates, including its rates to Industrial Customers.

Section 3 of the EPCA 1994 sets out the power policy of the Province. Sections 3(a)(i) and 3(a)(ii) establish two fundamental rate-setting principles:

- "3. It is declared to be the policy of the province that
  - (a) the rates to be charged, either generally or under specific contracts, for the supply of power within the province
    - (i) should be reasonable and not unjustly discriminatory,
    - (ii) should be established, wherever practicable, based on forecast costs for that supply of power for 1 or more years."<sup>7</sup>

Several provisions of the provincial power policy expressed in the EPCA 1994 have specific application to the issues in this hearing. The EPCA 1994 provides in section 3(b)(i)-(iii) as follows:

- "3. It is declared to be the policy of the province that
  - (b) all sources and facilities for the production, transmission and distribution of power in the province should be managed and operated in a manner
    - (i) that would result in the most efficient production, transmission and distribution of power,
    - (ii) that would result in consumers in the province having equitable access to an adequate supply of power,

<sup>&</sup>lt;sup>6</sup> *Public Utilities Act*, R.S.N.L. 1990, c. P-47.

<sup>&</sup>lt;sup>7</sup> *EPCA*, 1994, s. 3(a)(i) & c(a)(ii).

(iii) that would result in power being delivered to consumers at the lowest possible cost consistent with reliable service."<sup>8</sup>

Under section 4 of the EPCA 1994, the Board is required to implement this policy. Applying these principles, the Board must accordingly consider whether the proposals contained in Hydro's Application result in the most efficient production, transmission and distribution of power from *all* sources and facilities in the Province. In addition, the management and operation of those sources and facilities in the Province should result in power being delivered to consumers, including the Industrial Customers,<sup>9</sup> at the *lowest possible cost* consistent with reliable service.

The power policy of the Province, insofar as it relates to the profit which Hydro is entitled to include in its rates, is set out in s. 3 (a) (iii) of the EPCA 1994, as follows:

- "3. It is declared to be the power policy of the province that
  - (a) the rates to be charged, either generally or under specific contracts, for the supply of power within the province
    - (iii) should provide sufficient revenue to the producer or retailer of the power to enable it to earn a just and reasonable return as construed under the *Public Utilities Act* so that it is able to achieve and maintain a sound credit rating in the financial markets of the world."<sup>10</sup>

<sup>&</sup>lt;sup>8</sup> Ibid, s. 3(b)(i), (ii), (iii).

<sup>&</sup>lt;sup>9</sup> Ibid, s. 2(c) "Consumer' means a person purchasing power from a retailer for the use of that person and not for resale."

<sup>&</sup>lt;sup>10</sup> Ibid, s. 3(a)(iii).

The governing principle is that the rate of return should enable Hydro to achieve and maintain a sound credit rating in world financial markets. Section 80(1) of the *Public Utilities Act<sup>11</sup>* further addresses the issue of an appropriate return as follows:

"80(1) A public utility is entitled to earn annually a just and reasonable return as determined by the board on the rate base as fixed by the board for each type or kind of service supplied by the public utility  $\dots$ "<sup>12</sup>

This tells us that the return to be set by the Board is the just and reasonable return on rate base which will enable Hydro to achieve and maintain a sound credit rating in world financial markets as provided in s. 3(a)(iii) of the EPCA, 1994 while resulting in rates "at the lowest possible cost consistent with reliable service" as required by s. 3(b)(iii) of the EPCA 1994.

# PART 2

# **REVENUE REQUIREMENT ISSUES**

There are a number of revenue requirement issues, including the following:

- Return on Equity/Capital Structure
- Fuel Conversion Factor
- Implementation of Appropriate Hydraulic Data Stream
- Productivity Allowance
- Treatment of Non-Regulated Costs
- Capital Expenditure Adjustments

<sup>12</sup> Ibid, s. 80 (1).

<sup>&</sup>lt;sup>11</sup> *Public Utilities Act*, R.S.N.L. 1990, c. P-47.

# **Return on Equity/Capital Structure**

Hydro proposes a 9.75% return on equity. This is a 325% increase over the 3% return on equity approved by the Board in PU7.

It is inappropriate to grant a rate of return to an entity which does not resemble an investorowned utility comparable to that which a Board would grant to an investor-owned utility. The EPCA requires a just and reasonable rate of return for a regulated utility "so that it is able to achieve and maintain a sound credit rating in the financial markets of the world". The intent of the legislation is clearly that the utility secure and maintain a sound credit rating. In the case before the Board, all parties are agreed that a sound credit rating comes with the guarantee of the Government of Newfoundland and Labrador and the Board allows Hydro to recover the cost of procuring that guarantee, i.e. the guarantee fee, as a regulated expense. In fact, Hydro has abandoned the goal of achieving a stand-alone investment grade rating.<sup>13</sup>

The intent of the legislation is therefore met by allowing a sufficient interest coverage<sup>14</sup> to ensure that Hydro's debt is self-supporting, and, in our submission, that is the appropriate test to apply to a government-owned utility which does not operate like an investor-owned utility. There is no intention on the part of Government to withdraw the guarantee of Hydro's debt, nor is there any evidence to suggest that Government's guarantee of Hydro's debt has negative implications for

<sup>&</sup>lt;sup>13</sup> Roberts, October 15, 2003, p. 128.

<sup>&</sup>lt;sup>14</sup> The 3% return on equity corresponded to a 1.08 interest coverage in Hydro's 2001 general rate application. See Pre-Filed Evidence of Osler and Bowman, September 2, 2003, p.20.

Government's own credit rating.<sup>15</sup> Continuation of the present 3% return on equity will not adversely impact Hydro's ability to access the capital markets of the world.

The Board found in PU7 that Hydro did not merit treatment akin to that of an investor-owned utility. Mr. Roberts, in cross-examination, was asked to describe the attributes of Hydro which justified its being treated as an investor-owned utility and his answer consisted of a list of legislative and other changes which had all been implemented prior to the 2001 hearing.<sup>16</sup> Accordingly, there is no evidence that Hydro has satisfied the conditions laid down by the Board for treatment as an investor-owned utility.<sup>17</sup> On that basis, the return on equity of 3% previously approved by the Board should remain in place.

Hydro justified seeking (and acknowledged the Board's jurisdiction to impose) a 3% rate of return on equity in 2001 by reference to issues of rate shock arising from increases in the range of 17%. Obviously, a similar disposition is justified today when increases are in the range of 22-29% for Industrial Customers.

It must be remembered throughout that the determination of a rate of return on equity for Hydro is a theoretical exercise. Hydro has issued no shares other than those issued to Government in

<sup>&</sup>lt;sup>15</sup> McShane, Prepared Testimony dated April 2003, p. 17, lines 22-24.

<sup>&</sup>lt;sup>16</sup> Roberts, October 15, 2003, pp. 138-140.

<sup>&</sup>lt;sup>17</sup> See the evidence of Roberts, October 15, 2003 at pp. 138 and 140 where he confirms that Hydro has not developed a plan to achieve its financial target of achieving equivalence to an investor owned utility, and that the differences between Hydro and an investor owned utility listed in PU7 remain the same today as they did in 2002.

exchange for the shares of CFLCo which Government had acquired from Brinco, and that part of Hydro's business is unregulated. The effort then is to determine the rate of return which a theoretical shareholder would require to invest in shares of the company that Hydro would be if it engaged only in regulated activities, if such shares existed and were available for investment. This theoretical company would also have available to it the guarantee of the Government of Newfoundland and Labrador on all its short and long term debt.

The only real market which the Board need consider relative to Hydro's credit rating is the debt market—it issues no equity. Accordingly, if Hydro has a sound credit rating in the debt markets of the world by virtue of the Government guarantee, the Board need have no further concern about damaging Hydro's credit rating, unless it allows the Hydro debt to become non-self-supporting. Bearing in mind the independent legislative direction given in the EPCA that utilities be regulated so as to "result in power being delivered to consumers in the province at the lowest possible cost consistent with reliable service", the Board is required to take the lowest cost option in providing an adequate return to Hydro.

Rather than lose itself in a theoretical exercise of attempting to determine the return required by a non-existent investor on a non-existent share, the Board should direct its attention to the known realities of Hydro's situation. Hydro has, and pays for, a guarantee from the Government of Newfoundland and Labrador on its debt. Government has ultimate control of the debt/equity structure of Hydro and has demonstrated its propensity to withdraw funds from Hydro according

to its own requirements, regardless of the financial position of Hydro.<sup>18</sup> Accordingly, there is no practical effect of fixing a rate of return on Hydro's equity beyond that which allows its debt to continue to be self-supporting. Ms. McShane has conceded<sup>19</sup> that Hydro's debt is self-supporting and has continued to be so with a 3% return on equity. In light of the legislative direction to seek lowest possible cost electricity, it is difficult to justify anything more.

Should the Board decide to evaluate a "market risk" for Hydro as if it were a traded company, there are a number of realities of Hydro's situation which need to be borne in mind there as well. Clearly Government as sole shareholder is a non-taxable entity. As can be seen from the responses to IC 348-351, the tax rate another investor would have to pay on dividends would be 30.58%. Obviously, the return to Government can be reduced by that percentage since it will pay no taxes.

Further, economic theory assumes complete and perfect knowledge by investors of the workings of the company in which an investment is made, and that is a valid assumption in this case, since both the Board and Government have complete knowledge of the workings of Hydro. This includes how minimal the operating risk of Hydro actually is, in light of the functioning of the RSP. Even if the other entities to which Ms. McShane compares Hydro were actually comparable, it is obvious that one of the greatest risks to a generation utility is the failure of load to meet forecast. A generation utility's plant is built and staff hired to meet specific loads; if those loads do not materialize, losses are almost inevitable. Hydro is completely isolated from

<sup>&</sup>lt;sup>18</sup> Hydro has at Government's direction in the time frame 1995-2003 cumulatively paid out 105% of its net operating income as dividends – see Roberts, October 15, 2003, p. 137.

<sup>&</sup>lt;sup>19</sup> McShane, December 3, 2003, pp. 112-114.

that risk by the RSP. Mr. Greneman confirmed that such protection is unknown in the electricity industry elsewhere.<sup>20</sup> Clearly, on this ground alone, a rate of return on equity for Hydro less than that of Newfoundland Power is justified.

At bottom, the operating risks for Hydro are minimal and manageable. Its financial risk is essentially non-existent given the available Government guarantee, and it is essentially free of competition. Comparisons with volatile companies like Nicor or companies with a different business mix like Trans Alta are not particularly helpful in any event. The Board has the advantage of being able to evaluate independently the business risk of Hydro and not be concerned with effects on a non-existent equity market for its non-existent shares.

Ms. McShane adds 50 basis points to her indicated rate of return on equity to deal with financing and market costs, unanticipated market conditions and the fairness principle. This is discussed in the hearing transcript of December 3, 2003 at page 149 line 15 to page 151 line 14. In our submission, any such addition is not supportable. All of the issuance costs of debt are recovered as interest expense or deducted from the proceeds of debt issues. This adjustment is purely "notional", as Ms. McShane herself describes it, does not represent any cost to Hydro and should not be permitted to increase the amounts required to be paid by ratepayers.

In the event that the Board establishes a rate of return for Hydro which is greater than 3%, the Board should direct Hydro to establish an excess earnings account into which shall be paid all amounts earned in excess of the established return on rate base associated with the established return on equity. As Hydro is not an investor-owned utility and the Board is directed to ensure

<sup>&</sup>lt;sup>20</sup> Greneman, November 14, 2003, p. 204, lines 11-18.

lowest possible cost power, there should be no range above the minimum required return which Hydro should be allowed to earn. Any savings and any excess earnings arising should be redirected to the benefit of rate payers through an excess earnings account to be disposed of by direction of the Board either annually or upon achievement of a specific target amount.

#### **Fuel Conversion Factor**

Hydro proposes a 624 kWh/bbl fuel conversion factor in the present Application. The Industrial

Customers believe that this conversion factor is too low. The Board's financial advisors Grant

Thornton were critical of the suggested fuel conversion factor of 624kWh/bbl. They said in part:

"It can be argued that if it is the weighted average conversion factor since 1995 that is used to calculate the proposed conversion factor, the following items should also be considered in determining the appropriateness of the proposed factor:

- The impact of the Continuous Emissions Monitoring System is not included in the data from 1996 to 2002. Hydro has estimated that this initiative will increase efficiency by 3 kwh/bbl.

- The actual year to date factor for 2003 is currently 639 kWh/bbl as of June 2003."  $^{21}$ 

In fact, the actual year to date fuel conversion factor for 2003 current to November 30, 2003 is  $636.2 \text{ kWh/bbl.}^{22}$  This figure was viewed by Mr. Brushett to be within the range of

<sup>22</sup> NP 310 NLH.

<sup>&</sup>lt;sup>21</sup> Financial Consultants Report-Board of Commissioners of Public Utilities-Newfoundland and Labrador Hydro 2003 General Rate Application ("the Grant Thornton Report") pp. 32-34.

reasonableness for the purpose of the Board's determination of an appropriate fuel conversion factor.<sup>23</sup>

The proposed 624 kWh/bbl is a simple mathematical average of actual production and actual barrels of fuel used since 1996 as appears from the reply to NP-74. These numbers have already taken into account the variety of operating conditions which Hydro faces, including the six factors listed in the answer to IC-317 and the additional item relative to auxiliary systems referred to by Mr. Haynes in his evidence of October 24, 2003 at p. 37 lines 5-13. (See Transcript Oct. 24, 2003, p. 79 line 9 to p. 80 line 5). The numbers specifically do not take into account the efficiency improvements identified by Mr. Brushett and it is therefore obvious that an upward adjustment is required.

## **Implementation of Appropriate Hydraulic Data Stream**

Section 1 (r) of Consent No. 1 evidencing the parties' Agreement on Cost of Service and Rate Design Issues provides as follows:

"The appropriate hydraulic data stream for both hydraulic production projections and RSP calculations is long term. The parties agree that Hydro has properly filed its case using the 30-year record at this time. The Board may consider using the full historic hydraulic data flow record in Hydro's next GRA after Hydro addresses discrepancies identified in the Acres Island Study and Parties have had an opportunity to comment thereon."

The Industrial Customers believe that the appropriate process would be for Hydro to file its full historic hydraulic data flow record with the Board and provide copies to the other parties at such time as the discrepancies identified in the Acres Island Study have been addressed and rectified,

<sup>&</sup>lt;sup>23</sup> Brushett, December 11, 2003, p. 150.

and report to the Board and the other parties as to the matter in which such discrepancies have been addressed and rectified, with other parties to be then entitled to make submissions to the Board as to the acceptability of Hydro's proposal at the time of its next general rate application.

#### **Productivity Allowance**

Notwithstanding Hydro's assertion that the principal drivers of the Island Interconnected Systems' rate increase relate to new plant at Granite Canal and two new power purchase agreements with CBPPL and Exploits River Hydro Partnership, it appears on close analysis that fully 50% of the Island Interconnected System rate increase which has been requested is related to increased operating and maintenance costs, depreciation (excluding Granite Canal), return on debt and equity (excluding Granite Canal) and increased allocation of the rural deficit.<sup>24</sup> Hydro's assertion that the rate increases being sought are mainly attributable to Granite Canal and the two new power purchase agreements, at an aggregate cost of \$29 million, fails to recognize that these initiatives displace approximately \$25 million in fuel costs.

In PU7, the Board imposed a productivity allowance of two million dollars for the test year on Hydro's "other costs".<sup>25</sup> The productivity allowance was imposed because of the Board's dissatisfaction with Hydro's failure to demonstrate performance measures which would clearly demonstrate the efficiency of its operations. Hydro now proposes to add an amount to its vacancy allowance to take into account potential savings from increased efficiency. This is, in substance, a productivity allowance and should be recognized as such thereby allowing for

<sup>&</sup>lt;sup>24</sup> See Pre-Filed Testimony of C.F. Osler and P. Bowman dated September 2, 2003, pp. 18-19, Table 5.2.

<sup>&</sup>lt;sup>25</sup> PU7, pp. 72-74.

specific reporting and accounting for Hydro's performance in saving the amount of the allowance.

The Industrial Customers believe that the considerations which lead to the Board to impose a productivity allowance in PU7 apply even more forcefully today by reason of Hydro's position that its Business Process Improvement project has decreased and will continue to lower Hydro's costs.

In these circumstances, the Industrial Customers respectfully submit that the Board should again impose a productivity allowance in keeping with the least cost power policy of the Province. The Industrial Customers believe that the productivity allowance should be in the range of \$5 million.

#### **Treatment of Non-Regulated Costs**

Hydro has purported to add back to regulated equity the on-going amounts recorded as non-regulated expenses. The result of this is to add to the dollar value of Hydro's return or profit. This approach is, in our view, contrary to principle. Obviously, Hydro cannot recover from ratepayers the amount of non-regulated expenses—these are in some cases amounts which have been specifically disallowed by the Board as not being necessary for the purpose of providing service. The Board effectively recognizes, however, that such amounts can come out of the company's equity, not unlike a payment of dividends. Mr. Brushett agreed that the non-regulated expenses could properly or fairly be viewed to be in the nature of a dividend, in the sense that these amounts are disbursed by Hydro and applied to its shareholder's purposes.<sup>26</sup>

<sup>&</sup>lt;sup>26</sup> Brushett, December 11, 2003, p. 144.

While this may deplete the equity and ultimately cause financial stress, the powers of the Board in this regard may be limited.

However, Hydro's practice, as noted at p. 15 of the Grant Thornton Report on this Application, treats the monies as if they had not been spent at all—allowing Hydro a return on these funds which it has already applied to its own, or its shareholder's purposes. There is no justification for such a practice and the Board should disallow it.

## **Capital Expenditure Adjustments**

In the Grant Thornton Report, Grant Thornton recommended a downward adjustment to forecast capital expenditures for the purposes of determining the rate base and revenue requirement, as follows:

"...actual capital expenditures for the period 1998-2002 were, on average, below budget by approximately 14%. Based on our review, Hydro is probably underspending by approximately 5% on a project basis. Therefore, the remaining 9% variance must be due to delays and carryovers. In the context of the 2004 forecast revenue requirements, the historical trend of under spending, whether it be actual savings or due to delays and carry-overs, means that certain costs in the forecast year may be overstated. For example, using a 14% downward adjustment to the 2003 and 2004 forecast capital expenditures would result in a reduction in depreciation expense of approximately \$85,000 and \$169,000 respectively based on the composite depreciation rate of 1.70% in 2003 and 1.74% in 2004, and assuming all projects were put-in-service. A reduction in capital expenditures would also impact the forecast rate base for 2003 and 2004 and consequently the return on rate base included in the revenue requirement.

The Industrial Customers accordingly submit that an appropriate decrease, in the order of

14%, should be implemented with respect to the forecast capital expenditures. This

would, in the words of Mr. Brushett, have the effect of causing "...a reduction on return on rate base".<sup>27</sup>

Hydro should once again be directed to reduce rate base by the historical amount of its overbudget of capital spending for 2004. This does not reflect on the capital budget approval which Hydro has already been granted but simply adjusts rate base in the test year for the established pattern of spending, to avoid over-stating the rates.

# PART 3 Cost of service Issues General

The cost of service issues to be determined by the Board relate to:

(a) the appropriate assignment to Hydro's customer classes of the costs of certain of Hydro's generation, transmission and distribution facilities,

(b) the treatment of Newfoundland Power's demand and energy forecast in the cost of service, and

(c) the treatment of credit for Newfoundland Power's generating capacity in the cost of service study.

# ASSIGNMENT OF PLANT UNDER PU7

The departure point for the plant assignment issues in contention is the Board's decision and

<sup>&</sup>lt;sup>27</sup> Brushett, December 11, 2003, p. 148.

order in Order No. P.U.7 (2002-2003) ("PU7"). In PU7, the Board made the following assignments:

- all Hydro's assets on the Great Northern Peninsula ("GNP") were assigned to Hydro Rural;
- Hydro's Burin Peninsula transmission assets were assigned common; and
- Hydro's Doyles Port-Aux-Basques transmission assets were assigned specifically to Newfoundland Power.

In PU7, the Board also directed that Hydro undertake the study now filed as JRH-3 and entitled "Review of COS Assignment for the GNP, Doyles – Port-Aux-Basques, and Burin Peninsula Assets".

# **Assignment Guidelines**

A threshold consideration for the Board in considering the plant assignment issues is the matter of the appropriate guidelines or principles which should govern the consideration of whether plant should be assigned common or specifically assigned to one customer class. Specifically, the Board must decide whether the plant assignment guidelines identified by Hydro<sup>28</sup> should govern, or whether the "postage stamp" approach to plant assignment outlined by Ms. Gail Tabone of the Board's experts EES Consultants should apply.

It is the Industrial Customers' position that the guidelines for plant assignment as stated by Hydro in JRH-3 are correct. Of these guidelines, the ones of principal relevance to the plant assignment issues in contention in the Application are the following:

<sup>&</sup>lt;sup>28</sup> Exhibit JRH-3 at pages 23-24.

- 1. Common Plant is defined as plant that is of substantial benefit to more than one firm customer. Costs for common plant are assigned to all customers of the system.<sup>29</sup>
- Specifically Assigned Plant is defined as plant that is of benefit to only one customer.
  Costs for specifically assigned plant are assigned directly to the benefiting customer.<sup>30</sup>
- 5. Hydro Rural Sub-transmission is defined as all transmission and terminal station plant serving only Hydro Rural rate classes.<sup>31</sup>
- 6. NP-IC Sub-transmission is defined as transmission and terminal station plant, which serves both Newfoundland Power and an Industrial Customer but not Hydro Rural and has an original cost of at least 2% of the total transmission and terminal stations costs.<sup>32</sup>

The Industrial Customers also concur in Hydro's assertion that the guidelines must be applied in accordance with the fundamental and overriding guideline and requirement "...that each component of plant be assigned to customers in a fair and equitable manner".<sup>33</sup>

The principles of plant assignment outlined by Hydro, which are derived from long accepted principles established by the authoritative author Bonbright, were endorsed by Hydro's expert, Dr. Greneman and by the Consumer Advocate's expert Douglas Bowman.<sup>34</sup> Guidelines 1 and 2

<sup>34</sup> Greneman, November 14, pp. 66-67, where he says that the guidelines set out by Hydro "…are consistent with those that have been applied for decades in cost of service…", and at p. 207 where he describes them to be

<sup>&</sup>lt;sup>29</sup> Exhibit JRH-3, pp. 23-24.

<sup>&</sup>lt;sup>30</sup> Exhibit JRH-3, pp. 23-24.

<sup>&</sup>lt;sup>31</sup> Exhibit JRH-3, pp. 23-24.

<sup>&</sup>lt;sup>32</sup> Exhibit JRH-3, pp. 23-24.

<sup>&</sup>lt;sup>33</sup> Exhibit JRH-3, pp. 23; see Haynes evidence, October 23, 2003, pp.73-74.

set out above are reflective of the Board's discussion of appropriate cost allocation principles in PU7.<sup>35</sup>

The 'postage stamp' theory of plant assignment advocated by Ms. Tabone of the Board's experts EES Consultants was described by her to be a "policy issue".<sup>36</sup> Essentially, this theory is that, for transmission, all customers should be treated the same no matter where they are located, and that the consequential cost-averaging effect of common assignment should extend to and be consistent with generation.<sup>37</sup> Ms. Tabone conceded that the postage stamp theory constituted a presumption in favour of common assignment of interconnected plant unless there existed "irrebuttable" evidence to the contrary.<sup>38</sup> Ms. Tabone's postage stamp policy approach to plant assignment was not endorsed by any of the other experts who testified. Ms. Tabone did not offer any persuasive authority in support of this novel approach to plant assignment, or for her suggestion that the substantial benefit assignment guideline proposed by Hydro and previously endorsed by the Board was "past direction".<sup>39</sup> Similarly, there is no support by the other experts

<sup>&</sup>quot;...general industry guidelines..."; D. Bowman Pre-Filed Evidence dated September 5, 2003, pp. 6-8, where he describes Hydro's cost of service methodology to be consistent with previous Board rulings.

<sup>&</sup>lt;sup>35</sup> PU7, pp. 110-111.

<sup>&</sup>lt;sup>36</sup> Tabone, November 19, 2003, p.133.

<sup>&</sup>lt;sup>37</sup> EES Consultants, November 19, 2003, pp. 18-19

<sup>&</sup>lt;sup>38</sup> Tabone, November 19, p.145, the language at p.19 of EES Consultants' Pre-Filed Evidence dated September 2, 2003 is "...irrefutable evidence..".

<sup>&</sup>lt;sup>39</sup> Tabone, November 19, pp. 129-130.

who testified for the principle, also espoused by Ms. Tabone, that transmission and generation must be assigned consistently.

#### **Industrial Customers' Position**

The Industrial Customers' position is that, applying the assignment guidelines correctly identified by Hydro, the plant assignments made by the Board in PU7 should be sustained, with only one exception: transmission line 219 on the Burin Peninsula should be specifically assigned to Newfoundland Power, or to a new subtransmission class for Newfoundland Power and the Hydro Rural customer class.

#### **GNP** Assets

Hydro proposes that the GNP generation be assigned common and that the GNP transmission be assigned Hydro Rural. EES Consultants recommends the common assignment of all of Hydro's GNP assets.

The basis for Hydro's argument in favour of the common assignment of GNP generation is that this generation is of "significant benefit" to the Island Integrated System, and of corresponding benefit to the Industrial Customers as customers supplied by that system. Hydro relies on the fact that this generation can on occasion be dispatched to help support the existing grid and thereby provide benefits to the grid that would not be present were the GNP interconnected without generation installed.

The Industrial Customers disagree, and believe that the evidence is clear on two matters:

1. Absent the GNP interconnection, the customers on the Island Interconnected system would have better reliability than they have today, regardless of the GNP generation.

That is, rather than benefit the Island Integrated System, the GNP interconnection effects a materially negative impact upon the Island Integrated System. Particularly striking in this regard is the evidence found in IC-399 NLH. IC-399 NLH outlines the LOLH and Energy Balance in the hypothetical scenario in which the GNP was not interconnected; in this scenario, the Island Interconnected LOLH and the Energy Balance would both improve, and the requirement for future generation additions to the Island Interconnected grid would be delayed until 2012 from the presently-forecast 2010. Despite this reduction in service quality by reason of the GNP interconnection, the approach proposed by Hydro results in about \$190,000 in extra costs to the IC group. This added cost to the Industrial Customers group as a result of a project that is designed to provide service to rural customers (at the expense of the Island Interconnected grid) is not appropriate and contrary to the provisions of the EPCA 1994 which prohibit charging Industrial Customers for the costs to serve rural customers.

2. Even with the GNP interconnection in place, the appropriate test for allocation of resources to common versus specifically assigned is not simply "do they provide benefits to the Island Interconnection customers" but also "what is the appropriate allocation to track the relative benefits received". The evidence in this hearing is that the GNP generation is dispatched with relative frequency to support the rural customers in the GNP area by reason of transmission problems but rarely in support of the Island Interconnected grid itself. The frequency of the use of the GNP generation reflected in the evidence indicates that, since interconnection, the GNP generation has been commissioned 117 times (98% of the dispatch) for local support and back-up and 3 times

for system support (2% of the dispatch).<sup>40</sup> However, the allocation approach proposed by Hydro will result in the Island Interconnection customers (Newfoundland Power and the Industrial Customers) being assigned over 90% of the costs of these units. This allocation approach is simply not consistent with the principle of cost allocation tracking the benefits received.

There are a number of additional considerations in the record before this Board that weigh against Hydro's contention that the GNP generation is of "substantial benefit" to the Island Interconnected System within the meaning of the accepted plant assignment guidelines, including the following:

- Historically, it is clear that the interconnection was effected for the benefit of the GNP isolated system customers in 1996 at a cost of \$31,418,985.<sup>41</sup>
- Hydro has characterized the GNP generation in the past as being merely a backup system.<sup>42</sup>
- The GNP total generating capacity of 15.1MW is less than that necessary to service the full GNP load in normal operating conditions.<sup>43</sup>
- In rejecting Hydro's proposed assignment of GNP assets to common in PU7, the Board viewed the then-annual aggregate average radial generation from the GNP assets of 3% to be negligible in the context of the "substantial benefit" test;<sup>44</sup>

<sup>44</sup> PU7, p. 113.

<sup>&</sup>lt;sup>40</sup> IC 235 NLH; Haynes, October 24, 2003, pp.50-51.

<sup>&</sup>lt;sup>41</sup> PU7, p. 110.

<sup>&</sup>lt;sup>42</sup> IC 104 NLH – See paragraph 6 of Hydro's 1999 Application to the Board to decommission of its Roddickton generation.

<sup>&</sup>lt;sup>43</sup> Haynes, October 23, 2003, p.128.

since the time of PU7, the average annual generation from the GNP assets has declined further to 2.7% (2.4% in 2002).<sup>45</sup>

Accordingly, the Industrial Customers submit with respect that the GNP generation cannot be viewed to comprise a "substantial benefit" to customers other than the Hydro Rural customers for which this generation serves as a local back-up so as to warrant common assignment and the corresponding additional costs of approximately \$190,000 per annum to the Industrial Customers.<sup>46</sup>

The cost implications to the Industrial Customers by reason of assignment of GNP transmission to common, as recommended by EES Consulting, also cannot be discounted; U-Hydro No.14 evidences that the additional annual costs to the Industrial Customers in the event of assignment of GNP transmission to common would be approximately \$1,109,000.

In all the circumstances, the Industrial Customers submit with respect that the GNP assets can in no way be said to be of "substantial benefit" to the Island Integrated System and to the Industrial Customers as customers supplied by that system.

Mr. Haynes confirmed in his testimony that the assignment of GNP transmission to Hydro Rural was also justified by an application of the Hydro Rural Sub-Transmission guideline;<sup>47</sup> this guideline provides for direct assignment to Hydro Rural "...all transmission and terminal station plant serving only Hydro Rural rate classes." Ms. Tabone of the Board's experts EES Consultants acknowledged that the Hydro Rural Sub-Transmission guideline was an accepted, if

<sup>&</sup>lt;sup>45</sup> See IC 87 NLH, and Haynes, October 23, 2003, p.80.

<sup>&</sup>lt;sup>46</sup> See IC 233 NLH.

<sup>&</sup>lt;sup>47</sup> Haynes, October 23, 2003, p.93.

not in her view a common, guideline.<sup>48</sup> Section 3(a)(iv) of the EPCA 1994 establishes the power policy of the Province to be that Industrial Customers "...shall not be required to subsidize the cost of power provided to rural customers in the Province..."<sup>49</sup>. The Industrial Customers submit that to assign any of the GNP assets to common would offend this established policy and constitute a breach of the EPCA 1994.

#### **Burin Peninsula Transmission Lines**

Hydro proposes that all transmission lines on the Burin Peninsula be assigned common, principally on the basis that generation on this radial line is of benefit to the system.<sup>50</sup> The Industrial Customers submit with respect that, apart from transmission line 212 which in part services Hydro rural customers and interconnects Hydro's Paradise River hydro facility to the Island Interconnected System, the Burin Peninsula transmission line 219 and related generation is directly analogous to the GNP transmission and generation and should be specifically assigned to Newfoundland Power. This is because:

• Since PU7, when transmission on the Burin Peninsula was assigned common, a mobile Newfoundland Power 15MW generator has been moved, reflecting a decrease in the Burin generating capacity since 2001.

<sup>&</sup>lt;sup>48</sup> Tabone, November 19, 2003, pp. 140-141.

<sup>&</sup>lt;sup>49</sup> EPCA, 1994, s.3(a)(iv).

<sup>&</sup>lt;sup>50</sup> Haynes, October 23, 2003, p.135

- Transmission Line 219 was not constructed nor is it necessary to interconnect the Paradise River hydro facility to the Island Interconnect System; it was constructed to service the Burin Peninsula system (primarily Newfoundland Power customers).<sup>51</sup>
- Transmission Line 212 is the only Burin line that physically services Hydro rural customers.<sup>52</sup>
- Transmission Line 219 services only Newfoundland Power customers.
- Transmission Line 212 and Transmission Line 219 are not physically interconnected by Hydro assets.<sup>53</sup>
- The load allocation between the two customer classes on the Burin Peninsula, namely Newfoundland Power and the Hydro Rural classes, is respectively 99.5% to Newfoundland Power and .5% to the Hydro Rural class.<sup>54</sup>
- The Burin generating capacity is less than that necessary to service the Burin load in normal operating conditions. The Burin peak is 58.7 MW.<sup>55</sup> However, Burin generation is only 34.7 MW, of which 8 MW is the Paradise River GS connected to the TL 212 which the Industrial Customers propose to assign common. Even with a proposed (but not

<sup>&</sup>lt;sup>51</sup> Haynes, October 23, 2003, pp. 130-131.

<sup>&</sup>lt;sup>52</sup> Haynes, October 23, 2003, p.132.

<sup>&</sup>lt;sup>53</sup> Tabone, November 19, 2003, p.148; JRH-3, p.6.

<sup>&</sup>lt;sup>54</sup> Haynes, October 21, 2003, p.23.

<sup>&</sup>lt;sup>55</sup> IC 339 NLH.

approved) wind generation unit of 25 MW<sup>56</sup>there will not be sufficient firm generation on Burin to carry the winter peak. In other words, the Burin Peninsula situation is directly analogous to the GNP transmission and Doyle's-Port –aux-Basques transmission, a fact agreed to by Hydro in the 2001 proceeding.<sup>57</sup>

• Assignment of the TL219 to common increases the costs allocated to IC by \$230,000 despite being built to service effectively only Newfoundland Power rural customers.<sup>58</sup>

The Industrial Customers' argument that the Burin Peninsula transmission line 219 should be specifically assigned received support even from Newfoundland Power's expert, Mr. Brockman. Mr. Brockman described the Industrial Customer's position to be a "fair compromise".<sup>59</sup>

Hydro's cost of service expert, Mr. Greneman, raised the potential for an alternative treatment of the Burin Peninsula transmission line costs; he confirmed that it would be acceptable to establish a sub-transmission category to allocate the costs of the Burin Peninsula transmission lines to the customers of Newfoundland Power and Hydro Rural but not to the Industrial Customers.<sup>60</sup> Although disagreeing in principle with the idea of specific assignment of the Burin Peninsula transmission lines, Ms. Tabone conceded that, in the event that there was to be direct assignment

<sup>&</sup>lt;sup>56</sup> NP 219 NLH.

<sup>&</sup>lt;sup>57</sup> Pre-Filed Evidence of C.F. Osler and P. Bowman dated September 2, 2003, pp.34-35, citing IC 267 (2001).

<sup>&</sup>lt;sup>58</sup> IC 228 NLH.

<sup>&</sup>lt;sup>59</sup> Brockman, November 18, 2003, pp. 48-51.

<sup>&</sup>lt;sup>60</sup> Greneman, November 14, 2003, pp.207-207.

of the Burin transmission lines, "...there could be a precedent for splitting those two lines and assigning them differently."<sup>61</sup>

The only additional issue raised in this connection is the pending demonstration wind project on the Burin Peninsula. That project is beyond the scope of the Board's consideration at this time. If there is ever a significant contribution to the grid from wind generation on the Burin Peninsula, the assignment of plant can be re-visited, as with any change in circumstances.

#### Doyle's-Port-aux-Basques transmission line

In PU7, the Doyle's-Port-aux-Basques transmission line, which interconnects Newfoundland Power generation to the Island Interconnected System, was specifically assigned to Newfoundland Power. Neither Hydro nor Newfoundland Power proposes a different assignment in the present Application. Only EES Consultants, in a brief reference at p.19 of their Pre-Filed Evidence dated September 2, 2003, has proposed that the assignment of this transmission line to Newfoundland Power be now changed to common.<sup>62</sup>

In her testimony, Ms. Tabone appeared to abandon this position. In response to questions asking her to compare the GNP radial line to the Doyle's-Port-Aux-Basques radial line, she said "...I have not looked at the technical side of those two side by side. Again, if it's really only benefiting Newfoundland Power, perhaps it was a transmission line they should have built and

<sup>&</sup>lt;sup>61</sup> Tabone, November 19, 2003, p.153.

<sup>&</sup>lt;sup>62</sup> EES Consultants' Pre-Filed Evidence p.19.

they should pay for it. If it's benefiting them plus some other customers, then it would be common."<sup>63</sup>

The evidence is clear that the Doyle's-Port-Aux-Basques transmission line services only Newfoundland Power customers. Ms. Tabone's quoted testimony appears to be an admission that, if this is the case, the Doyle's-Port-Aux-Basques transmission line should indeed remain specifically assigned notwithstanding her "postage stamp" theory.

Moreover, Ms. Tabone viewed the Doyles-Port-Aux-Basques transmission line to be analogous to the GNP transmission line. She agreed that if the Board decided to make a specific assignment of the GNP transmission to Hydro Rural, that it should similarly specifically assign the Doyle's-Port-Aux-Basques transmission line to Newfoundland Power.<sup>64</sup>

# **Newfoundland Power Demand and Energy Forecast**

The forecast peak demand and energy figures have been identified as one of the principal factors that distinguish those portions of Island Interconnected System costs that are assigned in the cost of service respectively to the Industrial Customers, Newfoundland Power and Hydro Rural.<sup>65</sup>

The analysis of the Industrial Customers' experts Messrs. Osler and Bowman concluded that, when the 2002 actual cost of service is compared to the test year cost of service, the Industrial Customers' paid more than \$5 million dollars *in excess* of its measured costs in 2002 (including

<sup>&</sup>lt;sup>63</sup> Tabone, November 19, 2003, p.146.

<sup>&</sup>lt;sup>64</sup> Tabone, November 19, 2003, p.147.

<sup>&</sup>lt;sup>65</sup> Pre-Filed Testimony of C.F. Osler and P. Bowman, dated September 2, 2003, pp. 39-40.

RSP adjustments); in contrast, they concluded that Newfoundland Power's actual payments to Hydro were approximately \$5 million dollars lower than the amounts that should have been collected by rates (including the Rural Deficit).<sup>66</sup> Messrs. Osler and Bowman ascribed this anomaly in part to the Newfoundland Power actual load factor when compared to the Newfoundland Power forecast load used for test year purposes and submitted to Hydro. The difference was concluded to relate primarily to a Newfoundland Power forecast peak demand that was well below actuals (and well below historical averages).

In this proceeding, Newfoundland Power has again submitted a peak demand value that appears to be lower than would be expected based on historical actual load factors.<sup>67</sup> The evidence indicates that based on longer term averages, Newfoundland Power's peak demand forecast should be 16.3 MW to 29.0 MW higher than the values it has forecast for 2004 (based on 5 year averages and 10 year averages respectively).

Although the proposed demand/energy rate for Newfoundland Power does not have a direct impact upon the Industrial Customers, the Industrial Customers favour its implementation. The Industrial Customers believe that the implementation of a demand/energy rate for Newfoundland Power will have the salutary effect of ensuring that Newfoundland Power's demand and energy forecasts are properly scrutinized and prepared. On the evidence before the Board, it appears to be conventional North American utility practice for a retail utility of the significance of Newfoundland Power to be subject to a demand/energy rate. This will also, from the Industrial

<sup>&</sup>lt;sup>66</sup> Pre-Filed Testimony of C.F. Osler and P. Bowman, dated September 2, 2003, p. 39.

<sup>&</sup>lt;sup>67</sup> Information Item No. 17.

Customers' perspective, prevent the inappropriate allocation of costs under the cost of service arising from inaccurate demand and energy forecasts.

The industrial customers submit that Newfoundland Power's peak demand forecast for the purposes of cost-of-service allocations be increased by 16.3 MW to make it consistent with actual five year average load factors.

#### **NEWFOUNDLAND POWER GENERATION CREDIT**

All parties are agreed that the fact of Newfoundland Power having generating capability has to be taken into account in allocating system costs on the Island Interconnected System. This could be handled as it is with CBPPL, where a load requirement is determined, the amount of generation from CBPPL owned facilities is determined and a net amount required from Hydro is specified. This has not been historically the path chosen.

Newfoundland Power produces a load forecast which includes all the loads it expects to be required to meet in a given year. It then is given credit in the cost of service study for the megawatts of demand and kilowatt hours of energy it is capable of generating itself, whether or not it generates any amount of power or energy.

It appears that there is a natural economic incentive for Newfoundland Power to maximize its production from its hydro facilities, as this is likely cheaper power than can be bought from Hydro. The power policy of the Province, which the Board is required to implement, would direct this result in any event. Clearly, generating every available kilowatt hour of energy from these facilities is in the best interests of all stakeholders, subject, of course, to appropriate reserve requirements established in guide curves where possible. Newfoundland Power should, and presumably does, recover all the costs associated with supply of electricity from these facilities from the customers it serves.

Newfoundland Power's thermal production facilities present different issues. These are small, older gas turbines and diesel plants which are designed to serve emergency needs in specific service areas and, incidentally, provide some peaking capacity to the system. The energy produced by these units is some of the highest cost energy on the system. These are among the last generation units despatched under System Operating Instructions in time of system constraint<sup>68</sup>. Neither Hydro nor Newfoundland Power plan on generating any energy from these units in any given year, except for planned maintenance requirements.

To the extent that these thermal units provide the benefit of emergency or planned maintenance supply to Newfoundland Power's customers, those customers should pay the costs of those units. If there is a benefit to Industrial Customers from these units, it lies only in the effect they may have on LOLH whereby future generation may be deferred on account of them. That is one of the functions served by Hydro's own gas turbines—these units also provide backup capacity to the entire system including the Industrial Customers.

Table 6.4 on p. 30 of the Pre-Filed Evidence of C.F. Osler and P. Bowman dated September 2, 2003 sets out the cost per KW of the available peaking capacity on the system, and no witness, expert or otherwise, has challenged the validity of these numbers. On the application of a cost of service study which all parties agree generally allocates costs fairly among ratepayers, Industrial

<sup>&</sup>lt;sup>68</sup> Pre-Filed Evidence of C.F. Osler and P. Bowman dated September 2, 2003, p.36, lines 21-22, and the Exhibits there referred to.

Customers pay \$2.19 per KW for the front-line peaking units—Hydro's gas turbines. It is not only unfair, but unconscionable, that the Industrial Customers be asked to pay \$16.23/KW for peaking capacity owned by Newfoundland Power which is installed primarily, in our view, for local backup generation support, particularly given that it is located primarily on remote generation systems such as the Burin.

The inappropriateness of the treatment of the generation credit in the current system is highlighted in the effect of the addition of new generation to the system. The generation credit is calculated net of percentage system reserves. With the addition of new capacity the percentage system reserve has decreased (a mathematical effect from having increased total capacity) with the result that the dollar amount of Newfoundland Power's generation credit increased while the chances of such generation being called upon have decreased.<sup>69</sup>

There was substantial discussion in the hearing regarding the merits of Newfoundland Power's thermal generation, whether these units provide any benefits to the system, and the possible different approaches as to how this generation is to be treated. Ignoring for a moment the technical issues, there is a clear and undisputed financial result of the treatment proposed by Hydro that is simply not reasonable. As set out at page 37 of the Pre-Filed Evidence of Messrs. Osler and Bowman, Hydro's approach is to charge the Industrial Customers and Hydro's Rural customers for about 60% of the cost of Newfoundland Power's peaking generation (\$995,000 of \$1,691,000 in total costs), despite the Industrial Customers and Hydro Rural customers making up only 20% of the island peak. Even the costs of Hydro's own valuable gas turbines are

<sup>&</sup>lt;sup>69</sup> Pre-Filed Evidence of C.F. Osler and P. Bowman dated September 2, 2003, p. 39, footnote 137.

assigned only 20% to Industrial Customers and Hydro Rural, with the other 80% assigned to Newfoundland Power. There is simply no basis for providing a "credit" in the Cost of Service to Newfoundland Power that results in Newfoundland Power's customers only paying 40% of the costs of Newfoundland Power's thermal generation.

Newfoundland Power's expert, Mr. Brockman, acknowledged that the generation credit and the outcome described above was an anomaly in terms of its allocation of costs to the Industrial Customers.<sup>70</sup> His only suggestion against correction of the anomaly was that one should not deal with a single part of the Cost of Service Study in isolation. Given that this simply affects an input into the study (i.e. the load factor and demand of Newfoundland Power), this objection carries no weight.

Hydro's expert, Mr. Greneman agreed that there might be an anomaly and the issue merited review.<sup>71</sup> He further "tended to agree" that Hydro's gas turbines units should be regarded as more valuable to the system than NP's thermal generation.<sup>72</sup>

Whatever determination the Board may make on the issue of the demand/energy rate for Newfoundland Power, the credit for Newfoundland Power's thermal generation in the Cost of Service Study should be removed and the credit for the hydraulic generation should be reduced from 81.6 MW to 77.5 MW, i.e. to the actual anticipated production as opposed to the potential peak output.

<sup>&</sup>lt;sup>70</sup> Brockman, November 18, 2003, pp. 105-106

<sup>&</sup>lt;sup>71</sup> Greneman, November 18, 2003, p.219, lines 8-14.

<sup>&</sup>lt;sup>72</sup> Greneman, November 18, 2003, p.219, lines 3-16.

#### PART 4

#### **RATE ISSUES**

#### INTERRUPTIBLE B – CURTAILABLE RATE

Consistent with the notion that Hydro should be reviewing its longer term plans for supply of power in the Province as set out in Part 5 below, Hydro should be directed to make available to Industrial Customers a curtailable rate on terms and conditions essentially similar to those contained in the Interruptible B contract with ACCC Stephenville which expired in the spring of 2003.

This program was the only significant demand side management effort by Hydro directed toward Industrial Customers, and Hydro should not be permitted to abandon it at this time. Just as it would be inappropriate for the Board to disallow assets from rate base which might not be necessary to meet today's demands on the system (such as generating facilities that are technically unnecessary due to the implementation of larger projects), it is equally inappropriate to discontinue a demand side management initiative such as the Interruptible B rate due to a temporary capacity surplus on the system. Customers need to conform their operations and practices to accommodate this different type of product offering by Hydro. ACCC Stephenville has been in a position to accept a lesser quality product—i.e. an interruptible electricity supply in exchange for a specific payment from Hydro. Elimination of the interruptible B rate effectively requires ACCC Stephenville to purchase a higher quality product then it requires, at a price that is higher then it is properly charged for meeting ACCC's needs.

Curtailable rates can serve the purpose of shaving peak demands; demand is directly related to the need for new plant and hence must be a long term planning consideration—not a spigot to turn on and off at Hydro's whim. In advance of a credible and properly reviewed System Resource Plan that assesses both supply and demand side options for the system, it is not now appropriate to terminate a long-term rate offering such as Interruptible B. Continued confidence of both Hydro and its customers in the long-term presence of this type of rate offering should not be undermined at a time when, in the next very few years, major decisions on next generating plant addition must be made. The 46 megawatts which ACCC Stephenville was prepared to offer to change from firm to interruptible represents 4-5 years of demand growth on Hydro's system. This is not an insignificant contribution to the deferral of new capacity costs. It opens up possibilities for different system configuration which would not be available if the system was both demand and energy constrained, especially in a system where wind power is in contemplation as an energy source. This long-term view of interruptible rate availability has been recognized in such other jurisdictions as Manitoba, which although similarly in a power surplus situation at the present time, has continued its comparable interruptible program in order to recognize the long-term benefits that it provides.<sup>73</sup>

An Interruptible B type of arrangement represents an accepted rate form utilized by many utilities to manage loads, and can be a centrepiece of a demand side management strategy. While Hydro has not completed any integrated resource planning exercise, it would be singularly inappropriate to abandon this program and potentially make it impractical for ACCC Stephenville or others to conform their operating procedures and workplaces to this type of rate.

<sup>&</sup>lt;sup>73</sup> Pre-Filed Evidence of C.F. Osler and P. Bowman dated September 2, 2003, pp.69-70.

This was not only the opinion of the Industrial Customers' experts<sup>74</sup> but was the view expressed by the Board's experts EES Consulting.<sup>75</sup>

#### NEWFOUNDLAND POWER DEMAND AND ENERGY RATE

For the reasons outlined in our discussion respecting the Newfoundland Power Demand and Energy Forecast, *supra*, the Industrial Customers endorse the implementation of a demand/energy rate for Newfoundland Power.

# PART 5 FUTURE PLANNING

As is pointed out in the evidence of the Industrial Customers' experts C.F. Osler and P. Bowman,<sup>76</sup> Hydro is facing a short hiatus between the addition of the Granite Canal plant and the conclusion of two power purchase contracts on the one side and the necessity to add additional plant on the other side. Relevant to this conclusion is that the current load forecasts prepared by Hydro indicate the need for substantial new generation for both energy and demand purposes in roughly the first few years of the next decade. In terms of planning and construction times for new hydro stations, there may be a period of two to three years available before next plants must be committed.

<sup>&</sup>lt;sup>74</sup> Pre-Filed Evidence of C.F. Osler and P. Bowman dated September 2, 2003, pp. 69-70.

<sup>&</sup>lt;sup>75</sup> Chymko, November 19, 2003, pp. 160-161.

<sup>&</sup>lt;sup>76</sup> Pre-Filed Evidence of C.F. Osler and P. Bowman dated September 2, 2003, p.23, lines 7-11.

This current hiatus allows for the exploration at this time by Hydro of some integrated resource planning techniques which should ultimately benefit ratepayers by increasing efficiency and lowering long-run overall costs. Such initiatives will need to be implemented or confirmed well in advance of making commitments to the next system generation addition, in order to be most usefully evaluated in determining the best addition at that time.

Hydro needs a strategic plan to incorporate demand side management techniques, evaluate potential new sources of energy and new technologies, and maximize the value of existing resources. This exercise is properly undertaken while the staff of Hydro are not distracted by major capital projects or imminent rate hearings. Such a plan will incorporate the effects of the wind projects currently under consideration, curtailable or other alternative rate offerings similar or in addition to Interruptible B, a consideration of the likely next sources of generation to meet projected load and the timing of additions to generating capacity. This should mesh well with the depreciation study to be filed within the next year or so which will provide realistic values and service lives for major assets such as Bay D'Espoir and Holyrood. Mr. Chymko of EES further outlined and confirmed the role that such a planning process should play.<sup>77</sup>

The Board should direct Hydro to undertake such a strategic planning exercise in order to ensure that system expansion proceeds in a controlled and least cost fashion. This exercise should lead to a System Resource Plan that would be filed with the Board in time for a hearing well in advance of needing to commit to the next plant (likely filed within 2004 or early 2005). The plan should contain detailed information on the demand side management and rate initiatives

<sup>&</sup>lt;sup>77</sup> Chymko, November 19, 2003, pp.160-161.

undertaken to date and their impact on system loads, as well as an assessment of additional options that might change or defer the timing or type of next plant to be added to the system. A proceeding on this material would allow the Board to discharge its planning role under section 3 (b) of the EPCA 1994.

The Board should also recommend to Government arrangements for the transfer to Newfoundland Power of all of the Rural Customers of Hydro on the Island of Newfoundland, or at least the Island Interconnected Customers. Such an arrangement would simplify considerably the plant and cost assignment issues which take up so much time before the Board and put the Rural Deficit issue in a more appropriate context.

# PART 6

# INDUSTRIAL CUSTOMERS' COSTS OF HEARING

Section 90 of the *Public Utilities Act* provides as follows:

"(1) The costs of or incidental to a proceeding before the Board shall be in the discretion of the Board and may be fixed at a definite amount or may be taxed and the Board may order by whom they are to be taxed, to whom they are to be allowed, and the Board may prescribe a scale under which costs shall be taxed."<sup>78</sup>

The Industrial Customers submit with respect that this Board has the jurisdiction and ought to exercise its discretion to award them costs of this hearing on a party and-party basis.

As a regulated utility, Newfoundland Power is entitled to include in its rate the costs of regulatory hearings.

<sup>&</sup>lt;sup>78</sup> Public Utilities Act, s. 90 (1).

The Consumer Advocate, who has been appointed to represent consumers in the Province, is entitled by virtue of order-in-council to be paid his taxed hearing costs.

Hydro will also recover its hearing costs through its rates.

Each of Hydro, Newfoundland Power, the Consumer Advocate and counsel for the towns of Labrador City and Wabush has called expert witnesses in relation to cost of service issues. Experts have also testified for some of the parties on rate design, capital structure and rate of return issues.

As this hearing has demonstrated, the issues before the Board include both the appropriateness of Hydro's forecast costs and issues as to the appropriate allocation of costs among Hydro's customers in its costs of service.

In its Application, Hydro proposes to implement significantly higher rates for the services which it provides to its Industrial Customers. The overall rate increase to the Industrial Customers as a class which has been proposed by Hydro amounts to approximately 22.6% or, in dollar amounts, approximately \$13 million; in the case of ACCC Stephenville, the proposed rate increase is approximately 29%.

It seems reasonably clear that the Industrial Customers will be significantly impacted by rate increases of the range proposed by Hydro and that they are proper parties in this hearing. Indeed, the Industrial Customers believe that they would have been seriously disadvantaged had they not intervened and participated in this hearing and if they had not tendered the evidence of Intergroup and of Messrs Jean-Francois Guillot and Mel Dean of ACCC Stephenville.

The leading case which is supportive of the Board's broad jurisdiction and discretion with respect to costs is the Supreme Court of Canada's 1986 decision in *Bell Canada v Consumer's Association of Canada et al.*<sup>79</sup> That case established the principle that costs will be available to interveners who have participated in a responsible way and contributed to a tribunal's better understanding of the issues before it.

The Board's broad jurisdiction and discretion with respect to the awarding of costs of parties, including interveners, in Board hearings is also supported by the decision of the Supreme Court of Newfoundland and Labrador, Court of Appeal in *Newfoundland and Labrador Hydro v Newfoundland and Labrador Federation of Municipalities.*<sup>80</sup> In that case, Hydro challenged the Board's award of costs to the Newfoundland and Labrador Federation of Municipalities are ground that the costs amount was excessive and partly on the ground that the costs should have been taxed on a party and party basis. The Court of Appeal ultimately found that the Board had the jurisdiction and discretion to make the costs award in question. Subsequently, the Newfoundland and Labrador Federation of Municipalities was regularly awarded its costs of participating in Hydro's rate referrals. The Board's recent award of costs to the Industrial Customer's expert Steve Barreca in Hydro's 2004 capital budget application appears to be entirely consistent with the principles set out in *Bell Canada* and in *Newfoundland and Labrador Hydro*.

<sup>&</sup>lt;sup>79</sup> Bell Canada v Consumers Association of Canada et al [1986] 1 S.C.R. 190 (S.C.C.).

 <sup>&</sup>lt;sup>80</sup> Newfoundland and Labrador Hydro v Newfoundland and Labrador Federation of Municipalities (1979) 24 Nfld.
 & P.E.I.R. 317 (Nfld. Sup. Ct., Ct. of Appeal).

The Board has not issued guidelines setting forth the parameters within which it will exercise its discretion with respect to costs. Applying the approach in *Bell Canada*, the Industrial Customers submit with respect that the Board should exercise its discretion to award those costs that the Board perceives to be fair to those parties that it perceives to be justly entitled thereto.

The Industrial Customers constitute a distinct group of Hydro's customers with a discrete but significant set of issues meriting the Board's consideration. The Industrial Customers submit with respect that they have participated in the hearing process in a responsible and meaningful way, and contributed to the Board's understanding of the issues in contention. The Industrial Customers submit that they should accordingly be entitled to receive their taxed costs on a party-and-party basis. Given the funding available to all other major participants, the Industrial Customers submit that a refusal to grant their costs on a party-and-party basis would be unfair; in this connection, the Industrial Customers also support an award of party-and-party costs in favour of the towns of Labrador City and Wabush.

#### **PROCEDURAL ISSUES**

In the past, the Board has either not set a time limit for Hydro's implementation of the Board's recommendations or has indicated that such recommendations be implemented by the time of or at Hydro's next rate hearing.

The result is that the implementation of many good and valuable recommendations is delayed.

The Industrial Customers submit that any recommendations for implementation in the future should contain fixed timelines to be met by Hydro.

The Industrial Customers also have procedural recommendations with respect to the conclusion of this hearing. In particular, the Industrial Customers recommend:

- 1. that all interveners receive a cost of service study prepared by Hydro based upon the Board's final order in this matter;
- 2. that all interveners should receive, on an ongoing basis, RSP reports modified to show clearly the calculation of allocation and any customer splits;
- 3. that actual cost of service results should be provided to Hydro's Industrial Customers and to Newfoundland Power annually; and
- 4. that the interveners should be copied annually with Hydro's annual review reports prepared for the Board.

The above will make it easier for Hydro's customers, the interveners in this hearing to have basic information available to them to help them identify issues for future rate hearings, thereby hopefully permitting those hearings to be streamlined.

In addition, the Industrial Customers recommend that the Board order Hydro to conduct a rate referral at least every three years in order to provide for rates which reasonably reflect the costs which Hydro is or should be incurring.

#### SUMMARY OF RECOMMENDATIONS

The following is a summary of the Industrial Customers' recommendations in this written argument:

1. Respecting revenue requirement issues, the Industrial Customers recommend as follows:

- (a) Respecting the issue of Hydro's return on equity/capital structure, the Industrial Customers recommend that no increase to Hydro's 3% return on equity be endorsed by the Board.
- (b) Respecting the issue of the fuel conversion factor, the Industrial Customers recommend that Hydro's proposal for a 624 kwh/bbl fuel conversion factor be rejected as too low, and that the Board impose a fuel conversion factor in the range of 636 kwh/bbl.
- (c) Respecting the issue of a productivity allowance, the Industrial Customers recommend that the Board impose upon Hydro a productivity allowance in the amount of \$5 million dollars to be reflective of efficiencies intended to be achieved by Hydro through its Business Improvement Process initiatives.
- (d) Respecting the issue of Hydro's treatment of non-regulated costs, the Industrial Customers recommend that the Board should disallow Hydro's practice of adding back to its regulated equity the on-going amounts recorded as non-regulated expenses.
- (e) Respecting the issue of capital expenditure adjustments, the Industrial Customers recommend that a decrease in the order of 14% should be implemented with respect to Hydro's forecast capital expenditures to avoid over-stating Hydro's rates.
- 2. Respecting cost of service issues, the Industrial Customers' recommendations are as follows:
  - (a) Respecting assignment issues, the Industrial Customers recommend that, applying the assignment guidelines correctly identified by Hydro, the plant assignments made by the Board in PU7 should be sustained, with the sole exception that transmission line 219 on the Burin Peninsula should be specifically assigned to Newfoundland Power, or to a new subtransmission class for Newfoundland Power and the Hydro Rural customer class.
  - (b) Respecting the treatment of Newfoundland Power's demand and energy forecast in the cost of service, the Industrial Customers support the implementation of a demand/energy rate to be applicable to Newfoundland Power so as to make more meaningful Newfoundland Power's demand and energy forecasts and to prevent an inappropriate allocation of costs to the Industrial Customers in the cost of service by reason of inaccurate demand and energy forecasts.
  - (c) Respecting the issue of Newfoundland Power's Generation Credit, the Industrial Customers recommend that the credit for Newfoundland Power's thermal generation in the cost of service study should be removed and the credit for the hydraulic generation should be reduced from 81.6 MW to 77.5 MW, i.e. to the actual anticipated production as opposed to the potential peak output.

- 3. Respecting rate issues, the Industrial Customers recommend as follows:
  - (a) Respecting the issue of the Interruptible B rate, the Industrial Customers recommend that the Board direct Hydro to make such a curtailable rate available to the Industrial Customers as a significant part of a demand side management strategy.
  - (b) Respecting the issue of the Newfoundland Power demand/energy rate, the Industrial Customers recommend that such a two-part rate be implemented with respect to Newfoundland Power.
- 4. Respecting the issue of future planning, the Industrial Customers recommend that Hydro undertake integrated resource planning with the aim of increasing efficiency and lowering long-run overall costs, and implement such planning by adopting a strategic plan which should incorporate demand side management techniques, evaluate potential new sources of energy and new technologies, and maximize the value of existing resources.
- 5. The Industrial Customers seek their costs of this hearing.
- 6. As to procedural issues respecting the results of this hearing, the Industrial Customers recommend:
  - (a) that all interveners receive a cost of service study prepared by Hydro based upon the Board's final order in this matter;
  - (b) that all interveners should receive, on an ongoing basis, RSP reports modified to show clearly the calculation of allocation and any customer splits;
  - (c) that actual cost of service results should be provided to Hydro's Industrial Customers and to Newfoundland Power annually; and
  - (d) that the interveners should be copied annually with Hydro's annual review reports prepared for the Board.

# CONCLUSION

The Industrial Customers submit that the evidence in this hearing demonstrates that Hydro does

not require the rate increase which it is proposing.

The Industrial Customers respectfully request that the Board, in its consideration of Hydro's Application, be mindful of the principle of gradualism which holds that rate shock to Hydro's customers should be minimized, and the principle that power must be delivered to consumers at the lowest possible cost consistent with reliable service.

The Industrial Customers' witnesses Jean-Francois Guillot and Mel Dean fairly characterized Hydro's proposed rate increases to be "staggering".<sup>81</sup> The Industrial Customers request that the Board give every consideration to the arguments made in support of the minimization of the rate increases sought so as to mitigate rate impact.

<sup>&</sup>lt;sup>81</sup> Pre-Filed Evidence of Jean-Francois Guillot and Mel Dean, dated September 2, 2003, as amended on December

<sup>12, 2003,</sup> p. 9.