Newfoundland & Labrador

BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

ORDER NO. P. U. 8 (2007)

IN THE MATTER OF
the *Electrical Power Control Act* RSNL 1994, Chapter E-5.1 (the *EPCA*") and
the *Public Utilities Act* RSNL 1990, Chapter P-47 (the *"Act"*) and
their subordinate regulations;

AND IN THE MATTER OF
an application by Newfoundland and Labrador Hydro for approval of, *inter alia*,
rates to be charged its customers (the "*Application*").

BEFORE:

Robert Noseworthy
Chair and Chief Executive Officer

Darlene Whalen, P.Eng.
Vice-Chair

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PART ONE. PROCEDURAL MATTERS AND BACKGROUND

I. APPLICATION AND PROCEEDING

1. The Application

Newfoundland and Labrador Hydro ("Hydro") filed a general rate application (the "Application") with the Board of Commissioners of Public Utilities (the "Board") on August 3, 2006 for an Order of the Board approving, among other things, the rates to be charged, as of January 1, 2007, for the supply of power and energy to its Customers.

In its Application Hydro proposed:

(1) *"Hydro's forecast 2007 test year costs (before return on rate base) of $329,608,000;*
(2) *forecast average rate base for 2007 of $1,491,183,000;*
(3) *that the methodology approved by the Board for calculating the allowed rate of return on equity (for purposes of determining weighted average cost of capital) in Order No. P.U. 14(2004) be continued;*
(4) *that (consistent with this methodology) Hydro be allowed a rate of return on equity of 5.20% (or such other rate as results from the application of the long-term marginal cost of new debt to Hydro in the methodology referred to above, at the conclusion of the hearing);*
(5) *that (consistent with this methodology) Hydro be allowed a rate of return on forecast average rate base of 7.63% (or such other rate as results from the application of the long-term marginal cost of new debt to Hydro in the methodology referred to above, at the conclusion of the hearing);*
(6) *that effective January 1, 2007, the Board approve:*
   a. *that the demand and energy rates charged to Newfoundland Power be increased to $7.49 per kW per month, with a first block energy rate of 19.17 mills per kWh and an end block energy rate of 89.07 mills per kWh;*
   b. *that the total generation credit for Newfoundland Power be reduced to 117,930 Kw;*
   c. *that the Rate Stabilization Plan Adjustment rate charged to Newfoundland Power be decreased to 6.78 mills per kWh, with the fuel rider set to zero;*
   d. *that the rate charged to Newfoundland Power for firming up secondary energy purchased from Corner Brook Pulp and Paper Limited and re-sold to Newfoundland Power as firm energy be increased to 8.19 mills per kWh;*
   e. *that the rates charged to Industrial Customers for firm service be increased to a demand charge of $6.72 per kW per month, an energy charge of 38.11 mills per kWh and the respective annual specifically assigned charges;*
   f. *that the rates charged to Industrial Customers for non-firm service continue to be calculated in the manner set out in Order No. P. U. 7(2002), with the average system losses decreased to 2.68%, as stated on page 6 of the Rates Schedules attached to this Application;*
   g. *that the rate for wheeling energy for non-utility customers remain at 3.93 mills per kWh and that the average system losses be decreased to 2.68%;*
   h. *that the rates for Isolated Rural General Service Customers, excluding Government departments, be increased by the average change (forecast to be 17.2%) in base rates that has occurred since rates were flowed through and*

approved for Newfoundland Power to charge its customers following Hydro's last general rate application;

i. *that the policy outlined in Order No. P U. 7(2002-2003) of charging rates based on full cost recovery for Government departments and agencies, excluding hospitals and schools, in Isolated Rural Systems, be continued;*

j. *that the rates for Labrador Interconnected Customers be based on a uniform rate structure, as approved in Order No. P. U. 7(2002-2003) and confirmed in Order No. P. U. 14(2004), and that the phasing in of that uniform rate structure over a five-year period continue as outlined in the Rates Evidence filed with this Application;*

k. *that the Rules and Regulations which govern the provision of service to Rural Customers be confirmed with the exceptions that:*
   i. *the rate for the Burgeo school and library be deleted; and*
   ii. *the proposed clarifying footnote to section 16, Policies for Automatic Rate Changes, be added;*

l. *that the Automatic Adjustment Mechanism proposed by Hydro filed herewith in Exhibit MGB-2 in response to the Board's direction in Order No. P .U. 14(2004) be approved;*

m. *that the Rate Stabilization Plan be amended to reflect the impact of changes that may arise from time to time from the operation of the proposed Automatic Adjustment Mechanism, as set out in the Rate Schedules 2007, p. 10 of 53, attached to this Application;*

n. *that the Rate Stabilization Plan be amended to provide that, for Newfoundland Power, the revenue collected from secondary sales to CFB Goose Bay, less the cost of those sales, be included as a component of the Rate Stabilization Plan as set out in the Rates Schedules 2007, p. 11 of 53, attached to this Application;*

o. *that the straight line and equal life group depreciation methodology set out in the Gannett Fleming Inc. Depreciation Study, filed by Hydro on December 22, 2005, be approved in principle with implementation of the methodology deferred;*

p. *that Hydro continue to use regulated equity in the calculation of Hydro's capital structure; and*

q. *that the changes to the Rate Stabilization Plan proposed in the report filed by Hydro on June 30, 2006, the Review of the Operation of the Rate Stabilization Plan, be approved."*

The proposed base rate increase to Newfoundland Power Inc. (NP) was 6.6%, which would result in an approximate 4.6% average increase as of January 1, 2007 to NP's Island Interconnected customers and Hydro's customers served from the Island Interconnected system and the L'Anse au Loup system. The increase in rates for Island Industrial customers was forecast to be 8.2% as of January 1, 2007. Hydro's Labrador Interconnected customers would receive an average increase of approximately 8.5% as of January 1, 2007 and Hydro's Isolated Rural customers would receive an average increase of approximately 13.5%.

2. Notice and Pre-Hearing Conference

Notice of the Application and Pre-hearing Conference was published in newspapers throughout the Province beginning on August 19, 2006. The Pre-hearing Conference was held on September 7, 2006 at the Board's hearing room in St. John's.

Following the Pre-hearing Conference the Board issued Procedural Order No. P. U. 28(2006) on September 12, 2006 which identified registered intervenors, established procedural rules and set the schedule for the proceeding. In this Order the Board also directed that the request by Hydro for approval in principle of the straight line and equal life group depreciation methodology be addressed in 2007 following the conclusion of this Application with the process to be established by the Board.

Registered intervenors for the proceeding were:

1. Government appointed Consumer Advocate, Mr. Thomas Johnson;
2. Newfoundland Power Inc., represented by Mr. Ian Kelly, Q.C. and Mr. Peter Alteen; and
3. Hydro's Island Industrial Customers, namely: Abitibi Consolidated Company of Canada, Grand Falls Division; Aur Resources Inc.; Corner Brook Pulp and Paper Limited; North Atlantic Refining Limited; and Voisey's Bay Nickel Company Limited; represented by Mr. Joseph Hutchings, Q.C. and Mr. Paul L. Coxworthy.

Hydro was represented by Ms. Gillian Butler, Q.C., and Mr. Geoffrey P. Young.

The Board was assisted by Ms. Dwanda Newman, Board Counsel, and Ms. Cheryl Blundon, Board Secretary.

3. Information Requests/Reports

Pursuant to the Procedural Order No. P. U. 28(2006) a number of Requests for Information (RFIs) were exchanged. In total 643 RFIs were issued and answered.

On October 20, 2006 the Board's financial consultants, Grant Thornton LLP, filed a report "Financial Consultants Report, Board of Commissioners of Public Utilities Newfoundland and Labrador, Hydro 2006 General Rate Application", which presented Grant Thornton's observations, findings and recommendations with respect to their financial analysis of the pre-filed evidence of Hydro in connection with the Application. On January 12, 2007 Grant Thornton filed a Supplementary Report.

Pre-filed evidence was also filed on behalf of the experts for the Intervenors:

(i) Patrick Bowman and Andrew McLaren, InterGroup Consultants, October 24, 2006 (on behalf of the Industrial Customers);
(ii) Larry Brockman, Brockman Consulting, October 26, 2006 (on behalf of NP); and
(iii) C. Douglas Bowman and Dr. William T. Cannon, October 27, 2006 (on behalf of the Consumer Advocate).

4. Negotiations and Settlement Process

As part of the Board's methodology in setting the schedule and procedures for a public hearing into a general rate review or other substantive applications the Board provides for a number of negotiation days in advance of the hearing. The purpose of these negotiation days is to enable and/or facilitate discussion between the applicant and registered intervenors to determine what, if any, agreement may be reached on the issues contained in the application. The specific objectives of such a forum, commonly referred to as a settlement conference, is to clarify and reduce the number of contested issues to be addressed in a formal hearing and hence reduce regulatory costs associated with the application.

During the Pre-hearing Conference two (2) negotiation days (October 24 and 25, 2006) were scheduled with the hearing set to begin on October 31, 2006, which was later changed to November 1, 2006. Initial negotiations primarily involved technical and support staff from both utilities along with other technical experts engaged by the intervenors. The parties began settlement discussions well in advance of the formal negotiation days. These early discussions were successful and resulted in the filing of an agreement with the Board on October 20, 2006. In the context of the success of these early discussions Hydro, with the consent of all intervenors, requested a delay in the start of the hearing to allow parties an opportunity to more thoroughly consider the information and issues arising. The Board granted the request and technical discussions on the issues continued. In due course, legal counsels for the parties became engaged in the process in an effort to formalize and document the agreements being reached on the issues. To support the process the Board retained Mr. Mark Kennedy to act as facilitator to assist the parties with the formalization of these agreements. Mr. Kennedy was uniquely positioned to assist with this exercise having previously acted as Board Hearing Counsel for both Hydro's 2001 and 2003 general rate hearings. Final drafting of the agreements was carried out by the Board's facilitator in concert with the parties' legal counsels.

Four agreements (the "Settlement Agreements") were filed with the Board:

- October 20, 2006 – Parties' Agreement on Cost of Service, Rate Design and Rate Stabilization Plan;
- November 23, 2006 – Parties' Agreement on COS, Rate Design, and Other Issues;
- November 23, 2006 – Parties' Agreement on Revenue Requirement; and
- November 23, 2006 – Parties' Agreement on Labrador Interconnected Rates

These Settlement Agreements collectively represent a settlement on the majority of issues that would typically be contested before the Board in a general rate application. Pursuant to the terms of the Settlement Agreements parties consented to the admission to the record of all pre-filed testimony and exhibits pertaining to the subject of the Settlement Agreements without the calling of witnesses for the purpose of cross-examination. The parties recommended that the Board make its determinations on the agreed upon issues in accordance with the proposed resolution of these issues as stated in the Settlement Agreements. With the exception of the Agreement on Labrador Interconnected Rates, to which the Industrial Customers were not a party, the parties also stated that the individual agreements of the parties are not intended to be severable.

Following the filing of these Settlement Agreements the Board re-scheduled the start of the public hearing to Monday, January 22, 2007. On the opening day of the public hearing Hydro made a presentation on behalf of the parties to the negotiation and settlement process, with a particular focus on each of the Settlement Agreements, and the resulting impact on Hydro's Application.

5. Outstanding Issues

The Settlement Agreements set out the following issues as being unresolved:

"a. The Automatic Adjustment Formula;
b. The appropriateness of an Integrated Resource Planning exercise;
c. Reliability policy and initiatives;
d. Peer group benchmarking and Tracking and Reporting of Additional Performance Indicators;
e. Oil Purchasing/Hedging; and
f. Conservation Initiatives"

6. Government Directives

On September 29, 2006 Government issued an Order in Council [OC2006-436] to the Board pursuant to s. 5.1 of the *EPCA*, which directed the Board as follows:

> *"1) The Board of Commissioners of Public Utilities is directed to adopt a policy that, if Newfoundland and Labrador Hydro applies to the Board on or before October 1, 2006 for a change in the Industrial Customers Rate Stabilization Plan which is not on the normal schedule for adjustments to that Plan, such change being associated with the withdrawal of a significant industrial customer and including a contribution to the historic portion of the Plan to offset the implications of this withdrawal, the Board shall approve the application and, if the application is made on or before September 22, 2006, the Board shall apply procedures so that changes in Industrial Customer electricity rates are implemented no later than October 1, 2006; and*
> *2) In this Order in Council, "Rate Stabilization Plan" means those terms of service approved by the Board of Commissioners of Public Utilities for Newfoundland and Labrador under its Order No. P. U. 40(2003) to smooth rate impacts arising from variations between forecast and actual results pertaining to Newfoundland and Labrador Hydro's hydraulic production, fuel consumption, customer loads, and rural rates."*

As contemplated by this Order in Council Hydro applied to the Board on September 22, 2006 for approval of revised 2006 Industrial Firm Energy rates that reflected the following adjustments to the Island Industrial RSP:

a) a revised calculation of the fuel rider to adjust for 2004 test year barrels of No. 6 fuel forecast to be consumed at the Holyrood Generating Station to reflect a reduction in load resulting from the shutdown of Abitibi Consolidated Inc.-Stephenville Division;
b) a modification of the calculation of the Historic Plan RSP recovery rate to reflect a contribution to the plan on account of the shutdown of Abitibi Consolidated Inc.-Stephenville Division; and
c) an adjustment to the Industrial Customer kWh sales to reflect the shutdown of Abitibi Consolidated Inc.-Stephenville Division.

In accordance with the Order in Council the Board issued Order No. P. U. 31(2006) on October 5, 2006, which resulted in a reduction in firm energy rates to Industrial Customers of 7.6% as of October 1, 2006.

On December 6, 2006 Government issued a further Order in Council [OC2006-512] in relation to Hydro's Non-Government Rural Isolated customers pursuant to s. 5.1 of the *EPCA*, which directed the Board:

> *"…to adopt a policy for Non-Government Rural Isolated Domestic and General Service Customers of Newfoundland and Labrador Hydro that:*
>
> *i) any change in rates charged to these customers shall be equal to the change approved for equivalent rate classes of Newfoundland Power customers on or after January 1, 2007;*
>
> *ii) notwithstanding (i), commencing January 1, 2008 rate changes for these customers shall be made in accordance with a two-year plan to be filed with the Board by Newfoundland and Labrador Hydro during 2007 so that by January 1, 2009, rates for these customers shall be those that would have come into effect but for this directive.*
>
> *iii) The provisions of this directive do not apply to rates to be established for these customers following a subsequent general rate application of Newfoundland and Labrador Hydro."*

7. Revised Application

On December 6, 2006 Hydro filed a revised Application (the "Revised Application") incorporating the Settlement Agreements and the Government directives as described above. In the Revised Application Hydro proposed:

1. *"Hydro's forecast 2007 test year costs (before return on rate base) of $320,372,000;*
2. *forecast average rate base for 2007 of $1,489,323,000;*
3. *that the methodology approved by the Board for calculating the allowed rate of return on equity (for purposes of determining weighted average cost of capital) in Order No. P.U. 14(2004) be continued;*
4. *that (consistent with this methodology) Hydro be allowed a rate of return on equity of 4.47%;*
5. *that (consistent with this methodology) Hydro be allowed a rate of return on forecast average rate base of 7.44%;*
6. *that effective January 1, 2007, the Board approve:*
    - *(a) that the demand and energy rates charged Newfoundland Power be changed to a demand charge of $4.00 per Kw per month, with a first block energy rate of 32.46 mills per kWh and an end block energy rate of 88.05 mills per kWh;*
    - *(b) that the total generation credit for Newfoundland Power be reduced to 117,930 Kw;*
    - *(c) that the Cost of Service treatment of Newfoundland Power's thermal generation credit no longer apply to transmission costing and that it no longer impact system load factor calculations;*
    - *(d) that the Rate Stabilization Plan Adjustment rate charged to Newfoundland Power be decreased to 4.25 mills per kWh as result of setting the fuel rider to zero and applying the Hydraulic Variation balance in January 1, 2007 rates;*
    - *(e) that the rate charged to Newfoundland Power for firming up secondary energy purchased from Corner Brook Pulp and Paper Limited and re-sold to Newfoundland Power as firm energy be increased to 8.41 mills;*

(f) that the rates charged to Industrial Customers for firm service be increased to a demand charge of $6.68 per kW per month, an energy charge of 36.76 mills per kWh and the respective annual specifically assigned charges;

(g) that the rates charged to Industrial Customers for non-firm service continue to be calculated in the manner set out in Order No. P.U. 7(2002), with the average system losses decreased to 2.68%, as stated on page 6 of 11 of Schedule B attached to this Application;

(h) that the rate for wheeling energy for non-utility customers be decreased to 3.84 mills per kWh and that the average system losses be decreased to 2.68%;

(i) that the policy outlined in Order No. P.U. 7(2002-2003) of charging rates based on full cost recovery for Government departments and agencies, excluding hospitals and schools, in Isolated Rural Systems, be continued;

(j) that the rates for Labrador Interconnected Customers remain unchanged for 2007 but that in subsequent years, 2008 through to 2011, rate setting continue as outlined in the Labrador Interconnected Rates Agreement filed with the Board;

(k) that the Rules and Regulations which govern the provision of service to Rural Customers be confirmed with the exceptions that:

(i) the rate for the Burgeo school and library be deleted; and

(ii) Sections 16 and 17 of the Rules and Regulations be amended so that all rates paid by Rural isolated customers, excluding Government departments, shall be adjusted between Hydro General Rate Applications to reflect changes made to Newfoundland Power's rates, including changes to rates arising from Municipal Tax and Rate Stabilization adjustments and from Fuel Rider adjustments.

(l) that the Automatic Adjustment Mechanism proposed by Hydro filed with the August 3, 2006 Application as Exhibit MGB-1 in response to the Board's direction in Order No. P.U. 14(2004) be approved;

(m) that the Rate Stabilization Plan be amended to reflect the impact of changes that may arise from time to time from the operation of the proposed Automatic Adjustment Mechanism, as set out in the Rate Schedules 2007, Schedule C page 3 of 10, attached to this Application;

(n) that the Rate Stabilization Plan be amended such that when new test year base rates are implemented, if the fuel rider forecast is more current than the fuel forecast used for the new test year rates, a fuel rider which is calculated using the more current fuel forecast and the new test year values will be implemented at the same time as the change in base rates;

(o) that the Rate Stabilization Plan rules pertaining to the Rural Rate Alteration for Rural Labrador Interconnected Automatic Rate Adjustments be modified to accommodate the change in treatment of the CFB Goose Bay Credit for 2007, with further revisions to be filed with the Board for approval at a future date;

(p) that Newfoundland Power's portion of the December 31, 2006 Rate Stabilization Plan Hydraulic Production Variation Balance be transferred to Newfoundland Power's Historic Rate Stabilization Plan Balance, and that the Rate Stabilization Plan rate charged to Newfoundland Power be reduced to reflect the credit as described in Section F of the Rate Stabilization Plan rules, such that the collection of the reduced Historic Rate Stabilization Plan Balance will be amortized over eighteen (18) months (January 1, 2007 to July 1, 2008); and

(q) that

(i) effective December 31, 2006, the Industrial Customers' Current Rate Stabilization plan balance include the Industrial Customers' portion of the normal annual 25% allocation of the Hydraulic Variation balance; and

(ii) the portion of the Industrial Customers' share of the December 31, 2006 Rate Stabilization Plan Hydraulic Variation balance, net of the normal 25% allocation outlined in (i) above, be used to reduce any charge, or increase any credit, which would otherwise be applied effective January 1, 2008 to the rates of Industrial Customers under the current Rate Stabilization Plan rules.

(r) that the Rate Stabilization Plan rules be amended to include the statement that "References to approved Test Year weighted average cost of capital mean the weighted average cost of capital in Hydro's Test Year Cost of Service study, or as adjusted by the Automatic Adjustment Mechanism."

(s) that Hydro continue to use regulated equity in the calculation of Hydro's capital structure."

The Revised Application proposed an approximate increase of 0.4% to NP, which according to Hydro was expected to be *"almost completely offset by rate adjustments that NP will be applying for in its pass-through application and as a result of its automatic adjustment mechanism."* Rates for Industrial Customers would decrease by a further 13.9% in addition to the 7.6% October 1, 2006 decrease. The proposed 2007 rates for Labrador Interconnected customers would remain unchanged from 2006 levels with increases to be more gradual in the following years than were proposed in the original filing, in accordance with previous Board Orders.

In its Revised Application Hydro proposed, in accordance with Government's December 6, 2006 directive to the Board, that rates for Non-Government customers served from Hydro's Isolated systems be adjusted by the percentage change approved for NP customers on the Island Interconnected system. Adjustments in rates for these customers will be phased in so that, by January 1, 2009, these customers' rates will be the same as they would have been in the absence of the Order in Council.

8. Interim Rates

In its Revised Application Hydro requested approval of final rates, or in the alternative interim rates, for its customers for consumption on or after January 1, 2007. The Board did not approve the request for final rates but accepted the request for interim approval. In Order No. P. U. 41(2006) issued December 14, 2006 the Board approved, on an interim basis, Hydro's proposed rates for NP and for Government Departments in Hydro's diesel service areas. Industrial Customer rates were approved on an interim basis effective January 1, 2007 in Order Nos. P. U. 41(2006) and P. U. 3(2007).

On December 8, 2006 NP filed an application for approval of a revised schedule of rates, tolls and charges to be effective January 1, 2007. This application incorporated the combined impact of (i) the 2007 operation of NP's automatic adjustment formula; (ii) the impact of the change in the wholesale power rate on NP's 2007 purchased power costs; and (iii) the impact of a one-time adjustment to the historical balance to be recovered through Hydro's Rate Stabilization Plan ("RSP") on NP's Rate Stabilization Account. The overall rate impact of all proposed changes was an average increase in customer rates of approximately 0.07% effective January 1, 2007. On December 14, 2006 the Board issued Order No. P. U. 42(2006) approving, on an interim basis, NP's proposed schedule of rates, tolls and charges to be effective on all energy consumed on and after January 1, 2007.

On December 14, 2006 Hydro filed an application seeking approval of revisions to the rates charged to Rural Island Interconnected and Isolated Non-Government Customers. In accordance with the Order in Council, which directed that the changes in rates charged to Non-Government Rural Isolated Domestic and General Service customers shall be equal to the change approved for the equivalent rate classes of NP customers on or after January 1, 2007, the proposed rates were based on NP's rates as filed on December 8, 2006 and approved on an interim basis by the Board in Order No. P. U. 42(2006). On December 19, 2006 the Board issued Order No. P. U. 43(2006) approving, on an interim basis, Hydro's proposed rates for Rural Island Interconnected and Isolated Non-Government Customers to be effective on all energy consumed on and after January 1, 2007.

Also on December 14, 2006 Hydro filed an application for revisions to the Rate Stabilization Plan rules regarding the Rural Labrador Interconnected Automatic Rate Adjustments. These proposed changes were filed in accordance with the November 23, 2006 Agreement on Labrador Interconnected Rates. Under this agreement Hydro was to file with the Board on or before December 15, 2006 the rate plan for the years 2008 through 2011 for the Labrador Interconnected Rural customers so that by 2011, in the absence of a further Order of the Board: (i) rates will be based on the 2007 test year revenue requirement; (ii) uniform rates will be charged to all Rural customers on the Labrador Interconnected system; and (iii) the CFB Goose Bay Revenue Credit will be fully applied to reduce the Rural Deficit. Rates for Hydro's Labrador Interconnected customers for 2007 would remain unchanged at the 2006 levels. On December 22, 2006 the Board issued Order No. P. U. 45(2006) approving, on an interim basis, the proposed rates for Hydro's Labrador Interconnected Customers to be effective for consumption on and after January 1, 2007, which were unchanged from the 2006 rates previously approved by the Board.

9. The Hearing

Oral testimony was heard on January 22, 23 and 25, 2007. Written submissions were filed by Hydro and the registered intervenors on February 9, 2007. Final oral submissions were presented on February 13, 2007.

During the hearing the following witnesses testified:

On behalf of Hydro:

Mr. Ed Martin	President and Chief Executive Officer ("CEO")
Mr. Glenn Mitchell	Manager, Rates and Financial Planning
Mr. Jim Haynes	Vice-President, Regulated Operations
Mr. Rob Henderson	Manager, System Operations and Customer Services
Mr. Mark Bradbury	Corporate Comptroller and Treasurer

<u>On behalf of the Consumer Advocate:</u>

Dr. William T. Cannon	Chair, Faculty Board and Commerce ’83 Teaching Fellow in Finance, Queen’s University School of Business
Mr. C. Douglas Bowman	Energy Consultant

Interested persons and organizations were also given the opportunity by way of public notice advertised in newspapers throughout the Province to submit a letter of comment or make an oral presentation to the Board. Letters of comment were submitted by:

Mr. Curtis Richards, Town Manager, The Town of St. Anthony, St. Anthony, NL
Ms. Holly Walsh, Mayor, Town of Massey Drive, Massey Drive, NL
Mr. Ernest Simms, Private Citizen, St. Anthony, NL
Ms. Pam Bennett, Vice-Chair, Hyron Youth Development Council, Labrador City, NL
Burgeo School – represented by Mr. Michael F. Harrington, Stewart McKelvey, St. John’s, NL, Solicitor for the Western School District

On February 5, 2007 the Board heard oral presentations via video conferencing from Mayor Graham Letto and Mayor Jim Farrell of the Towns of Labrador City and Wabush respectively, and from Mr. Jason Ste. Marie of the Hyron Regional Economic Development Corporation of Labrador West. Supplementary material was also provided by both Towns and Hyron following the presentations.

The Board expresses its appreciation to those persons and organizations submitting letters of comment or making oral presentations. These submissions formed part of the evidentiary record considered by the Board in rendering its decisions on this Application.

II REGULATORY UPDATE

1. Current Industry Structure

The following provides an update to the current industry structure contained in Order No. P. U. 14(2004).

Electrical services in the Province of Newfoundland and Labrador are provided by two utilities, Newfoundland and Labrador Hydro, which is a Crown corporation, and Newfoundland Power Inc. (NP), an investor owned subsidiary of Fortis Inc. Hydro is principally responsible for generation and transmission in the Province, with a relatively small amount of distribution in predominately isolated rural areas. NP operates solely on the Island portion of the Province and is primarily a distribution company with some generating capacity.

Together Hydro and NP supply, transmit and distribute electricity to 264,871 domestic and general service customers. NP's operations on the Island service 229,500 customers or 86.6% of all general service and domestic customers. Hydro serves the remaining 13.4% or 35,371 customers, both on the Island and Labrador, as well as five regulated industrial customers and two non-regulated industrial customers.

There are two major electrical systems operating within the Province. The Island Interconnected system functions as a stand-alone system comprising various hydro-electric developments and thermal power generated at Holyrood. The Labrador Interconnected system is supplied by Churchill Falls and is connected to the North American power grid. The more remote and isolated areas of the Province are serviced by individual diesel generating facilities owned and operated by Hydro.

The table below updates the generation capacity on the Island since Hydro's 2003 general rate application.

Island Generation Capacity (MW)	2003[1]		2007[2]	
Producer	**Capacity**	**%**	**Capacity**	**%**
NLH Island Hydro	927.3	48.13	927.3	48.43
NLH Island Thermal	598.2	31.05	598.2	31.24
NLH Isolated Island	7.6	0.39	7.4	0.39
NP	147.4	7.65	135.6	7.08
Deer Lake Power	121.4	6.30	121.4	6.34
Abitibi Consolidated	58.5	3.04	58.5	3.06
Non Utility	66.3	3.44	66.3	3.46
Total	**1926.7**	**100%**	**1914.7**	**100%**

[1] Order No. P. U. 14 (2004), pg. 14
[2] Forecast as per IC 45 NLH, Schedules JRH-2-III and JRH-2-VII

The net decrease in Island generation capacity is primarily attributable to decreases in NP's generating capacity.

On the Island Hydro has approximately 1,533 MW of installed capacity consisting of 927.3 MW of hydro-electric generation from Bay d'Espoir, Upper Salmon, Cat Arm, Hinds Lake and Granite Canal, 598.2 MW of thermal generation from Holyrood and various gas and diesel units, and 7.4 MW of isolated diesel generation. Hydro also owns 3,742 km of high voltage transmission lines and 3,334 km of distribution lines.

NP's generating capacity is 92.1 MW from its various hydro-electric generating sites and 43.5 MW from thermal generation. NP purchases approximately 90% (4,925.8 GWh forecast for 2007) of its energy requirements from Hydro.

Energy generated by Deer Lake Power and Abitibi Consolidated Company of Canada is used primarily for paper mill operations in Corner Brook and Grand Falls-Windsor respectively. In situations where energy production exceeds operational requirements at the mills, Hydro will purchase the excess for the Island grid. Under agreements Hydro also purchases power from four Non Utility Generators: the Star Lake Hydro Partnership (15 MW); Algonquin Power (4 MW); Corner Brook Pulp and Paper Limited (15 MW); and the Exploits River Hydro Partnership (32.3 MW).

On the Island system NP operates in the majority of areas excluding the South Coast, Little Bay Islands and St. Brendan's. In these areas service is supplied by Hydro using six isolated diesel generation and distribution systems. Service is supplied to the Great Northern Peninsula by Hydro through the Island Interconnected system.

In Labrador Hydro provides service to all customers. Power is purchased (2,362 GWh in 2006) from Churchill Falls to supply the Labrador Interconnected system consisting of the Towns of Labrador City and Wabush and the Happy Valley-Goose Bay area. In isolated coastal areas Hydro operates 15 diesel generation facilities with a combined capacity of 22.5 MW. Hydro also buys a small amount of energy from a private company in Mary's Harbour and secondary energy, when available, for the L'Anse au Loup system from Hydro Quebec's Lac Robertson hydro plant.

The interconnected systems of the Island of Newfoundland and of Labrador, as well as the isolated systems of both these regions of the Province, are shown on pgs. 13 & 14 respectively.

It should also be noted that Hydro is actively exploring the potential for wind energy as a future source of generation supply for the Island Interconnected system. This initiative has resulted to date in one operating project at Ramea with installed wind capacity of 390 kW. Furthermore Hydro has announced a pilot project for this Ramea site to investigate integrating wind power with hydrogen and diesel generation as a means of supplying electricity to remote communities. In addition, Hydro recently awarded two separate contracts for wind energy projects located at St. Lawrence (25 MW) and Fermeuse (24 MW).

(Pre-filed Evidence, J. R. Haynes, Schedule 2-I August 2006)

T.R.O. Communities Served by Interconnected Systems & Diesel Systems

(Pre-filed Evidence, J. R. Haynes, Schedule 2-VI, August 2006)

2. Regulatory Framework – Negotiations and Settlement Process

Beginning with Order No. P. U. 7(2002-2003) the Board has made it a practice to outline the overall framework applied by the Board in the regulation of utilities, both Newfoundland and Labrador Hydro and Newfoundland Power. This regulatory framework is referenced in Appendix A and incorporates the Board's statutory authorities and responsibilities, jurisprudence, established Board procedures and reporting/compliance requirements of utilities, along with a list of governing regulatory principles and a description of the rate setting process. The Board believes clarity, consistency, efficiency and transparency are essential cornerstones to sound and effective regulation. This framework remains a stable, useful and predictable roadmap for stakeholders participating in the regulatory processes of the Board. The Board will continue to rely on this regulatory framework but acknowledges revisions may be required from time to time to encompass legislative amendments and/or changes to Board policies, practices or procedures. As part of the Board's continuing efforts to update and improve the efficiency of its regulation, the Board will avail of the opportunity presented by this proceeding and examine the factors contributing to the success of the negotiations and settlement process. Such an examination may serve to assist participating parties with future negotiations and possibly contribute to a further streamlining of the Board's regulatory framework.

The parties expressed enthusiastic support for the settlement process as a means of seeking common ground and providing a mechanism to jointly explore creative, flexible, practical and compromise solutions that otherwise may not be achievable through a formal, fully contested public hearing. In addition, all parties acknowledged the benefits of the process in contributing to improved regulatory efficiency and reduced regulatory costs. There was a consensus that the success of this particular effort can be attributed to the willingness and cooperation of the parties to negotiate in good faith. Credit was also given to the Board appointed facilitator, Mr. Mark Kennedy, as being instrumental to the success experienced. While parties concluded the negotiations were not easy and still required considerable information exchange and commitment of time and resources, the outcomes realized were seen as beneficial to the various stakeholders and support for the continuing use of the settlement process was encouraged. All parties acknowledged that, despite their endorsement of these negotiated agreements, the Board retains independent jurisdiction to accept or reject any agreement to ensure the appropriate balancing of interests and compliance with legal and regulatory imperatives. Furthermore, Hydro suggested that the outcomes of each agreement should be considered collectively rather than on an issue by issue basis, recognizing that the Board may have reached a somewhat different set of individual decisions in a fully contested evidentiary hearing.

More specifically, some of the comments made by each of the parties concerning the negotiations and settlement process are as follows:

<u>Hydro</u>

(Mr. Young) The result of negotiations is a rate case that has been all but completely agreed upon between the applicant and the intervenors. This means that a rate hearing that might have typically taken months may this time be completed within a week. This settlement has enabled Hydro to pass onto its customers savings in regulatory costs. It's something that we're quite proud of at Hydro.

We are very grateful to the Board for its guidance and patience in these negotiations and to the Consumer Advocate, our Industrial Customers, and to Newfoundland Power for their hard work, sense of fair play in the results oriented engagement and through their foresight to see that their clients and the consumers they represent could be assured of a fair outcome through cooperation and the creative seeking of common ground.
(Transcript, Jan. 22, 2007, pgs. 19/23-25; 20/1-16)

(Mr. Young) While settling a rate case requires less resources, time and money than a fully contested hearing, I am here to tell you that it has not been easy. It does require an extensive amount of work, in some ways comparable to fighting it out before the panel.
(Transcript, Jan. 22, 2007, pg. 20/17-23)

Consumer Advocate

(Mr. Johnson) Negotiation processes, such as those employed successfully in this case, are rightly to be encouraged, even though they won't, in all cases, produce agreements which are as comprehensive as those that the parties, with the assistance of the Board appointed facilitator, Mr. Mark Kennedy, were finally able to reach in this case. In fact, as the Board recognizes, alternative dispute resolution processes are a vital component of modern public utility regulation; regulation, which at its heart, seeks to balance the interest of consumers with those of the utility.
(Transcript, Jan. 22, 2007, pgs. 28/25; 29/1-13)

(Mr. Johnson)…Such negotiations and discussions are by no means easy, as they are still, of course, taking place amongst parties with various and sometimes competing interests. However, the good faith engagement of all parties gave rise to reasoned consensus on a number of issues. The process, I should also say, was more conducive to identifying practical solutions to the problems than is often the case within the context of more traditional adversarial hearing processes. In my judgment, consumers have reaped a benefit from this process.
(Transcript, Jan. 22, 2007, pgs. 29/22-25; 30/1-9)

Industrial Customers

(Mr. Hutchings) The process of negotiation that we undertook, I think, allows a great deal of flexibility in the solutions that can be put forward, which go beyond what we would normally expect the Board to be in a position to order or direct, and I think that is one of the great advantages of that system.

I must say, for the Board's benefit, that throughout the entire process, there was always an overriding concern that whatever the parties agreed to, the Board ultimately needed to be in a position to be able to approve an order and know that the proper scrutiny had been given to all of the information and issues before the Board could feel comfortable in approving whatever came out of this process, and that was a constant theme throughout the negotiations, not in the sense of any sort of threat to the proceedings at all, but simply in the sense that we needed to continue to be constantly aware of the Board's role and to try to ensure that as far as possible, Board staff were kept in the loop, shall we say, and that the parties didn't go off on tangents that the Board would not be able to deal with.
(Transcript, Jan. 22, 2007, pgs. 36/13-25; 37/1-13)

Newfoundland Power

(Mr. Kelly) …To the best of my knowledge this is the first time in this jurisdiction that a settlement agreement has been reached with respect to a utilities revenue requirement. The negotiated settlement of the various issues reflected in the four agreements represents a significant advancement for the regulatory process in this jurisdiction. In other Canadian and North American jurisdictions negotiated settlements are

an accepted part of the regulatory framework. Negotiated settlements are consistent with sound public utility practice. They result in regulatory efficiency, thereby facilitating benefits for all parties and, most importantly, for customers.
(Transcript, Jan. 22, 2007, pgs. 41/14-25; 42/1-4)

The concept of Alternative Dispute Resolution (ADR), which incorporates the settlement process as one of its tools, has been actively pursued by the Board in the past. The most recent general rate applications of both NP and Hydro utilized mediation and technical conferences involving all participating parties as a means of reaching consensus, albeit on a more modest list of proposals than resulted from this effort. In addition, successive capital budgets of each utility over the past two years have been considered without a public hearing using provisional capital budget guidelines developed by the Board in concert with the Consumer Advocate, the Industrial Customers and the utilities. Another example of improved regulatory efficiency includes simplifying the proceedings by identifying certain technical and highly complex issues which can appropriately be addressed in a different type of process, usually involving a technical conference and often negotiation/mediation style processes, and sometimes involving deferral of the issue to a separate proceeding where participants' focus can be brought to the matter. This was the case in this proceeding when the Board determined that the depreciation issue would be addressed in a separate process. Deferral of these kinds of complex and time consuming issues allows the consideration of the application to proceed in a more expeditious manner. Procedural streamlining, ADR initiatives and reduced regulatory costs will continue to be key objectives of the Board in other avenues of its regulatory responsibilities.

The extent of the regulatory efficiencies arising from the negotiated settlement agreements in this rate application are significant as reflected in the following comparative outcomes:

GRA	No. of Requests for Information (RFI's)	No. of Hearing Days
NLH 2001	1,415	61
NLH 2003	1,520	35
NLH 2006	643	5

While total regulatory savings are not available, specific references were made during the hearing to the magnitude of costs savings in this proceeding:

- *"Hydro agreed to overall reduction of operating expenses of $1 million which includes an estimated savings in regulatory costs of $250,000 in 2007."*
  (Final Argument, NLH, pg. 6/4-6)

- *"…The Industrial Customers' own costs of participation in the settlement conference were considerably less, $300,000 less, than what they had been in the 2003 GRA. So a 50 percent, less than 50 percent of the cost."*
  (Transcript, Feb. 13, 2007, pg. 67/1-6)

The Board shares the view that the negotiations and settlement process in this proceeding was a successful endeavour. The Board commends the resourcefulness and commitment demonstrated by the parties to make the process work. The Board appreciates the fact that these same outcomes or results will not be achievable in every general rate application but acknowledges that this process is only one of many regulatory tools that may be necessary to bring resolution to the myriad of issues contained in a utility's general rate application. The Board, however, is prepared to support and encourage the use of the negotiation and settlement process and other approaches in future general rate applications as a means of initially testing the level of engagement by the parties on specific issues. The Board believes it has an obligation to promote an environment which enhances opportunities for regulatory efficiency and, furthermore, that it is incumbent on parties to strive to maximize these opportunities on behalf of their clients/stakeholders.

Bearing this in mind, and with this being by far the most successful experience to date in reaching negotiated settlement agreements among the parties, the Board is interested in reviewing the key factors contributing to this overall success and the lessons learned.

In final argument NP summarized four key success factors, which were also noted at times by other parties during the course of the hearing. These are as follows:

1. Commitment of the parties to work hard at the process is essential in order to constructively resolve matters at issue.
2. Meaningful negotiation requires important information be exchanged among the parties whether in the form of application data, expert reports or information requests. This information continues to remain a critical part of a negotiated settlement process and/or ultimately in a test of the matter before the Board.
3. The negotiation process must provide sufficient time and have adequate structure to move forward in an appropriate fashion. Negotiations require more than just a few days and should allow for both common and separate meetings among the parties.
4. The Board appointed facilitator plays an important role in advancing the process and reporting on progress.

In considering additional lessons learned regarding the negotiations and settlement process the Board offers the following comments:

- The panel, which is ultimately responsible for the procedures, timing and scheduling, should receive appropriate updates on the negotiation process to enable efficient and timely oversight of the entire proceeding.

- Notwithstanding the negotiated agreements reached among the parties, the Board maintains and reserves the right to disagree on issues which violate established regulatory principles or are in conflict with the regulatory framework of the Board. On a go-forward basis it is critical that the regulatory framework governing the operations of the Board be sound, consistent, transparent and understandable and not be subject to compromise to serve the collective or separate interests of the parties.

- A successful settlement process generally begins with the careful identification of those issues which are appropriate to negotiate and those which are best considered in

> a full hearing or some other context such as a technical conference. Often issues involving technical and complex matters can be time consuming and elicit controversy in a negotiation which may jeopardize agreement on the more fundamental issues contained in a general rate application.

In conclusion, the Board is encouraged by the results of the negotiations and settlement process and believes it will serve as a valuable tool to be expanded and structured as required to meet the varying regulatory needs of the Board and its stakeholders. A number of useful lessons have been learned through the success experienced during this particular exercise, which will contribute to further enhancements to ensure the process becomes an integral part of the Board's regulatory framework.

3. Regulation of Hydro

In Order No. P. U. 7(2002-2003) the Board noted the related application represented Hydro's first general rate application in ten years and its first as a fully regulated utility. The Board indicated that the application presented a host of regulatory challenges impacting a variety of stakeholders, including Hydro, its domestic/general service customers and Industrial Customers, Government and others. The Board acknowledged it would take time to address these challenges and lay the groundwork for the effective regulation of Hydro.

In Order No. P. U. 14(2004) the Board commented on a number of items impacting the regulation of Hydro. Among them the Board noted several public policy considerations which if addressed, may mean greater regulatory stability for Hydro going forward. In particular, the Board's statutory obligations under the *EPCA* were referenced in light of Government's recurring exemptions of new sources of supply and the resulting impact on rates.

During this hearing issues related to future planning and supply were also raised in the context of discussion regarding the commencement of work on an Integrated Resource Plan (IRP) given the scheduled release of the Province's Energy Plan. The proposed IRP is intended to address future supply issues and is dealt with by the Board in Part II – Section VII of this Decision and Order. Other relevant public policy considerations concerning Hydro may also be addressed with the release of the Province's Energy Plan including corporate governance, financial structure and regulation. The Board is encouraged by the proposed release of the Energy Plan currently planned for the first half of 2007 and is hopeful that this blueprint will serve to clarify some of the more pertinent policy issues affecting the regulation of Hydro.

In both its prior Orders the Board indicated its goal of establishing a proactive and sustainable policy of regulatory decision-making and oversight of Hydro. Conceptually this is the same methodology applied by the Board regarding the treatment of NP as a fully regulated utility. The focus of this approach relies on the utility to exercise sound judgment in the governance and management of its operations while enabling performance to be appropriately evaluated by the Board in fulfilling its mandated obligations regarding the supply of reliable and least cost power throughout the Province. In this way, full and complete managerial discretion is accorded the operations of the enterprise and the Board is supplied with the necessary data to monitor performance and ensure its regulatory responsibilities are met.

In this regard Order No. P. U. 7(2002-2003) stated:

"The Board believes the onus is on NLH to bring forward measures which clearly demonstrate the efficiency of its operations. This perspective was not presented into evidence before the Board in any of the normal business performance measures, either overall corporate performance, cost efficiencies or business unit accountability. There was also no indication that NLH had any of these performance measures/targets/objectives built into its existing business systems or was contemplating their implementation in relation to the strategic or business planning exercise currently underway."

As a follow-up in Order No. P. U. 14(2004) the Board noted:

"The linkage between sound planning and performance, more appropriately called accountability, is a key element in the regulatory oversight by the Board. This linkage remains a concern of the Board in this Application as it was previously. Now that suitable performance measures have been established and other strategic components are in place within NLH, the Board feels the timing is right to bring these pieces together into an appropriate regulatory accountability and reporting framework. The Board acknowledges that this process is substantial but should serve the interests of both NLH and the Board."

Because of these expressed concerns the Board was very prescriptive in requiring Hydro to develop internal and external ("peer group") KPI's, a report describing how strategic goals/targets were to be linked to performance measures/outcomes within the organization, and enhanced annual reporting on a host of operating (including KPI's) and financial data, both historic and forecast.

In conformance with these requirements, a report on established KPI's internal to Hydro has been filed with the Board each year beginning in March 2005. As outlined in Part II – Section VII of this Decision and Order the development of "peer group" KPI's has been difficult. A report entitled "Strategic and Business Planning Process for Newfoundland and Labrador Hydro" was filed with the Board in December 2004. A separate report on Hydro's strategic goals, objectives and commensurate results has also been filed with the Board each year beginning in March 2005. In addition, as part of this proceeding Hydro filed various financial projections of its regulated activities from 2007 to 2011. (CA 212 NLH) Hydro also files an annual return containing its audited financial statements, an annual capital budget application, and a variety of other routine and compliance filings, as directed by the Board.

Recognizing that Hydro's organization, including its Board of Directors and in particular its executive and senior management, has undergone extensive change since the last general rate application and the issuance of Order No. P. U. 14(2004), Chair Noseworthy asked several questions of Mr. Ed Martin, President and CEO of Hydro, addressing the planning and performance mechanisms employed by the organization under his leadership. Mr. Martin confirmed that the development of KPI's to track costs is central to the implementation of their maintenance planning activities. He indicated Hydro was investing some time in the proper development of these key performance measures but that substantially improved KPI's should be in place by February 2007. Mr. Martin noted this exercise also included Hydro's corporate objectives, departmental vice-president objectives, as well as personal performance objectives.

Mr. Martin described in detail the planning process within Hydro and suggested he spends a massive amount of his time on the planning cycle with the vice-presidents. Mr. Martin outlined a highly consultative process of goal setting which engages all levels of the organization from tradespeople and utility workers in rural areas through to supervisors and management and involves the union (IBEW) executive as part of the leadership team overseeing the planning exercise. A five-year set of corporate objectives flows from this process with the first year locked down in the form of performance contracts with the vice-presidents, who then replicate these contractual accountabilities within their own respective management groups. Mr. Martin observed accountability contains both behavioral and technical components within Hydro and vice-presidents have the autonomy to manage their own business units. Monthly performance meetings are held with vice-presidents and related accountability and decision-making is shared through the leadership team although final authority resides with the President and CEO should this prove necessary.

The Board is encouraged by the planning and accountability processes described by Mr. Martin. Emerging from these rigorous processes, as indicated by the President and CEO, will be a five-year planning horizon, a clear set of corporate objectives, and key indicators to measure performance throughout the organization. The appropriate regulatory reporting of this information, both historic and forecast, will go a long way toward the maturation of the regulation of Hydro by the Board. The Board believes Hydro is on the right track with its planning and accountability processes and acknowledges that, given the management transition, it may take time to more fully evolve data from these processes which may prove useful to the Board in regulating Hydro. The Board will not be requiring any reporting in addition to that currently being required from Hydro of strategic priorities/objectives or financial/operational KPI's as a result of this Decision and Order. The Board is interested in pursuing with Hydro ways to further improve its regulatory reporting based on the comprehensive nature of the planning and accountability systems which, over the next year or so, are likely to be fully tested and operational.

PART TWO. BOARD DECISIONS

1. COST OF SERVICE

The October 20, 2006 Agreement on Cost of Service, Rate Design and Rate Stabilization Plan stated that all parties consider that the cost of service study filed by Hydro is in compliance with Board Orders regarding the use of embedded cost of service studies as a guide in determining the revenue requirement to be applied to each customer class. All parties also agreed on the cost of service methodologies in Exhibit RDG-1 ("2007 Forecast Cost of Service") with respect to Functionalization, Classification and Allocation, with the exception of: i) the treatment of customer owned generation and related matters, or issues arising as a result of any changes made to the current treatment of customer owned generation; and ii) the calculation and application of specifically assigned charges to customers.

In the November 23, 2006 Agreement on Cost of Service, Rate Design and Other Issues the parties advised that agreement had been reached on the outstanding cost of service issues relating to customer owned generation and specifically assigned charges. With respect to customer owned generation the Agreement proposed that:

> *"Consistent with recommendations in Exhibit RDG-2 (Review of Newfoundland and Labrador Hydro's Treatment of Newfoundland Power's Generation), NP will continue to receive a credit for its hydro and thermal generation in the cost of service study as proposed in the Application with two modifications, as follows:*
>
> a. *the impact on system load factor of the existing thermal credit mechanism and its resulting change in cost classification will no longer form part of the compensation; and*
> b. *compensation for transmission relating to NP thermal will be discontinued such that NP's common transmission cost allocation is not reduced."*

With respect to the calculation and application of specifically assigned charges to customers the Agreement stated:

> *"All Parties agree on the cost of service methodologies in Exhibit RDG-1 ("2007 Forecast Cost of Service") with respect to Functionalization, Classification and Allocation and in particular, but without limiting the generality of the foregoing, the calculation and application of specifically assigned charges to customers as proposed therein."*

The Agreement also dealt with the impact on NP's 2007 load forecast of a planned generation outage, stating:

> *"All Parties acknowledged that owing to a major generation outage planned for Newfoundland Power's Rattling Brook Generating station in 2007, Newfoundland Power's hydro generation for 2007 is forecast at 381.4 GWh compared to a long-term average of 419.6 GWh, a reduction of 38.2 GWh. The Parties agreed that Newfoundland Power's load forecast for the cost of service in Test Year 2007 shall be reduced by 38.2 GWh compared to Hydro's filing in order to reflect long-term average hydro output."*

The Board has reviewed the cost of service as filed by Hydro in its Revised Application and finds that the proposals reflect the Settlement Agreements and are in accordance with previous Board orders and established regulatory practice concerning the use of embedded cost of service studies in determining the revenue requirement to be applied to each customer class.

The Board accepts the 2007 test year cost of service as filed by Hydro in its Revised Application as the basis for final rates.

II. REVENUE REQUIREMENT

The November 23, 2006 Agreement on Revenue Requirement stated that the parties had reached consensus on all revenue requirement issues (the "Consensus Revenue Requirement"). It was proposed that the Consensus Revenue Requirement be incorporated into Hydro's revised cost of service study and that rates should reflect the terms of this Agreement, to be effective January 1, 2007.

As set out in the Agreement, the parties agreed to the following issues with respect to Hydro's proposed revenue requirement as filed in its August 2006 Application and which was the subject of a number of Requests for Information from the parties and the Board:

"*a.* *There will be a correction of an error in the calculation of NP's Coincident Peak (Reference IC 41 NLH).*

b. *There will be a correction of an error in the Cost of Service calculation of specifically assigned charges (Reference IC 34 NLH).*

c. *Boiler and machinery insurance expense will be reduced by $167,000 from the GRA filing based on quotes received subsequent to filing of Hydro's Application (Reference CA 150 NLH-1st Revision-October 25, 2006).*

d. *Equipment Rental expense will be reduced by $150,000 (Reference NP 13 NLH)."*

With respect to issues for which more recent actual or forecast data is available the Agreement sets out the following required updates to be reflected in the revised cost of service study:

"*a.* *The Holyrood No. 6 fuel expense will be updated to reflect the oil market price forecast from the PIRA Energy Group as of September 25, 2006 (including applicable exchange rates), which reflects a monthly average price for No. 6 fuel in 2007 of $55.38 (Cdn) per barrel, and also the impact of a more recent forecast of the opening January 1, 2007 inventory price of $50.91. The forecast average monthly price for No. 6 fuel in Hydro's original filing was $56.59 and the opening inventory price for 2007 was projected to be $57.20.*

b. *The No. 2 fuel expense, as well as isolated power purchases linked to No. 2 fuel prices, will be updated to reflect the oil market price forecast from the PIRA Energy Group as of September 25, 2006 (including applicable exchange rates).*

c. *Island interconnected purchased power costs which have fuel adjustment clauses will be updated to reflect the oil market price forecast from the PIRA Energy Group as of September 25, 2006 (including applicable exchange rates).*

d. *Loss on disposal of fixed assets will be updated to reflect a 2007 forecast loss of $1,366,000, a $304,000 reduction from the original filing of $1,670,000.*

e. *Regulated portion of interest earned on overdue accounts will be incorporated into the weighted average cost of capital calculation for 2007.*

f. *In light of the fact that discussions between Hydro and others are still ongoing, the deficit of $380,000 related to providing service to the community of Natuashish (ref: NP 169 NLH) will be excluded from the 2007 test year. The Parties consent to Hydro deferring the recovery of any costs incurred by Hydro in providing service to Natuashish until the matter is dealt with by the Board on a subsequent application by Hydro.*

g. *Hydro's 2007 forecast interest charges on new long term debt will be updated to reflect the actual 4.30% interest rate incurred on the $225,000,000 bond issued by Hydro on October 13, 2006. Interest was forecast in Hydro's original filing to be 5.0%.*

h. *For the purposes of determining the weighted average cost of capital for the 2007 test year, return on equity is forecast at 4.47%. Return on equity was forecast in Hydro's original filing to be 5.2%.*

i. *The forecast average interest rate for promissory notes for the 2007 test year will be changed to 3.86%. The 3.86% average interest rate includes a credit spread of 20 basis points. Interest on short-term debt, including a credit spread of 20 basis points, was forecast in Hydro's original filing to be 4.11%.*

j. *Revenue requirement will be updated to reflect the announcement by the Government of Newfoundland and Labrador of an extension to the suspension of dividends to April 1, 2008.*

k. *The rate base impacts of all of the above items will be incorporated into Hydro's rate base."*

With respect to other issues the following was also agreed upon:

"a. *For rate setting purposes:*

i *the forecast 2006 capital expenditure used in the original filing, and the 2007 capital expenditure, based on the approved 2007 Capital Budget, shall be reduced by 5%, and otherwise the approved 2007 Capital Budget shall be substituted for the Capital Budget proposed by Hydro for all purposes of Hydro's application.*

ii. *using the most recent historical 10-year average, the forecast 2007 transmission losses will be rounded down by 0.1% and the cost of No. 6 fuel for the Island interconnected system will be reduced accordingly in the Revised COSS.*

iii. *the forecast 2007 capitalized salaries will be increased by $250,000 resulting in a corresponding decrease in operating costs.*

iv. *of the forecast 2007 demand side management expenditure of $500,000, an amount of $250,000 (representing the forecast cost of a DSM study) will be deferred and amortized over a period of 5 years, commencing January 1, 2007.*

v. *an overall expense reduction of $1,000,000 will be incorporated into Hydro's cost of service, which reduction includes an estimated savings in 2007 of $250,000 related to the amortization of the costs associated with the 2006 GRA rate hearing."*

The parties agreed that *"all other revenue requirement issues will be as filed in Hydro's evidence unless adjusted by the Parties' Agreements dated October 20, 2006 (COS Agreement) and November 23, 2006 (COS, Rate Design and Other Issues Agreement and Labrador Interconnected Rates Agreement)."* Hydro's Revised Application incorporated the agreements on revenue requirement issues.

In its January 12, 2007 Supplementary Report (pg. 2) Grant Thornton confirmed that the revised forecast 2007 test year revenue requirement (before return on rate base) of $320,372,000 appropriately incorporates the impact of the agreed changes as per the Settlement Agreements. The following table shows the change in the 2007 test year revenue requirement from Hydro's

August 2006 filing to the December 2006 filing as a result of the Settlement Agreements outlined above.

NLH Revenue Requirement					
Description	**2004 Test Year Revenue Requirement (Cost of Service)[1] $(000)'s**	**August 2006 Filing[2] $(000)'s**	**December 2006 Filing[2] $(000)'s**	**Variance[2]** $	%
Revenue					
Revenue from Rates	357,225	441,374	429,058	(12,316)	-2.8%
Other Revenue	1,928	2,021	2,021	0	0.0%
Total Revenue	359,153	443,395	431,079	(12,316)	-2.8%
Expenses					
Operating Expenses					
Salaries and Fringe Benefits	55,638	59,312	58,457	(855)	-1.4%
System Equipment Maintenance	17,440	20,799	20,579	(220)	-1.1%
Insurance	2,019	2,123	1,881	(242)	-11.4%
Transportation	1,759	2,029	1,994	(35)	-1.7%
Office Supplies Expenses	1,913	2,109	2,106	(3)	-0.1%
Building Rentals and Maintenance	894	851	825	(26)	-3.1%
Professional Services	4,453	4,668	4,418	(250)	-5.4%
Travel Expenses	2,395	2,499	2,332	(167)	-6.7%
Equipment Rentals	1,756	1,524	1,369	(155)	-10.2%
Miscellaneous Expenses	4,185	4,765	4,530	(235)	-4.9%
Cost Recoveries	(1,858)	(2,899)	(2,199)	700	-24.1%
Allocated to non-regulated customer	(2,619)	(2,897)	(2,874)	23	-0.8%
Net Operating Expenses	87,975	94,883	93,418	(1,465)	-1.5%
Fuels					
No. 6 fuel	83,609	142,488	136,867	(5,621)	-3.9%
less: RSP deferral		(38)	0	38	0.0%
Diesel and other	7,558	13,164	11,568	(1,596)	-12.1%
Total fuels	91,167	155,614	148,436	(7,178)	-4.6%
Purchased Power	33,594	38,348	38,327	(21)	-0.1%
Depreciation	35,648	40,762	40,191	(571)	-1.4%
	248,384	329,607	320,372	(9,235)	-2.8%
Return on Rate Base	110,769	113,788	110,707	(3,081)	-2.7%
Average Rate Base	**1,483,506**	**1,491,184**	**1,489,323**	**(1,861)**	**-0.1%**

[1] Pre-filed Evidence, M. G. Bradbury, Schedule III, Page 2 of 2, Aug. 2006
[2] Revised Application, Schedule A, pg. 2 of 6, Dec. 2006

The Board has reviewed the components of the forecast 2007 test year revenue requirement as initially filed by Hydro, in conjunction with the evidence on the record and the proposed changes to the revenue requirement. The Board notes that the total forecast 2007 test year costs (before return on rate base) to be recovered from ratepayers has been reduced significantly from $329,607,000 to $320,372,000, a decrease of $9,235,000. This is a positive result for all electricity consumers in the Province and will result in lower rates than initially proposed by Hydro. The Board also notes that Hydro's President and CEO testified that Hydro's revised filing, which is based on the Settlement Agreements and includes the revised 2007 test year revenue requirement, would provide stable rates over the short term for consumers in the

Province and would not negatively impact Hydro's financial stability. (Transcript, Jan. 22, 2007, pg. 116/13-25) The Board is satisfied that the proposed forecast 2007 test year revenue requirement as revised by the Settlement Agreements achieves a fair balance between the interests of consumers and Hydro and that it should be accepted as filed.

The Board accepts the proposed 2007 test year costs of $320,372,000 (before return on rate base) as filed by Hydro in its Revised Application.

III. RATE STABILIZATION PLAN (RSP)

1. Application Proposals

In Order No. P.U. 14(2004) the Board directed that Hydro file a report on the operation of the RSP for the period January 1, 2004 to December 31, 2005. This report was filed with the Board on June 30, 2006. As part of the report Hydro proposed several changes to the RSP, including the addition of a provision regarding variations in diesel fuel costs and a change to allow the use of updated fuel rider forecasts when new test year base rates are implemented.

In its August 2006 Application Hydro requested that the Board approve the changes as set out in its June 30, 2006 report. Hydro also proposed to change the treatment of NP's allocated share of the CFB Goose Bay Revenue Credit whereby NP's portion of this credit would be removed from NP's base rates and refunded to NP through its RSP based on secondary revenue. The Application also proposed changes to the RSP to reflect the operation of the proposed annual automatic adjustment mechanism for Hydro's rate of return on rate base.

2. Settlement Agreements

The October 20, 2006 Agreement on Cost of Service, Rate Design and Rate Stabilization Plan proposed that the current provisions of the RSP continue as approved for all hydraulic, fuel and load related components and all recovery-related calculations. The parties also agreed with Hydro's proposal that *"when new test year base rates are implemented, if the fuel rider forecast is more current, a fuel rider which incorporates the new forecast should be implemented at the same time as the change in base rates."* Proposed changes to the RSP dealing with variations in diesel fuel costs and the CFB Goose Bay Revenue Credit, and the disposition of the forecast hydraulic production variation balance in the RSP were not agreed upon. This Agreement proposed that a review process be initiated by Hydro to examine the re-design of the RSP to better meet design objectives. This review is intended to include, but not be limited to:

- *i.* *Definition of the design objectives against which the current RSP and all proposed modifications will be evaluated.*
- *ii.* *A review of the necessity of a load variation component of the RSP, given potential changes to Industrial Customers rates to reflect marginal fuel costs.*
- *iii.* *Modification of the RSP to enhance the price signal for marginal consumption by ICs and NP.*
- *iv.* *Simplification of the RSP by separately tracking provisions not related to the hydraulic and fuel price components of the plan through an accounting mechanism discrete from the RSP.*

The parties agreed that *"As soon as practicable following the conduct of the review of the IC rate design and re-design of the RSP, and in no event later than October 31, 2007, Hydro shall host a Technical Conference, to be attended by the Parties and others as determined by the Parties, to further discuss the IC rate design and the re-design of the RSP."*

In the November 23, 2006 Agreement on COS, Rate Design and Other Issues the parties agreed that Hydro's proposals related to the treatment of NP's allocated share of the CFB Goose Bay Revenue Credit and the recovery of additional rural diesel fuel and power purchase costs would be withdrawn and added to the list of issues to be addressed as part of the proposed RSP review. The current treatment of the CFB Goose Bay Revenue Credit would continue for the purpose of this Application, except to the extent modified by the Agreement on the Labrador Interconnected Rates.

The November 23rd Agreement on Labrador Interconnected Rates proposed that a sufficient portion of the CFB Goose Bay Revenue Credit be used to maintain existing rates paid by Rural customers on the Labrador Interconnected system for 2007. The revenue shortfall to Hydro from maintaining existing rates will be recovered through the RSP. The RSP rules pertaining to the Rural Rate Alteration (Rural Labrador Interconnected Automatic Rate Adjustments) will be modified to reflect this proposal and to facilitate the phasing in of the CFB Goose Bay Revenue Credit for secondary energy sales to reduce the Rural Deficit. Hydro will submit the modified RSP rules to the Board for approval.

The November 23, 2006 Agreement on Revenue Requirement set out the parties' agreement on the disposition of the RSP Hydraulic Production Variation Balance. With respect to NP's portion of this balance the Agreement stated:

"i. Effective December 31, 2006, Hydro will transfer Newfoundland Power's portion of the actual RSP Hydraulic Production Variation Balance as of December 31, 2006 (in total, currently forecast at $20,700,000) to Newfoundland Power's Historic RSP Balance.

ii. Effective January 1, 2007, Hydro will decrease the RSP rate charged to Newfoundland Power commensurate with a reduction in Newfoundland Power's Historic RSP Plan Balance. For the purposes of setting the new RSP rate, the reduction in Newfoundland Power's Historic RSP Balance will be calculated by deducting Newfoundland Power's portion of the forecast $20,700,000 RSP Hydraulic Production Variation Balance from Newfoundland Power's Historic RSP Balance. This will enable Hydro to amortize the collection of the reduced Historic RSP Balance over the eighteen (18) months (January 1, 2007 to July 1, 2008) and recognizes that RSP rates will again be reset on July 1, 2007 in accordance with the normal operation of the RSP.

iii. Effective January 1, 2007, Newfoundland Power will reduce the RSA adjustment it charges its customers to reflect the change in the RSP rate charged to Newfoundland Power".

With regard to the RSP Hydraulic Production Variation Balance for Industrial Customers the Agreement stated:

"i. The normal annual 25% allocation of the Industrial Customers' share of the actual RSP Hydraulic Balance as of December 31, 2006 (in total, currently forecast at $20,700,000) shall be incorporated into customer rates effective January 1, 2007 in accordance with the existing RSP rules, and

ii. the portion of the Industrial Customers' share of the actual RSP Hydraulic credit balance, net of the allocation outlined in (i) above, shall be transferred, effective December 31, 2006, to the Industrial Customers' Historic RSP and used to reduce any *charge, or increase any credit, which would otherwise be applied effective January 1, 2008 to the rates of Industrial Customers under the current RSP rules".*

3. Revised Application

In the Revised Application Hydro seeks approval of changes to the RSP which reflect the Settlement Agreements. Hydro filed a further application with the Board on December 20, 2006 seeking approval of the revisions to the RSP rules to reflect the intent of the December 6, 2006 Government Directive related to rural rate alterations, the Settlement Agreements and the Revised Application.

In Order No. P. U. 46(2006) the Board did not approve all of the proposed changes but granted those which were appropriate in the context of the approval of interim rates effective January 1, 2007. Specifically, the Board approved on an interim basis:

i. Changes to the monthly amount of the 2007 automatic rate adjustment for the Rural Labrador Interconnected system resulting from the phase-in of the CFB Revenue Credit from secondary sales to CFB Goose Bay to the rural deficit, leaving the CFB Revenue Credit applied to the rural deficit in Hydro's final 2007 test year cost of service and future years to be determined later by final Order of the Board; and

ii. The use of a reserve account to maintain the December 31, 2006 RSP Hydraulic Variation balance, net of the normal 25% December 31, 2006 allocation, with normal RSP financing charges applied, until the balance is disposed of later by final Order of the Board.

4. Board Findings

Hydro proposed changes to the RSP rules pertaining to the Rural Rate Alteration for the Labrador Interconnected automatic rate adjustments. This proposal was accepted by the parties in the November 23, 2006 Agreement on Labrador Interconnected Rates. The language and specific amounts necessary to accommodate the revised amount of the CFB Goose Bay Revenue Credit for 2007 was approved on an interim basis in Order No. P. U. 46(2006). The Board is satisfied that it is reasonable and consistent with regulatory principles to allocate a portion of the CFB Goose Bay Revenue Credit during the extended phase-in of uniform Labrador Interconnected rates.

The Board accepts Hydro's proposed methodology for the allocation of the CFB Goose Bay Revenue Credit during the extended phase-in of uniform Labrador Interconnected rates. Hydro will be required to file supporting calculations with each annual application for approval of changes to Labrador Interconnected rates. The Board will accept on a final basis the monthly amount of the automatic rate adjustment in the Rural Rate Alteration.

The Board notes that the RSP rules as proposed include specific elements of the rates beyond 2007 for the Labrador Interconnected Customers. Future rates will be established with the approval of the Board upon application by Hydro. The RSP should not set out specific amounts in relation to rates for these customers beyond 2007 as these elements must be approved by the Board in subsequent Orders based on circumstances at that time.

Hydro will be required to revise the RSP rules to remove reference to the specific amounts in the Rural Rate Alteration calculation for the years beyond 2007.

Pursuant to the Settlement Agreements Hydro also proposed a special adjustment to the Hydraulic Production Variation Balance in the RSP for both NP and the Industrial Customers. The Board accepts the proposed special adjustment as set out separately in Schedule B to this Decision and Order. Hydro will be required to distribute the balance in the reserve account that was established pursuant to Order No. P. U. 46(2006), in accordance with Schedule B. Hydro proposed that this one-time adjustment be set out in the RSP rules. Given that it has been specifically included as Schedule B to this Decision and Order Hydro should now remove this special adjustment from the RSP rules.

Hydro will be required to distribute the balance of the reserve account established in Order No. P. U. 46(2006) in accordance with the special adjustment to the RSP Hydraulic Production Variation Balance as set out in Schedule B. Hydro will be required to revise the RSP rules to exclude reference to this one-time adjustment.

Hydro seeks approval of changes to the RSP rules which are necessary with the implementation of the proposed AAM. As discussed later in Part II - Section VII of this Decision and Order the Board will not approve Hydro's proposal to implement an AAM at this time. As the proposed RSP rules were prepared contemplating the implementation of an AAM the language will have to be changed to remove all reference to an AAM.

Hydro will be required to revise the RSP rules to remove reference to the AAM.

Hydro will be required to file for the Board's approval, within fifteen days of the Order approving final rates for customers of NP, revised RSP rules in accordance with the findings of the Board as set out in this Decision and Order.

Hydro also proposed the addition of new language in the RSP rules requiring that the most recently available fuel rider be used with the implementation of new test year base rates. This proposal was accepted by the parties in the October 20, 2006 Agreement, which the parties clearly state is a non-severable agreement. Given that Hydro's rates are implemented effective January 1, 2007 this provision will not be operative for the 2007 test year. The Board has concerns that the provision as written could complicate the implementation of rates in future test years. However, the Board will accept this proposal in principle since it cannot be used until the next general rate application and a review of the RSP will be completed before that time. To ensure that the purpose and language of this provision is appropriate for the next test year the Board suggests that this provision be placed on the list of items to be discussed in the RSP review.

With respect to the proposed review of the RSP as agreed to by the parties in the Settlement Agreements, the Board agrees that a review of the RSP design may be appropriate.

The RSP was established by the Board in 1985 and many changes have been made flowing from Hydro's previous general rate applications in 2001 and 2003. While commending the parties' agreement to undertake such a review, the Board notes that the Settlement Agreements do not specifically contemplate a role for the Board. According to the Settlement Agreements the specifics of the process to be followed in the review were to be established by the parties before February 1, 2007. In particular the Settlement Agreements contemplate a technical conference being held before October 31, 2007, yet neither the format nor scope of this conference is detailed. In addition the Settlement Agreements state that unresolved issues may be submitted to the Board for resolution. How these unresolved issues, or indeed issues which are resolved for that matter, get brought before the Board is not addressed.

The Board notes the importance of the RSP as it is the mechanism through which variations in fuel prices are managed. These variations have been the biggest driver for rate changes in recent years. Since the approval of the Board would be necessary for any changes to this mechanism, the involvement of the Board early in this process would facilitate an efficient and timely determination of the issues. However it is difficult at this stage to determine the appropriate level of involvement of the Board in advance of the filing of the terms contemplated in the Settlement Agreements. The participation of the Board may be influenced by the process and substance proposed by the parties for the review. With these particulars the Board would be in a better position to decide if and how it should participate in the RSP review. To this end the Board will require Hydro to file with the Board, on behalf of the parties, a description of the terms of reference, the specific review objectives, a list of participants, a planned timeline, and an outline of the review process. The Board will then be in a position to make a determination as to its participation in the RSP review and advise the parties accordingly.

Hydro will be required to file with the Board no later than May 31, 2007 a copy of the terms which are proposed for the RSP review, setting out the terms of reference, the specific review objectives, a list of participants, a planned timeline, and an outline of the review process.

IV. RATE BASE

1. Issues Arising from Order No. P. U. 14(2004)

i. <u>Report on Property and Assets Review</u>

In Order No. P. U. 14(2004) the Board ordered Hydro to submit, as part of its next general rate application, a report with respect to the review of its property and assets setting out the acquisition date, the original cost, the purpose of the asset, the net book value and, where applicable, the load served. Based on this report the Board would consider whether a valuation of the property and assets of Hydro is necessary and appropriate at Hydro's next general rate application.

Hydro filed a report "Property and Assets Review" dated July 2006 as part of its Application. (Exhibit MGB-3) The report provided a list of Hydro's property and assets as at December 31, 2005, and included for each unit of property the date acquired, original cost and the net book value as of December 31, 2005. The report also noted that, as a result of identifying discrepancies between the asset records and the actual assets, a total net book value of $6,221,384 was identified for write-off, representing 0.4% of the total fixed assets. Details of these asset write-offs were provided in Table 1 (pg. 7) of the report.

In response to questioning from Board Counsel Mr. Bradbury reviewed the process used by Hydro in undertaking its asset review, and also explained the improvements implemented as part of this review to ensure asset records are kept up to date and complete. Board Counsel also questioned Mr. Bradbury on Hydro's position with respect to the need for a valuation of the property in light of the asset review just completed:

> Q. (Ms. Newman) So is it Hydro's position now that this review having been done and the value of assets having been incorporated into the calculation of the value of the property for the determination of the rate base calculation, that the rate base accurately reflects the used and useful net book value of Hydro's property?
> A. (Mr. Bradbury) Yes, we are confident in that regard.
> Q. (Ms. Newman) And is it Hydro's position then that a valuation under Section 64 of the Public Utilities Act of Hydro's property is not necessary at this time?
> A. (Mr. Bradbury) We don't consider it necessary. We feel that we've improved controls over our asset records. We should point out, I guess, that even with respect to the controls that were previously in place with respect to our records to have resulted in a six million dollar write-off on an asset base in excess of 1.4 billion dollars is an error rate of something less than one half of one percent. So we consider the controls to have always been in place over our asset records. We've simply improved them.
> (Transcript, January 25, 2007, pgs. 65/16-25; 66/1-15)

No parties raised any issue or question with respect to the valuation of Hydro's property or in relation to the property and assets review report. The evidence indicates that the asset review process undertaken by Hydro was comprehensive and thorough. Mr. Bradbury confirmed that the updated value of assets has been incorporated into the calculation of the value of property for the determination of the rate base and that the rate base accurately reflects the used and useful net book value of Hydro's property.

The Board has reviewed the report "Property and Assets Review" completed and filed by Hydro as part of this proceeding and is satisfied that a valuation of the property and assets of Hydro is not required at this time.

ii. Use of Regulated Common Equity versus Book Equity

During Hydro's 2003 general rate application the issue of whether Hydro should be adding back non-regulated expenses to equity was raised. The Board noted that this was essentially the same issue raised at NP's 2003 general rate application. In the interest of ensuring consistent regulatory practice between the utilities the Board decided it would also direct Hydro to review the issue. In Order No. P. U. 14(2004) the Board ordered Hydro to file as part of its next general rate application a report on the appropriateness of discontinuing the use of regulated equity in favour of book equity.

Hydro filed its report "A Report on the Discontinuance of the Use of Regulated Equity in Favour of Book Equity" as part of its August 2006 Application. (Exhibit MGB-2) Hydro's report provides an explanation of the difference between book equity and regulated equity (pg. 1):

> *"Book equity is the shareholder's equity as reflected in a company's financial statements and is typically comprised of share capital and retained earnings. Regulated equity is derived from cumulative regulated net income, less regulated dividends. Non-regulated expenses are treated as if they had not been incurred and are excluded from the calculation of regulated net income. Consequently, regulated equity equals book equity plus cumulative non-regulated expenses. In companies that have no source of non-regulated income or equity, then regulated equity will exceed book equity. In companies that have non-regulated sources of income, book equity will exceed regulated equity. This regulated equity amount is then used in the calculation of projected weighted average cost of capital ("WACC"), return on rate base and return on equity ("ROE"). No adjustment is typically made to actual debt balances."*

The report also sets out how Hydro separately tracks and reports regulated activities, non-regulated activities and investments in its subsidiaries. Non-regulated expenses are applied against non-regulated revenues and form part of the non-regulated equity pool of Hydro. The sum of these equity or capital pools is equal to the total book equity of Hydro. In its report Hydro concluded:

> *'The book equity approach is not appropriate for Hydro. Hydro has both regulated and non-regulated sources of equity, and separate sources of revenue against which regulated and non-regulated expenses are incurred. The total of Hydro's regulated and non-regulated debt and equity balances equal those that are presented in its financial statements. The issue of regulated equity exceeding book equity is not a factor for Hydro as it is for other companies without non-regulated income streams – rather, regulated equity is a subset of book equity. Hydro's approach to tracking separate balances of capital is appropriate in the context of a single corporate entity which engages in both regulated and non-regulated activities."*

In discussing NP's move to discontinue the use of regulated common equity in favour of regulated book equity Hydro noted in its report that NP does not have non-regulated sources of income.

Grant Thornton reviewed Hydro's report filed in Exhibit MGB-2 and commented at pg. 60 of its report as follows:

> *"In its report and pre-filed evidence Hydro concludes that the use of book equity is not appropriate for regulating Hydro. However, we understand this conclusion is made in the context of Hydro's total non-consolidated book equity and on this point we concur.*
>
> *Based on our understanding of the approach and methodology used by Hydro for separately tracking regulated and non-regulated activity, we conclude that Hydro is in effect using book equity from regulated operations in its filing."*

No parties raised any issue or question with respect to this matter during the proceeding or in written or oral submissions.

Although the Board has approved the discontinuance of using regulated equity in favour of book equity for NP the Board is satisfied that the same approach is not appropriate for Hydro. Unlike NP Hydro does have non-regulated sources of income and tracks regulated and non-regulated revenues, expenses and dividends separately. By tracking these balances separately and using only the capital structure associated with regulated activities in its calculation of the weighted average cost of capital, return on rate base, and ROE Hydro is, in effect, using book equity from regulated operations, which is appropriate and correct.

The Board will not require Hydro to discontinue the use of regulated equity in favour of book equity.

2. 2007 Forecast Average Rate Base and Return On Rate Base

Hydro's forecast average rate base for the 2007 test year, based on the revised December 2006 filing, is $1,489,323,000. The components of the rate base as proposed in Hydro's initial August 2006 filing and the revised forecast 2007 rate base as set out in the December 2006 filing are shown below:

Newfoundland and Labrador Hydro
2007 Forecast Rate Base
($000)

	August 2006 Filing	**December 2006 Filing**	**Variance**	**%**
Capital Assets	2,016,023	2,008,654	(7,369)	-0.37%
Less: Contributions in aid of construction	92,256	92,250	(6)	-0.01%
Accumulated Depreciation	560,713	559,855	(858)	-0.15%
Balance – Current Year	1,363,054	1,356,549	(6,505)	-0.48%
Balance – Previous Year	1,356,750	1,354,631	(2,119)	-0.16%
Average	1,359,902	1,355,590	(4,312)	-0.32%
Cash Working Capital Allowance	3,057	3,030	(27)	-0.88%
Fuel	24,470	27,473	3,003	12.27%
Materials and Supplies	19,912	19,912	0	0.00%
Deferred Charges	83,843	83,318	(525)	-0.63%
Average Rate Base	**1,491,184**	**1,489,323**	**(1,861)**	**-0.12%**

(Revised Application, Schedule A, pg. 1 of 6, Dec. 6, 2006)

Grant Thornton confirmed in its January 12, 2007 Supplementary Report that the revised forecast 2007 average rate base of $1,489,323,000 appropriately incorporates the impact of the agreed changes as per the Settlement Agreements.

Hydro's return on rate base is calculated by applying its weighted average cost of capital (WACC) to its rate base, excluding rural assets, and its weighted average cost of debt to the rural assets component of the rate base. Hydro's 2007 forecast weighted average cost of capital (WACC) as proposed in Hydro's initial August 2006 filing and the revised 2007 forecast average WACC as set out in the December 2006 filing, incorporating the impacts of the Settlement Agreements, is set out below:

2007 Forecast Weighted Average Cost of Capital (WACC)			
	Cost Rate	**Ratio**	**Weighted**
August 2006 Filing			
Debt	8.39%	83.50%	7.01%
Employee Future Benefits	0.00%	2.42%	0.00%
Retained Earnings	5.20%	14.08%	0.73%
Weighted Average Cost of Capital		**100.00%**	**7.74%**
December 2006 Filing			
Debt	8.26%	83.58%	6.90%
Employee Future Benefits	0.00%	2.42%	0.00%
Retained Earnings	4.47%	14.00%	0.63%
Weighted Average Cost of Capital		**100.00%**	**7.53%**

(Revised Application, Schedule A, pg. 5 of 6, Dec. 6, 2006)

The 2007 forecast return on rate base as proposed in Hydro's initial August 2006 filing and the revised 2007 forecast return on rate base set out in the December 2006 filing, incorporating the impacts of the Settlement Agreements, is set out below:

2007 Forecast Return on Rate Base ($000,000)				
Component Base	**Assets**	**Weighted Average Cost of Debt**	**Weighted Average Cost of Capital**	**Allowed Return**
August 2006 Filing				
Rural Interconnected and Isolated Assets	212.6	7.01%		14.9
Other Rate Base Assets	1,278.6		7.74%	98.9
Total Assets	1,491.2			113.8%
Rate of Return on Rate Base				**7.63%**
December 2006 Filing				
Rural Interconnected and Isolated Assets	212.0	6.90%		14.6
Other Rate Base Assets	1,277.3		7.53%	96.2
Total Assets	1,489.3			110.8
Rate of Return on Rate Base				**7.44%**

(Revised Application, Schedule A, pg. 6 of 6, Dec. 6, 2006)

Grant Thornton confirmed in its January 12, 2007 Supplementary Report that the proposed revised rate of return on average rate base of 7.44% for the 2007 test year appropriately incorporates the agreed changes to forecast interest rates, embedded cost of debt, forecast return on equity and resulting changes to the weighted average cost of capital as per the Settlement Agreements.

The Board is satisfied that the approach and methodology used by Hydro in calculating its forecast average rate base and return on rate base for the 2007 test year in its Revised Application reflects the impacts of the Settlement Agreements and is in accordance with the methodology required by the Board in Order No. P. U. 14(2004). Section 3 of the *EPCA* requires that the rates set by the Board *"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…"* As previously indicated Mr. Martin, Hydro's President and CEO, has stated that the proposals contained in its Revised Application would not negatively impact Hydro's financial stability.

In Order No. P. U. 40(2004) the Board approved a range of return on rate base for Hydro of 30 basis points (plus or minus 15 basis points on the approved rate of return on rate base) to be effective January 1, 2005. The Board also approved a definition of excess earnings for Hydro. There were no issues raised during this proceeding to indicate that this approved range of return on rate base and the definition of excess earnings is no longer appropriate. Accordingly, the Board will continue the use of the existing approved range and definition of excess earnings in this Decision and Order.

The Board accepts Hydro's proposals for the forecast 2007 average rate base of $1,489,323,000 and return on rate base of 7.44%, within a range of 7.29% to 7.59%, as set out in its Revised Application.

V. RATE ISSUES

1. Utility Rates

The October 20, 2006 Agreement on Cost of Service, Rate Design and Rate Stabilization Plan set out the parties' agreement with respect to the wholesale rate for NP. The parties agreed:

> "a. *Except as otherwise stated in this Agreement, rate designs and other tariff provisions for Newfoundland Power as outlined in the Application should continue to apply.*
>
> i. *Hydro's energy rate to Newfoundland Power should continue to be a two-block structure as follows:*
>
> ii. *the first-block energy charge should be applied to the first 250 GWh of energy purchases per month,*
>
> iii. *the energy charge for the first block would be calculated in accordance with Board's Decision and Order, and*
>
> iv. *the energy charge for the end or 'run out' block rate would be set at a level that reflects the production cost at the Holyrood thermal plant, which production cost shall be determined by the Board in its Decision and Order.*
>
> c. *It is appropriate to reduce Hydro's demand rate to Newfoundland Power to $4.00 per Kw per month to better reflect the marginal capacity costs currently indicated on the Island Interconnected System (see July 2006 report entitled Implications of Marginal Cost Results for Class Revenue Allocation and Rate Design).*
>
> d. *Unless altered as a result of the Board's decision with respect to the treatment of customer-owned generation, Hydro's demand rate to Newfoundland Power will continue to apply to the single highest weather adjusted native load for the winter season.*
>
> e. *Following the current GRA, Hydro and Newfoundland Power will enter into discussions toward development of a demand billing approach to reflect the marginal cost of capacity during the winter months. A report documenting the agreement and justifications (or if agreement is not reached the reasons why agreement was not reached) will be prepared by Hydro and submitted to the Board on or before June 30, 2007."*

As discussed previously in Part II – Section III the November 23, 2006 Agreement on Revenue Requirement proposed that NP's portion of the December 31, 2006 RSP Hydraulic Production Variation Balance be transferred to NP's Historic RSP Balance. The effect of this Agreement was to reduce the RSP rate charged to NP by Hydro, and hence reduce NP's rates to its customers. This impact was reflected in Hydro's Revised Application and in the interim rates approved by the Board in Order Nos. P. U. 41(2006) and P. U. 42(2006). The Board has approved this one-time special adjustment to NP's RSP rate in Part II – Section III of this Decision and Order.

The proposed 2007 rates for NP, which have been approved on an interim basis, flow from a comprehensive negotiation process in which all parties were engaged, with the participation of each of the experts. The proposed rates were uncontested by any participant in this proceeding. The Board is satisfied that the proposed rates for NP are consistent with the provision of least cost reliable service and fairly balance the interests of the utility and consumers.

The October 20th Agreement also stated that, following the current application, Hydro and NP will enter into discussions toward development of a demand billing approach to reflect the marginal cost of capacity during the winter months, with a report to be submitted by Hydro to the Board on or before June 30, 2007. The Board is encouraged by the efforts of both Hydro and NP in this regard. Since the Board will have to approve any changes to NP's current wholesale rate design the Board will not make any further comment on this initiative.

The Board accepts Hydro's proposals in relation to Utility rates as reflected in the Revised Application.

2. Industrial Customer Rates

The October 20, 2006 Agreement on Cost of Service, Rate Design and Rate Stabilization Plan set out the parties' agreement with respect to rates for the Industrial Customers. The parties agreed that, except as otherwise stated in the Agreement, rate designs and other tariff provisions for the Industrial Customers as outlined in the Application should continue to apply.

As discussed previously in Part II – Section III the November 23, 2006 Agreement on Revenue Requirement proposed that the normal annual 25% allocation of the Industrial Customers' share of the actual RSP Hydraulic Variation Balance as of December 31, 2006 be incorporated into Industrial Customer rates effective January 1, 2007 in accordance with existing RSP rates. The portion of the Industrial Customers' share of the actual RSP Hydraulic Variation Balance, net of the normal 25% allocation, would be used to reduce any charge, or increase any credit, which would otherwise be applied effective January 1, 2008 to the rates of Industrial Customers under the current RSP rules. The effect of this Agreement was to reduce the RSP rate charged to the Industrial Customers in both 2007 and 2008. The impact on 2007 rates was reflected in Hydro's Revised Application, and in the interim rates approved by the Board in Order No. P U. 41(2006). The Board has approved this special adjustment to the Industrial Customers' RSP rate in Part II – Section III of this Decision and Order.

The proposed 2007 rates for Hydro's Industrial Customers, which have been approved on an interim basis, flow from a comprehensive negotiation process in which all parties were engaged with the participation of each of the experts. The proposed rates were uncontested by any participant in this proceeding. The Board is satisfied that the proposed rates for the Industrial Customers are consistent with the provision of least cost reliable service and fairly balance the interests of the utility and consumers.

The October 20th Agreement also proposed a review process to examine the rate design for the Industrial Customers and included a "Framework for Industrial Customers' Rate Design Review". The Agreement also stated that as soon as practicable following the conduct of the review of the Industrial Customer rate design (and re-design of the RSP), and in no event later than October 31, 2007, Hydro will host a Technical Conference to be attended by the parties and others as determined by the parties, to further discuss the Industrial Customers' rate design (and re-design of the RSP). Since the Board will have to approve any changes to the Industrial Customers' current rate design the Board will make no further comment on this initiative.

The Board accepts Hydro's proposal in relation to Industrial Customer rates as reflected in the Revised Application.

3. Rural Rates, Rules and Regulations

i. Burgeo School and Library Rates

In its August 2006 Application Hydro proposed deletion of the reference to the Burgeo School and Library because the premises to which the rate previously applied have a new owner and hence the rate is no longer active. On February 19, 2007 the Board received correspondence from the Western School District regarding Hydro's proposal to eliminate the preferential rate for the Burgeo School. The Western School District expressed the position that *"the preferred rate for the supply of electricity to the Burgeo School should be retained and that this rate should now be transferred to and applied to all electricity supplied to the replacement building – Burgeo Academy."* The Western School District requested that the Board deny approval of Hydro's request and direct that the preferred rate for the Burgeo School be retained and applied to the present school.

In its written submission (pg. 47) Hydro acknowledged that, based on the Order in Council issued prior to the hearing of Hydro's 2003 general rate application, the preferential rate applies to the newly constructed school that became a customer of Hydro's shortly after the Order in Council was issued. Hydro confirmed this position in oral argument. By correspondence to the Board received February 22, 2007 Hydro proposed that this rate class be continued and accordingly filed the rate schedule for this customer. Hydro advised that, upon approval of this rate by the Board, it will contact the customer to make any necessary credits or refunds arising from this change.

The Board accepts that a preferential rate for the Burgeo School and Library should be continued. Hydro will be required to report to the Board no later than June 30, 2007 as to the final resolution of the necessary credit/refund related to this change.

ii. Changes to Rules and Regulations

Hydro did not file amendments to the Rules and Regulations to reflect the withdrawal of its proposal with respect to the Burgeo School and Library, or otherwise indicate that changes were not required. Hydro will therefore be required to refile the Rules and Regulations for its Rural customers.

Hydro will be required to refile the Rules and Regulations for its Rural customers for the approval of the Board.

The November 23, 2006 Agreement on COS, Rate Design, and Other Issues proposed that, in future, the rates for Hydro's Isolated Rural customers, should be subject to periodic adjustments by Hydro to reflect NP's periodic RSA and MTA[1] adjustments, including any fuel

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[1] Rate Stabilization Account (RSA) and Municipal Tax Adjustment (MTA)

rider adjustments. This proposal affects Hydro's Rural Isolated Domestic customers (excluding Government Departments) for consumption greater than the lifeline block, Hydro's Isolated Rural General Service customers (excluding Government Departments).

Pursuant to this Agreement Hydro proposed in its Revised Application a change to the Rules and Regulations for certain Rural customers as follows:

> *"Amend Sections 16 and 17 so that rates paid by Rural Isolated Customers, excluding Government Departments, be adjusted between Hydro GRAs to reflect changes made to NP's rates, including changes arising from MTA and RSA adjustments."*

According to Hydro's written submission (pg. 47) the purpose of this change in policy is to mitigate the potential for rate shock between general rate applications for its Rural Isolated customers (excluding Government Departments), by providing an RSP, or fuel related annual price change for these customers. The Board is satisfied that this proposed change contributes to rate stability and should be approved.

The Board accepts the proposed changes to the Rules and Regulations in relation to the periodic adjustment of the rates of Hydro's Rural Isolated Domestic customers (excluding Government Departments) for consumption greater than the lifeline block, Hydro's Isolated Rural General Service customers (excluding Government Departments).

In accordance with the December 2006 Government Directive [OC2006-512] Hydro also proposed changes to the Rules and Regulations in relation to the rates for its Rural Isolated Domestic and General Service customers (excluding Government Departments). This Directive ordered that the Board adopt a policy for these customers that any change in rates for 2007 be equal to the rate change approved for equivalent classes of NP customers. In addition Hydro is to file a two-year plan with the Board setting out rates for these customers for each of 2008 and 2009 such that the rates effective January 1, 2009 are the same rates that would have been in place without the Directive. This Directive effectively delays and spreads out the proposed rate increase which would have been experienced by these customers based on the 2007 test year revenue requirement and cost of service. Hydro has not applied to recover any shortfall arising from the implementation of this Directive and has added language to the RSP to ensure that the Rural Rate Alteration is not triggered. The Board accepts this policy as directed and will approve the specific changes to the Rules and Regulations in relation to this Directive.

The Board accepts Hydro's proposed changes to the Rules and Regulations in accordance with the Government Directive. Hydro will be required to file with the Board by November 30th in each of 2007 and 2008 an application for rates in the subsequent year for these customers in accordance with the two-year plan, which shall also be filed with the application.

VI. LABRADOR INTERCONNECTED SYSTEM

1. Background

In Hydro's previous two general rate applications the Board considered a number of issues with respect to the Labrador Interconnected system, in particular with respect to the cost of service methodology to be used by Hydro in setting rates for all customers on this system. This issue had been before the Board a number of times dating back to 1979. Following the generic cost of service hearing held in 1992 the Board recommended, among other things, a single cost of service study for the Labrador Interconnected system, comprising customers in the Towns of Labrador City and Wabush, and Happy Valley-Goose Bay.

In Order No. P. U. 7(2002-2003) the Board found that the Labrador Interconnected system should be treated as one system for the purpose of setting rates. The Board approved a proposal by Hydro to simplify rate classes and structures for the Labrador Interconnected system and also to implement uniform interconnected rates for customers on this system. As a result the 24 different rate classes were consolidated into six (6) rate classes which aligned with those in place on the Island Interconnected system. The Board approved Hydro's proposal to equalize rates for customers in Labrador City and Wabush. The Board ordered Hydro to file a five-year plan for implementation of a uniform rate structure for the Labrador Interconnected system as part of its next rate application.

As part of the hearing of Hydro's 2003 general rate application the Board heard a complaint from the Towns of Labrador City and Wabush that Hydro's proposed uniform rate structure, filed in accordance with the Board's direction in Order No. P. U. 7(2002-2003), was unjustly discriminatory. In Order No. P. U. 14(2004) the Board found that Hydro's proposals for uniform rates were not unjustly discriminatory and rejected the complaint of the Towns of Labrador City and Wabush. The Board accepted Hydro's proposed five-year plan to implement uniform rates for Labrador Interconnected customers and directed Hydro to file for approval a revised Schedule or Rates for each proposed rate change set out in the five-year plan.

The implementation of the five-year phase-in of rates for customers on the Labrador Interconnected system commenced in 2004. As of 2008 all domestic and general service customers on the Labrador Interconnected system would be paying the same rates, and rates for street and area lighting would also be equalized. In its August 2006 application Hydro filed revised rates for the Labrador Interconnected customers, proposing an increase, on average, of 8.5% based on the 2007 cost of service study.

2. Settlement Agreement

The November 23, 2006 Agreement on Labrador Interconnected Rates set out the proposed agreement of the parties, with the exception of the Industrial Customers who took no position, on rates for the Labrador Interconnected system. The Agreement set out the rate principles for the Labrador Interconnected system, a proposal for 2007 rates, and a proposal for the phase-in of rate changes for 2008-2011.

Rate Principles

The Agreement recognizes the principles and practices established by the Board as follows:

"(a) *The Rural customers in the communities of Labrador City, Wabush and Happy Valley-Goose Bay and the Rural customers served from Hydro's facilities in these vicinities are served from the Labrador Interconnected system;*
(b) *Similar customers served from a single electrical system should pay the same rates ("uniform rates");*
(c) *Where changing rates to accomplish uniform rates on a single electrical system required that large percentage rate increases occur, those rate changes should, where practicable, be phased in gradually; and*
(d) *The application of the CFB Goose Bay revenue credit for secondary energy sales will be phased in to reduce the Rural Deficit."*

2007 Rates

For 2007 the parties propose that there will be no changes to rates for firm sales paid by Rural customers served from the Labrador Interconnected system.

Phase-In of 2008-2011 Rates

In years 2008 through 2011 inclusive the parties propose that rate changes will be phased in so that by 2011:

"(a) *Rates will be based on the 2007 Test Year revenue requirement;*
(b) *Uniform rates will be charged to all Rural customers on the Labrador Interconnected system; and*
(c) *The CFB Goose Bay revenue credit will be fully applied to reduce the Rural Deficit."*

The Agreement also stated that, on or before December 15, 2006, Hydro will file with the Board the rate plan for the years 2008 to 2011 for the Labrador Interconnected Rural customers to achieve the above objectives. Hydro filed an application with the Board on December 14, 2006 seeking approval of rate schedules for customers for 2008-2011 and setting out information regarding specific rate impacts. The Board did not approve this application but did approve rates for the Labrador Interconnected system on an interim basis for 2007. The Agreement also proposed that Hydro apply to the Board each year for approval of the Schedule of Rates to be charged as set out in the rate plan. The Agreement does not prevent Hydro from applying to the Board for a rate adjustment resulting from changes in costs in any year subsequent to 2007.

3. Presentations on Behalf of Labrador West Customers

In his presentation to the Board Mayor Graham Letto of Labrador City objected to any proposed increase by Hydro to consumers in Labrador West. Mayor Letto stated: *"Both Labrador East and Labrador West receive power from Churchill Falls which is sold to Newfoundland and Labrador Hydro at a cost of approximately one quarter cent per kilowatt* *hour. The result of the Public Utilities Board (PUB) ruling on Hydro's 2003 General Rate Application is that the average rate for the entire LIS on January 1st, 2004 was approximately 2.7 cents per kilowatt hour or some 11 times the cost of the production of power."* (Transcript, Feb. 5, 2007, pg. 26/9-18) Mayor Letto suggested that the historical development of the Labrador West system by Wabush Mines and the Iron Ore Company of Canada, and the fact that costs for Labrador East are based on 1970s construction costs together with maintenance, should mean lower rates for consumers within the Labrador Interconnected system than currently charged by Hydro. Mayor Farrell of Wabush also commented on the historical context of the Labrador West system in support of Mayor Letto.

Mayor Letto also raised the issue of the subsidization of rural electricity rates in isolated areas served by diesel generation. According to Mayor Letto the burden of subsidizing rural electricity rates should not fall exclusively to electrical consumers within the areas served by NP and those of the Labrador Interconnected system. It was suggested a better approach would be to spread this burden over all electrical production of the Province, including that exported, by means of a per kilowatt hour tax imposed on such production, pursuant to the authority of s. 92A(4) of the Canadian Constitution. Mayor Letto stated that the Board "*…has an obligation to assess the feasibility and viability of a per kilowatt hour tax utilizing Section 92A(4) and to recommend same to the Province, rather than simply rubber stamping the present flawed Provincial policy."* (Transcript, Feb. 5, 2007, pgs. 35/22-25; 36/1-2)

Mr. Jason Ste. Marie of the Hyron Regional Economic Development Corporation highlighted the negative impacts that increases resulting from the equalization of rates in the Labrador Interconnected system will have on residents, businesses, and future economic development prospects in the Labrador West area. Mr. Ste. Marie pointed to the challenges of recruiting and retaining people to live and work in Labrador West and cited affordable hydro rates as one of the retention tools used to keep residents, especially retirees, from leaving the area. The resulting impact of rate increases for small and medium sized businesses will be higher prices for goods and services in the region as businesses pass on increasing costs to their customers. Changes to energy costs during periods of low ore demand will also negatively impact the mining companies, and it was suggested that the companies may not be able to sustain current rate subsidies provided to employees. The Hyron Board supported Mayor Letto's position that residents of Labrador West are paying in excess of Hydro's costs of providing service and also supported the recommendation of the Towns of Labrador City and Wabush with respect to the subsidization of rural electricity rates.

4. Board Findings

The Board acknowledges the submission of both the Towns of Labrador City and Wabush and the Hyron Regional Economic Development Corporation with respect to the impact of rate increases in Labrador West as a result of the Board's decision to equalize rates for customers on the Labrador Interconnected system. This decision was made by the Board after considerable evidence and testimony from the parties and expert witnesses, including that of the Towns of Labrador City and Wabush, in Order No. P. U. 7(2002-2003) and confirmed in Order No. P. U. 14(2004), following the hearing held in Labrador City into a complaint of discriminatory rates by the Towns of Labrador City and Wabush. The Board's Order with respect to this issue was also the subject of an appeal to the Court of Appeal by the Towns of Labrador City and Wabush. This appeal was denied.

There was insufficient evidence presented in this hearing to support a change in the Board's previous findings and Order on this issue. The Board is satisfied that a single cost of service study for customers on the Labrador Interconnected system continues to be appropriate as the basis for determining rates for all customers on that system.

With respect to the position of the presenters from Labrador West that customers in that area are paying significantly more than the cost of service (11 times the cost according to the Towns), the evidence in this proceeding does not support this contention. According to the information filed by Hydro in Schedule H of its December 2006 application, the 2007 forecast cost of service for the Labrador Interconnected system is as shown below:

Labrador Interconnected System Forecast 2007 Cost of Service ($000)	
Forecast Revenue (excluding IOCC and CFB Goose Bay)	**$14,416,226**
Forecast Costs	
Production – Demand	$2,485,355
Energy	855,710
Transmission – Demand	1,728,290
Distribution	4,756,433
Accounting	1,295,992
Expense Credits	-1,179,537
Rural Deficit Allocation	4,443,984
Total Costs	**$14,416,227**

(Revised Application, Schedule H, Dec. 6, 2006)

As this information indicates, the forecast cost of service for the 2007 test year for the Labrador Interconnected system, including the rural deficit allocation, is $14,416,227. The forecast revenue to be collected from customers on the Labrador Interconnected system is $14,416,226. Based on this evidence the Board is satisfied that Hydro is collecting in its rates charged to customers on the Labrador Interconnected system only its cost of service, including a just and reasonable return as provided for in the *Act* and approved by the Board.

The issue of the appropriate manner in which to collect the subsidy for the rural deficit, and in particular the proposal that Government implement a tax on all electricity consumption in the Province, including exports, was considered by the Board in Hydro's previous general rate applications. In Order No. P. U. 7(2002-2003) the Board concluded that taxation is a prerogative of Government and is beyond the control of the Board. At Hydro's 2003 general rate application the Towns of Labrador City and Wabush again proposed that the Board recommend the introduction of taxing legislation to recover the rural deficit from all electrical production in the Province. In Order No**.** P. U. 14(2004) the Board found that s. 83 of the *Act* did not give the

Board the broad jurisdiction to recommend legislation with respect to the issue of taxation, and therefore rejected the proposal of the Towns. There has been no change in the Board's mandate or jurisdiction since this prior Order and the Board's findings are still applicable.

With respect to the settlement agreement on rates for the Labrador Interconnected system the Board notes that both presenters supported the agreement that there would be no rate increase for 2007, but still objected to the proposed phase-in of the rate increases approved by the Board in Order No. P. U. 14(2004). The Board has reviewed the Agreement on Labrador Interconnected Rates and notes that the principles upon which the Agreement is based are consistent with previous orders of the Board, and in accordance with accepted regulatory practice.

The Board is satisfied that the November 23, 2006 Agreement on Labrador Interconnected rates is fair and reasonable and will result in uniform rates for all Labrador Interconnected rural customers, as approved by the Board in Order No. P. U. 14(2004). As acknowledged in the agreement Hydro will be required to apply to the Board in each year for approval of the Schedule of Rates to be charged to customers on the Labrador Interconnected system as set out in the rate plan.

The Board accepts Hydro's proposals in relation to the 2007 rates of the Labrador Interconnected customers as reflected in the Revised Application. Hydro will be required to file for the approval of the Board, no later than November 30th of each year, the rates for the subsequent year for the Labrador Interconnected customers in accordance with the planned phase-in for the period 2008 to 2011 inclusive.

VII. OTHER ISSUES

1. Automatic Adjustment Mechanism

In Order No. P. U. 14 (2004) the Board considered the appropriateness of establishing an automatic adjustment mechanism (AAM) for Hydro's rates. A similar automatic adjustment formula has been in place for NP since 1998. The Board agreed that in the interests of regulatory consistency and efficiency an automatic adjustment mechanism should be considered for Hydro. However the Board was not satisfied that there was sufficient evidence to implement an AAM at that time. The Board ordered Hydro to submit with its next general rate application a proposal for such a mechanism with analysis as to the impacts for consideration by the Board.

Hydro filed the report with its August 2006 Application (Exhibit MGB-1) setting out a proposal for an AAM. The proposed mechanism was modeled on the formula in place for NP with three key differences. These differences were explained by Mr. Mark Bradbury, Hydro's Corporate Controller, in oral testimony and summarized in Hydro's written submission (pg. 17):

"1. Hydro's rate of return on equity remained tied to the Province's marginal cost of long term debt (unlike NP's which is based on a risk free rate plus a premium);
2. The dates for determination of the Province's marginal cost of long term debt were proposed to be the first ten trading days in October (ahead of those approved for NP) which Mr. Bradbury explained was designed to give the time required for NP to flow through proposed rate changes to its customers; and
3. The early trigger point proposed was different from that approved for NP (because of the differences in the capital structures of the two utilities)."

In its written submission (pg. 24) Hydro argued that:

- *"There is now sufficient evidence before the Board to enable it to approve terms of an AAM for Hydro;*
- *A full cost of capital hearing (such as preceded the establishment of NP's formula in 1998) is not necessary as Hydro's ROE is currently tied to the Province's marginal cost of long term debt thus rendering such a hearing unnecessary to determine the variables in the proposed formula;*
- *The relationship between rate of return on rate base and the cost of the various components of the capital structure of Hydro are fully explained in Exhibit MGB-1;*
- *The Board has been provided with more certainty surrounding Hydro's forecast capital structure;*
- *The benefits of an AAM at this time are reduced costs and enhanced regulatory efficiency; and*
- *Further regulatory principles of fairness and consistency suggest that Hydro should be entitled to an AAM based on the only model already approved in this jurisdiction which regulates on a return on rate base basis."*

The Consumer Advocate did not take exception to the idea of establishing an AAM for Hydro but expressed concern that the AAM as proposed does not reflect Hydro's circumstances. Dr. William Cannon, the Consumer Advocate's expert financial witness, suggested that the operation of an AAM for determining Hydro's annual allowed rate of return on rate base *"should*

(1) be based on an up-to-date estimate of Hydro's embedded cost of debt for the test year and (2) should incorporate, in the year-by-year calculation of the range for the allowed return on rate base, a weighted average cost of capital ("WACC") value that, subject to forecast error, is as close as possible to the actual WACC likely to be experienced by Hydro in each future year." (Dr. William Cannon, Pre-filed Evidence, pg. 2)

In his written final submission (pg. 28) the Consumer Advocate argued:

> *"The Consumer Advocate does not claim that Dr. Cannon's proposal is perfect but it is, with respect, superior to Hydro's approach which is tantamount to assuming without any analysis or probing that the ECD for the test year is appropriate to the years beyond the test year, and <u>limiting</u> ourselves to after-the-fact and potentially costly remedies in the event that the assumption turns out to be off-base. With Dr. Cannon's proposal we at least make an attempt to get it right with the best information available at, and tested during, the GRA hearing."* (Consumer Advocate, Final Submission, pg. 28)

The Consumer Advocate stated that, if the Board rejects Dr. Cannon's proposal to set the debt costs for the period of operation of the AAM as of this hearing, the Board should establish Hydro's debt costs on an annual basis. According to the Consumer Advocate this would be superior to having no formula at all in place, particularly in light of the extent to which Hydro's return on rate base is dominated by its embedded cost of debt. (Consumer Advocate, Final Submission, pg. 30)

NP supported Hydro's proposals with respect to an AAM and disagreed with Dr. Cannon's proposal to utilize forecast values for the cost of debt beyond the test year. According to NP this proposal is not in accordance with generally accepted public utility practice. In its written final submission (pg. 4) NP stated:

> *"Revising the debt component of a utility's costs for years beyond the test year potentially leads to the forecasting of changes in other costs, such as fuel, depreciation, salary costs, transportation costs and other operating expenses. To ensure a just and reasonable return, if future debt costs are to be forecast, a utility should also be permitted to forecast other future expenses and have them approved by the Board for recovery in rates in future years.*
>
> *Such an approach would be less efficient than using the proposed Formula within the generally accepted forecast test year method. It would add unnecessary complexity to rate proceedings, increasing the regulatory burden for the parties and increasing the regulatory costs to be borne by consumers. This is not in accordance with sound public utility regulatory policy."*

The Industrial Customers did not take a position on the issue of the AAM.

The Board notes that no party to this proceeding argued that an AAM for Hydro's rate of return on rate base should not be implemented for Hydro at this time. The Consumer Advocate, suggested that Hydro's proposed AAM fails to account for two significant differences between Hydro and NP, being the capital structure and the rate of return. Since the cost of debt is a much larger part of Hydro's return than it is for NP, the Consumer Advocate supported an AAM which reflects changes to the embedded cost of debt on an annual basis. He recommended that, as a part of this proceeding, the Board establish the estimated embedded cost of debt for each of the three years of the operation of the AAM. Alternatively, the Consumer Advocate suggested the annual adjustment of the embedded cost of debt in the AAM in the years after the test year.

In Order No. P. U. 14(2004) (pg. 87) the Board stated the following with respect to the implementation of an AAM for Hydro:

> *"The Board notes that the existing formula to adjust the rate of return on rate base for NP was accepted and implemented by the Board following a full cost of capital hearing at which specific evidence regarding the appropriateness and the structure of an automatic adjustment mechanism was reviewed. The resulting formula adopted by the Board in Order No. P.U. 16(1998-99) reflects the complex relationship between rate of return on rate base and the cost of the various components of the capital structure of NP. In the Board's opinion such a mechanism to automatically adjust NLH's rate of return on rate base would be similarly complex and would have to be designed to reflect the costs specific to NLH."*

The Board went on to comment that, given the uncertainty surrounding Hydro's forecast capital structure over the short-term and in light of the Board's decision with respect to the ROE to be used in rate setting, there were no discernable benefits to be gained by putting an AAM in place at that time.

Hydro's proposed AAM as outlined in its report was modelled directly on NP's existing automatic adjustment formula, with some modifications. Hydro stated in its report that its objective was to *"…adopt the features of NP's automatic adjustment mechanism that were equally applicable to Hydro and to adapt the remainder to Hydro's unique circumstances."* The proposed changes were with respect to the manner and timing of the annual calculation of the allowed return on equity and the trigger point for early review.

In commenting on the appropriateness of using NP's existing formula as the template for designing an AAM for Hydro, Dr. Cannon stated that NP and Hydro are not comparable when it comes to the treatment of the embedded cost of debt within the AAM. He stated:

> A.(Dr. Cannon) As has been pointed out, Hydro, in Hydro, the debt represents a far larger proportion of the overall capital structure, you know, 83-84 percent in the case of Hydro, whereas for Newfoundland Power debt, it's only approximately 55 percent of the regulated capital structure. Similarly, for Hydro, the regulated return on equity is dramatically lower, you know, by design than the allowed return for Newfoundland Power, right, and these two differences between Hydro and Power are, in my view, very, very material differences that affect the appropriateness of keeping the embedded cost of debt constant in the formula.
>
> Because of these two differences, the embedded cost of debt basically determines 92 percent of the overall return on rate base for Hydro, whereas the return on equity determines only somewhat less than eight percent of the required return on rate base. For Newfoundland Power, this split is more like 50/50, instead of 92 to eight. So it seems to me to sort of undermine the purpose and the credibility of Hydro's proposed automatic adjustment mechanism to, on the one hand, fix at a constant rate for four years, fix at a constant rate for the life of the automatic adjustment mechanism, the cost rate on that component that makes up 92 percent of the return on rate base, but to allow year-by-year adjustments through the adjusting the return on equity for that component that accounts for only eight percent of the total return on rate base.
>
> (Transcript, Jan. 25, 2007, pgs. 105-106)

The Consumer Advocate also commented in oral submission on the appropriateness of using the NP formula as the model for Hydro's AAM:

> (Mr. Johnson) Newfoundland Power does not have anywhere near 92 percent of its overall return on rate base determined by its embedded cost of debt. Newfoundland Power is more like 50/50. And this is a very material difference between the two utilities. It's my submission that the Board should consider this material difference very closely and in judging the appropriateness of what Hydro has proposed in this case. Hydro, the evidence is clear, really didn't look any further than the Newfoundland Power formula, according to Mark Bradbury, who said that he was the principal architect of the mechanism. So I do not find that Hydro's appeal that it should be entitled as a matter of regulatory consistency and fairness to be particularly compelling, particularly in the absence of Hydro taking an exhaustive review of other possibilities…Hydro I believe improperly limited it review to the more obvious adaptations it could make to the Newfoundland Power formula, without sitting back and taking a good hard look at the differences between the make up in the return on rate base of the two utilities.
> (Transcript, Feb. 13, 2007, pg. 36/19 to pg. 38/2)

The question of whether NP's existing formula is the appropriate model for Hydro's AAM is an important one for the Board. In Order No. P.U. 14(2004) the Board noted that NP's formula reflects the complex relationship between rate of return on rate base and the cost of the various components of the capital structure of NP and that it expected that an AAM for Hydro would be <u>similarly complex</u>. There is no evidence before the Board to suggest that NP's formula is an appropriate model for Hydro's AAM in the context of the significant differences between Hydro and NP in terms of its capital structure. The Board finds the opinion expressed by Dr. Cannon with respect to this issue to be very compelling. However the Board is not satisfied that the solution proposed by Dr. Cannon with respect to the treatment of the embedded cost of debt solves the inherent issue of whether the NP model is an appropriate starting point for the development of an AAM for Hydro. The fundamental differences between the two utilities including differences in the capital structure have not been sufficiently addressed by Hydro to the Board's satisfaction.

The Board notes that the capital structure of the two utilities is dramatically different. NP has a much higher level of equity with a deemed capital structure for regulatory purposes. The AAM proposed by Hydro would use its test year capital structure, with a higher debt to equity ratio, in its proposed AAM. NP also has a full market return on equity calculated by determining a risk free rate and a risk premium for NP. Hydro's proposed AAM uses a risk free rate plus a spread for Hydro's cost of borrowing as determined by Hydro's underwriters. The significance of these differences in the judgment of the Board is but one area that was not adequately addressed in this proceeding.

In addition, implementation of an AAM for Hydro is further complicated by the fact that the 2007 test year ROE was established as part of a settlement agreement without any evidence or commentary as to how this figure is calculated. While the Board has accepted the proposed ROE in determining Hydro's return on rate base for the 2007 test year the record does not set out how this ROE was determined in relation to the long-term bond rates and the credit spread, which is proposed by Hydro to be the basis for future adjustment in the proposed AAM. The Board is not satisfied that it is appropriate to move from this negotiated figure to the operation of the proposed AAM for 2008.

Before implementing an AAM for Hydro the Board would expect to have before it a proposal setting out a detailed explanation of alternatives with evaluation showing why the proposed model is most appropriate to the particular circumstances of Hydro. The proposed model must be shown to contribute to regulatory certainty and efficiency while observing the principle of consistency to the extent appropriate. As an example, the Board would expect that a proposed AAM would maintain the utility specific test year parameters established as part of a general rate application while allowing appropriate changes to market related benchmarks going forward. The Board also notes that NP's automatic adjustment formula was established in the context of a full cost of capital hearing. It may be that an alternative process such as a technical conference may be an appropriate forum to examine an AAM proposal for Hydro. However the Board is satisfied that a more detailed review of the particular circumstances of Hydro and available alternatives is required before an AAM for Hydro can be implemented.

The Board will not approve Hydro's proposal for an Automatic Adjustment Mechanism at this time.

2. Reliability Policy and Initiatives

During the public hearing and final submissions the Consumer Advocate raised the issue of whether Hydro should be required to develop a formal distribution reliability policy and plan for submission to the Board.

In pre-filed evidence (pg. 25) Mr. Douglas Bowman, on behalf of the Consumer Advocate, submitted that:

> *"In summary, the problem I see with Hydro's 20% target reliability improvement is that there is no formal policy or procedure with minimum reliability performance benchmarks. This makes it difficult to conduct a proper audit of reliability expenditures, an extremely important consideration given the high value customers place on reliable service, and the high level of expenditures necessary to maintain adequate reliability. A formal reliability policy with minimum performance benchmarks will ensure that in future rate and capital budget proceedings the Board and stakeholders will be able to properly assess and determine in an evidence-based manner if reliability performance is adequate, and if reliability expenditures are indeed warranted."*

In response to questioning from the Consumer Advocate on this issue Mr. Martin outlined Hydro's approach to balancing costs and reliability as follows:

> A. (Mr. Martin) I believe cost should be driven by what it takes to maintain the reliability criteria that we set. So the first thing we have to do is set some reliability criteria, and when we set reliability criteria, that gives us a frame in terms of what to base our thinking on. And then following that we put together a comprehensive maintenance plan. And once we have that comprehensive maintenance plan and philosophy in place that's going to drive maintaining existing assets or in some cases it's going to tell us we have to replace them.
>
> (Transcript, Jan. 22, 2007, pgs. 57/24; 58/1-11)

Mr. Martin went on to describe the process that would be undertaken to arrive at reliability parameters as an iterative one that would have to consider many factors, including the operating environment for Hydro's systems, the experience of other jurisdictions in terms of reliability statistics, costs, safety, and customer expectations. With input from outside parties such as the Board, the Consumer Advocate and other Intervenors, and through iterative revision and review, the result will be, according to Mr. Martin, a band of reliability parameters that would be considered reasonable for Hydro and take into account Hydro's operating requirements. These reliability parameters will, in conjunction with the manufacturer's specifications, influence maintenance planning. The end result of this iterative approach will be a long-term comprehensive maintenance plan.

In oral testimony, under cross-examination by the Consumer Advocate, Mr. Haynes described the efforts currently underway to develop this maintenance plan. An engineering group is formed with three engineers to be hired, and this group's work will be focused on maintenance planning and long-term asset performance and maintenance strategies. This work will cover all aspects of Hydro's operations – transmission, distribution and generation – although not all at once. Mr. Haynes stressed that this work is in the early stages and the team is "*in the process of being put together.*" (Transcript, Jan. 23, 2007, pgs. 71-74)

In written submission (pg. 12) the Consumer Advocate stated:

> *"The Consumer Advocate's position is that given Hydro has identified a problem with distribution reliability and acknowledges that there is a cost associated with bringing reliability up to standard, and that improvements must be made over a period of years, a policy must be developed first, along with a plan consistent with the policy for addressing the problem. Hydro's approach that has not identified the magnitude of the required improvement, the cost of achieving the improvement, and does not include a monitoring and tracking mechanism for ensuring customers are getting the projected value from the plan can be improved upon."*

The Consumer Advocate proposed:

> *"That at the Board's direction, Hydro develop a plan documenting its approach that will ensure acceptable distribution reliability performance going forward. The plan should address the issues identified above including targets, a plan for meeting those targets and a tracking mechanism for monitoring performance relative to the plan. The plan should be contingent and consistent with a distribution reliability policy approved by the Board. The plan would be the initial filing under the new distribution reliability policy. Hydro should likewise review current Board reporting requirements and make recommendations for streamlining the process, and in particular, eliminating any reporting requirement that is duplicated by reporting requirements stemming from the new distribution reliability policy. We anticipate that the distribution reliability plan would form part of the annual Capital Budget submission."*

NP's position on this issue was summarized in its written submission (pg. 7):

> *"The evidence in this proceeding does not justify the increased regulatory burden and costs involved in the establishment and pursuit of minimum reliability criteria. Decisions with respect to system maintenance and capital replacement are best considered within Hydro's existing framework of asset management and maintenance, and capital expenditures review."*

Hydro does not agree with the Consumer Advocate's position on this issue or with Dr. Bowman's proposal with respect to the establishment of a reliability policy. With respect to the proposal specifically Hydro stated in its written submission (pg. 33):

- *"Hydro has reviewed its performance in Generation, Transmission and Distribution and has established targets for improvement in reliability as reflected in CA 30 NLH (1st Revision) pages 3-9. These targets are reviewed annually, based upon past performance, industry benchmarks, and customer feedback;*
- *Hydro's President and CEO explained Hydro's philosophy for an inspection maintenance program in cross examination(Transcript January 22, 2007, page 57, line 23 to page 65, line 18). In Mr. Martin's view, the first step is to establish an acceptable band of reliability which would assist in the preparation of a long term comprehensive maintenance plan which would in turn be used to support both capital and operating expenditures. As he explained, this iterative process is currently underway.*
- *Hydro's KPI report provided the Board with historic, current and forecast comparisons of eight reliability criteria and seven other key performance measures listed in Table 4.0 on page 23. Subsequently, in CA 30 NLH (1st Revision), Hydro confirmed its 20% improvement targets for distribution and transmission reliability and compared Hydro's performance for D-SAIFI, D-SAIDI, T-SAIFI, T-SAIDI, T-SARI, DAFOR and Weighted Capability Factor against NP and CEA composites;*
- *Hydro notes that the existence of penalties and remedies converts the policy recommended by Mr. Bowman from a minimum reliability policy to a mandatory reliability policy (Transcript January 23, 2007, page 193, line 8-14)."*

Hydro concluded its written submission on this issue by stating (pg. 35):

> *"Hydro has complied with the Board's directives on reliability and other KPI reporting. If, in the Board's opinion, it would improve the Board's oversight of the utility and/or improve the efficiency of the regulatory process, Hydro would be prepared to modify its existing reports to provide any available additional information the Board considers appropriate.*
>
> *However Hydro submits that modifications to the existing reporting requirements (established by prior Board Orders) should follow only if the Board is satisfied that such changes provide value sufficient to warrant the associated cost."*

The Board currently requires Hydro to report on reliability performance for its transmission, distribution and generation systems on a quarterly basis. As well Hydro must report outage and incident reports to the Board on an occurrence basis. However these measures are reported to the Board based on historical performance. The Consumer Advocate is requesting Hydro be required to report annually to the Board its planned reliability targets, its planned actions and projects, expected costs, and then provide a follow-up report as to how and whether it achieved these targets.

Based on the evidence presented at the hearing and the final submissions the Board is not persuaded that a direction to Hydro to develop a distribution reliability plan is required at this time. The Board acknowledges the Consumer Advocate's submission with respect to the requirement for such a plan, and the need for a monitoring and tracking mechanism tied to accepted reliability targets, to ensure that customers are receiving value from expenditures on reliability improvements. According to the testimony of both Mr. Martin and Mr. Haynes it is understood that Hydro is currently in the process of working towards the development of a long-term maintenance plan, with accountability to rest with the engineering group of Hydro. According to Mr. Martin, *"…we're in the process of laying out that maintenance plan so we get it under one umbrella in one document and something that we can all look at and consider."* (Transcript. Jan. 22, 2007, pg. 65/10-14) Hydro's efforts currently underway to develop reliability parameters for each of its systems and to produce a comprehensive maintenance plan for all of its assets should, in part, address the Consumer Advocate's concerns. The Board is prepared at this time to allow Hydro to fully develop its reliability standards and related comprehensive maintenance plans as outlined by Mr. Martin. The Board will however monitor Hydro's ongoing work in this area and require regular updates from Hydro as part of its quarterly reports.

Hydro will be required to include, as part of its quarterly reports, beginning with its second quarter 2007 report, an update on the progress of the development of a comprehensive maintenance plan for its assets and associated reliability standards.

3. Peer Group Benchmarking

In Order No. P. U. 14(2004) the Board accepted the recommendation of the Mediation Report, where the parties agreed, inter alia, that:

> *"aa. Hydro will propose a peer group of utilities and measures upon which to compare its performance not later than six months following the date of the Board Order in this proceeding. Upon approval thereof, Hydro will collect and report such measures for itself and the peer group annually beginning in 2005."*

In its Decision the Board indicated that it would require Hydro to incorporate the following Key Performance Indicators (KPIs) into its annual report to the Board, commencing with its 2004 annual report:

i. Thermal conversion factor (MWh generated at Holyrood per barrel of oil – MWh/bbl);
ii. Hydraulic conversion factor (MWh generated per million cubic meters of water – MWh/MCM);
iii. Corporate operating, maintenance and administrative expense (OM&A) per MWh generated;
iv. Generation OM&A per MWh generated;
v. Generation OM&A per MW installed capacity;
vi. Transmission OM&A per km of transmission line; and
vii. Distribution OM&A per km of distribution line.

The Board also ordered Hydro to file a report no later than December 31, 2004 proposing a "peer group" of utilities for the purposes of external benchmarking of its KPIs. As well the Board directed Hydro to file with its annual financial report commencing in 2004 an annual report outlining, among other things, *"appropriate historic, current and forecast comparisons of* *reliability, operating, financial and other key targeted outcomes/measures including the additional KPIs accepted in this Order."*

Hydro prepared and filed a report entitled "Defining a Utility Peer Group for Newfoundland and Labrador Hydro", dated December 2004, which was also filed in these proceedings in response to CA 4. In this report (pg. 10) Hydro recommended that:

> *"The most cost effective and administratively feasible choice for the selection of a peer group of utilities for Hydro's external benchmarking purposes is the peer groups already established within the CEA and CEA COPE frameworks. Hydro recommends that CEA be used as the means for Hydro to externally benchmark to its industry counterparts operating elsewhere in Canada."*

In its response to CA 4(b) Hydro advised that, subsequent to Hydro's December 2004 report to the Board, the CEA[1] finalized a policy paper in October 2005 for its member utilities on the use of benchmarking data in regulatory settings. (CA 4 Attachment 2) According to Hydro the CEA recommended trending the performance of a utility over time as opposed to peer-to-peer benchmarking due to the complexity of peer benchmarking. The CEA undertook to develop a set of high-level indicators for use in regulatory settings. The CEA's policy paper restricted the use of existing CEA metrics by member utilities in regulatory settings during the review and development period. Since this work is ongoing Hydro advised in its response that it has not engaged in any external benchmarking. Furthermore Hydro also indicated in its response to CA 4(d) it intends to adhere to the CEA policy and guidelines respecting benchmarking data in regulatory settings and that the CEA targets completion of regulatory performance indicators during 2007.

In Pre-filed Evidence (pg. 29) Mr. Douglas Bowman, on behalf of the Consumer Advocate, expressed the following opinion:

> *"I repeat what I said at the 2003 GRA that Hydro performance relative to an external peer group provides valuable insights to the Board and the stakeholder review process. The importance of the peer group information is not solely its use as an external benchmark in absolute terms, but also as a measure of relative changes in performance. For example, Hydro has been successful in reducing its controllable costs by almost 2% annually in real terms over the past five years. It would be interesting to see if comparable utilities have been more or less successful in controlling their costs as a means for gauging the relative success of Hydro's cost control programs. I was under the impression that Hydro agreed with the importance of tracking external peer group performance when it signed on to the mediation agreement. I note that Hydro indicates that its reliability improvement target was established on the basis of, among other things, its performance relative to available comparable utilities (see responses to CA 56 NLH).*
>
> *Benchmarking performance against an external peer group of comparable utilities is a vital component of a utility's business process, highlighting the areas requiring improvement. It is also an important component of the regulatory process, providing valuable information to the stakeholder audit process."*

[1] Canadian Electricity Association

In final submission the Consumer Advocate argued that, because of the importance of external benchmarking and the value of trending this information over time, the Board should direct Hydro to initiate reporting of key performance indicators in Exhibit JRH-1 with performance externally benchmarked to a comparable peer group beginning with 2006 data. The Consumer Advocate also proposed that the remaining non-reliability related performance data should be reported no later than the KPI report on 2007 performance. It was also suggested that the data from 2003 onwards should also be compiled and reported to allow for trending of historical data. (Consumer Advocate, Final Submission, pgs. 18-19)

Mr. Haynes clarified Hydro's position with respect to peer group reporting during cross-examination by the Consumer Advocate:

> *"On a peer group reporting we have committed to continue with the CEA on the reliability factor and we will also go out and seek another peer group through FERC, for instance, or any other thing that we can find to put together a credible peer group to compare it to and we'll prepare statistics based on that and present those with our KPI reports in the future. I don't know if the---I should qualify for the next KPI report, if that will be done by then because that's usually done in the Spring, but certainly for the next review, which will be 2007, we will be in a good position to present whatever we find and would hopefully do that."* (Transcript, Jan. 23, 2007, pg. 120/5-19)

In final argument Hydro advised that it met with the CEA in December 2006 and received confirmation that the CEA has decided to be less restrictive regarding the use of reliability-type composite KPIs in public or regulatory settings during the performance data review period. In light of this clarification Hydro filed a revised response to CA 30 NLH (1st Revision) with the understanding that, on a go-forward basis, it will be able to include in its annual KPI report and related reports to the Board, available CEA industry composite reliability data. However Hydro advised that the CEA's approach to the use of KPIs of an economic or financial nature is not resolved to the same degree, and that progress on this aspect of performance measurement will be ongoing for some time. Hydro's original recommendation therefore to obtain all peer group information from a central source is, according to Hydro, no longer possible and exploration of other alternatives for KPIs of an economic or financial nature is now required.

NP does not take any issue with Hydro's proposals with respect to benchmarking and reporting of key performance indicators. In its written submission (pg. 8) NP cautioned that *"The limitations on available data and differences in service conditions make it difficult to use composite averages or to draw comparisons with other utilities."*

The Board agrees with the submission of the Consumer Advocate that external benchmarking of KPIs is important for measuring the overall performance of Hydro in key areas. Hydro has, to the extent possible, provided the required report and information to the Board on the matter of peer group benchmarking but, due to reasons beyond its control, there have been delays in accessing and reporting reliability composites. This issue appears to have been addressed with the clarification of CEA's policy. With respect to non-reliability composites, and in light of the CEA's position, Hydro has indicated its willingness to seek alternate peer group measures and the Board understands this work is on-going. The Board accepts that this information may not be available for the 2006 report, which is filed in the spring of 2007. The Board will require Hydro to provide an update of progress in developing an acceptable peer group for financial KPIs at the generation and transmission level as of September 30, 2007 with a view to determining whether further direction or changes will be made for the 2007 KPI report. The Board will not, however, require Hydro to compile historical data back to 2003 as this information would be of limited value on a go-forward basis.

Hydro will be required to file a report no later than October 31, 2007 updating the progress, as of September 30, 2007, of the development of an acceptable peer group for financial KPIs.

4. Energy Conservation Initiatives

During the hearing and in final submission the Consumer Advocate argued that Hydro can and should play a key role in educating customers regarding the relative costs of heating their homes with electricity compared to other means such as oil. This information is *"…not known to the vast majority of consumers, accordingly they cannot be expected to take such information into account in deciding upon the most cost-effective means of heating their homes."* The Consumer Advocate acknowledged Hydro's efforts to increase its activities to encourage consumers to take action regarding energy conservation. In final submission (pg. 33) the Consumer Advocate requested that the Board direct Hydro to bring forward a plan aimed at educating consumers as to the relative costs of electricity versus oil for home heat and hot water usage by way of including such information in electricity bills or other effective means.

According to testimony from Mr. Henderson Hydro is in the process of issuing a request for proposals for a study to determine the potential for energy conservation in the Province and to examine what types of programs could be implemented to yield positive results in terms of energy conservation. Mr. Henderson also described other initiatives being planned by Hydro for 2007, including promotional information regarding Hydro Wise and development of pilot projects related to conservation programs that come out of the study. Hydro also plans to work with NP, Government departments and other non-government agencies to build partnerships to promote conservation initiatives. (Transcript, Jan. 23, 2007, pgs. 140-143)

In its written submission (pg. 44) Hydro indicated that the proposed study, referred to as a Conservation and Demand Management ("CDM") Potential Study, will be completed by mid-year 2007 and a five-year strategic plan will be the focus of the third and fourth quarters. Hydro submitted that the Board should await the completion of this study before making any Order directing Hydro as requested by the Consumer Advocate.

In its written submission (pg. 8) NP indicated its support of Hydro's approach to energy conservation:

> *"Hydro has begun a process to determine what opportunities exist for cost effective demand side management/conservation. This process is being carried out in cooperation with Newfoundland Power and other stakeholders, and is appropriately funded.*

The proposed conservation and demand management potential study will provide information that will assist the utilities in identifying cost-effective conservation programs, thereby fulfilling the policy objectives of the EPCA to ensure least cost reliable power. The coordinated approach with other stakeholders will ensure that conservation benefits are maximized and programs are delivered in an effective manner."

In oral submission Hydro clarified its position on the issue of conservation and the Consumer Advocate's request for an education plan:

> Hydro, with the co-operation of Newfoundland Power, has issued an RFP and the consultant who is hired will identify a host of initiatives relative to conservation, and not only will they identify the list, but they will also indicate to the utilities where they expect to get the best results based on best practices from other jurisdictions.
>
> (Transcript, February 13, 2007, pg. 89-90)

The issue of energy conservation has been a recurring theme before the Board in prior hearings and the Board commends both Hydro and NP for their joint initiative in this area. The Board agrees with the Consumer Advocate that Hydro can play an important role with regard to educating consumers concerning energy usage and improved efficiency and also about the relative costs of alternate energy sources by comparison to electricity. However, in light of the prospective and joint initiative being funded by both utilities, the Board finds that it would be prudent and practical to await the results of the CDM study. The consultant is expected to catalogue CDM technologies, identify applicable technologies, develop program concepts as well as complete a market and economic analysis for the residential, commercial and industrial sectors. The study will also provide a list of initiatives and expected results for each initiative based on experience in other jurisdictions. In the Board's view this comprehensive information will be valuable in determining what energy conservation programs and demand management techniques can be employed by each utility in satisfying the needs of their respective customers. It is the Board's understanding that these initiatives will have both a short-term and long-term focus and consequently may prove valuable in impacting demand and hence future supply considerations to be determined within the context of the Integrated Resource Plan, considered below.

Hydro will be required to file, no later than June 30, 2008, a report outlining its five-year strategic plan with respect to energy conservation initiatives, which should include a description, timing and cost of the program elements to be implemented by Hydro and a copy of the CDM Potential Study.

5. Integrated Resource Planning

Both the Industrial Customers and the Consumer Advocate raised the issue of Hydro's long term system planning and the importance of commencing work on an integrated resource planning (IRP) process in 2007.

Mr. Douglas Bowman, the Consumer Advocate's witness, submitted that:

"…demand and supply procurement decisions have long-term effects on the cost of power. An integrated resource plan with full public input is necessary to properly assess the risks of such

decisions and provide confidence that consumers are gaining maximum value from both cost and social-economic perspectives."
(Douglas Bowman, Pre-filed Evidence, pg. 19/15-18)

The Industrial Customers' expert witnesses stated:

"In its Order for this proceeding, the Board should ensure that there is a firm submission timeline set for a long-term Island Interconnected System Resource Plan and clarify that Hydro has the lead role in preparing that plan for PUB review."
(P. Bowman and A. McLaren, Pre-filed Evidence, pg. 42/26-28)

In final submissions both the Consumer Advocate and the Industrial Customers asked that the Board make an Order that any party shall have leave to bring an application to the Board seeking directions on the IRP process at any time after 60 days following the public release of the Energy Plan in the event that it is released on or before the 30th of June, 2007, or at any time after should the Energy Plan not be released by June 30, 2007 or should it become apparent that it will not be released by that date.

Hydro submits that its ongoing system planning analysis and annual "Report on Generation Planning Issues" assesses the various potential sources of meeting future load requirements and allows the Board to meet its obligations under s. 4 of the *EPCA*. Hydro's position was summarized in its written submission (pg. 30):

- *"Hydro already prepares an annual system planning report, which reviews the latest long term load forecast, generation expansion requirements, options, costs and issues;*
- *Demand side management is a key element of an IRP and a study of the technical and economic potential for conservation in the Province will be underway in 2007;*
- *The Board addressed an IRP for Hydro in Order No. P. U. 14(2004) and expressed its preference for a generic process;*
- *The BC Hydro model referred to by Mr. Douglas Bowman demonstrates the scope and enormity of the process;.*
- *The Board does not have an accurate estimate of the costs of an IRP; and*
- *Most importantly the Province's Energy Plan, which will establish provincial policy for the supply of energy, has not yet been released but is anticipated in the coming months."*

With respect to the appropriateness of an IRP Hydro submitted:

"1. The Board should await the release of the Province's Energy Plan;
2. It accepts the Board's finding in Order No. P. U. 14(2004) at page 149 that such an exercise should be coordinated with the involvement of both utilities and is best addressed in the context of a generic process; and
3. Hydro could meet with the Board and Intervenors within a reasonable period following the release of the Province's Energy Plan to discuss the appropriateness of an IRP. If the Board believes an IRP is appropriate, it would discuss the participants, timing and scope of such an exercise."

In Order No. P. U. 14(2004) the Board addressed the issue of an IRP in the context of Hydro's future generation planning. The Board confirmed that it has the authority and responsibility to ensure that adequate planning occurs for the production, transmission and distribution of least cost power in the Province, pursuant to sections 3, 4 and 6 of the *EPCA*. In addressing the question of whether Hydro should be required to undertake an integrated resource planning exercise, the Board noted (pg. 149):

> *"…implementation of Integrated Resource Planning may present sound opportunities for coordinated planning and improved regulation involving both utilities. This process brings together strategic planning, future supply and demand, least cost analysis, demand side management options and environmental considerations."*

The Board concluded, however, that more detailed information was required before the Board can move forward with an IRP, including a marginal cost study. The Board found that this matter should be considered as part of a generic process involving both utilities and other interested parties.

The Board notes that a marginal cost study is now complete and has been filed with the Board and the parties as part of this proceeding. As well Hydro and the parties have agreed as part of the settlement process to undertake rate design reviews for both NP and the Industrial Customers. As noted in the previous section on Energy Conservation Initiatives Hydro and NP are also currently undertaking a joint study of conservation and demand management potential in the Province. In addition, Government is currently in the process of finalizing the Energy Plan, which is expected to set out provincial policy for the supply of energy over the short and long term. It is understood that the Energy Plan may be released during the first half of 2007, although there is uncertainty as to the actual release date.

The Board is not prepared to proceed with an IRP exercise given the pending release of the Energy Plan and completion of the various rate design reviews and conservation and demand management studies currently underway. In the Board's view the Province's future policy direction respecting energy supply will be a key ingredient in formulating an IRP. As well these various studies/reviews would also comprise important inputs needed to stimulate informed discussion and debate contributing to a comprehensive IRP acceptable to all stakeholders.

In terms of the Board's ongoing role with respect to ensuring adequate planning Hydro prepares an annual system planning report, which reviews the latest long-term load forecast, generation expansion requirements, options, costs and other important issues. The 2005 report was filed on November 27, 2006 (Schedule JRH-Supplementary 1) and the 2006 report was filed on December 8, 2006. This report provides fundamental information regarding future supply issues in the Province and is valuable to the Board in meeting its responsibilities under s. 4 of the *EPCA*. The Board remains convinced that an IRP undertaken as part of a generic process as described in Order No. P. U 14(2004) is an important planning tool and would enhance the information available to the Board and other parties regarding future generation and supply options in the Province. The Board will convene a meeting of stakeholders including Hydro and the parties to this proceeding to discuss the scope of an IRP process with the timing of such an exercise to be determined by the Board.

The Board will not establish at this time a process with respect to the commencement of an IRP exercise.

6. Oil Purchasing/Hedging

While the issue of oil purchasing/hedging was identified in the Settlement Agreement as an unresolved issue it was not specifically addressed in any level of detail during the hearing. The only direct evidence presented on this issue was testimony by Mr. Martin on behalf of Hydro during cross-examination by the Consumer Advocate. Mr. Martin explained that a speculative hedging program would require a corporation to take positions on future supply and demand commodity. In Hydro's case a successful hedging program would require the utility to correctly speculate on the direction and magnitude of future prices for oil. According to Mr. Martin such expertise is not a core competency of Hydro and should not be expected of the utility.

In final argument Hydro stated: *"Hydro does not believe that ratepayers and stakeholders would accept the potential risks associated with being on the losing end of an active or speculative hedging program. Hydro does not accept that such an oil hedge program is appropriate or necessarily consistent with the utility's obligation to supply safe and reliable power at least cost."* Hydro further stated that the existing RSP appropriately mitigates the financial impacts of volatile fuel prices for Hydro while at the same time providing reasonable rate stability and predictability. The appropriate strategy according to Hydro is to manage the exposure to the volatility of international oil markets to minimize the absolute fuel requirements required for the production of electricity on the island. (Hydro, Final Argument, pg. 46)

The Board notes that, with the exception of Hydro, no party addressed the issue of oil purchasing/hedging in final argument or asked for relief or direction in this Order on this issue. This matter was raised in each of Hydro's last two general rate applications and, in Order No. P. U. 14(2004), the Board agreed with Hydro's evidence that the RSP alone has the greatest impact on fuel price variations and that there were no significant benefits from further exploring an oil price hedging program. No evidence was presented at this hearing to warrant any further consideration of this issue.

The Board will not make any Order with respect to an oil purchasing or hedging program for Hydro.

VIII. IMPLEMENTATION

In December of 2006 the Board, pursuant to s. 75 of the *Act*, approved interim rates to be charged to all of Hydro's customers effective January 1, 2007. These rates were consistent with the proposals set out in Hydro's Revised Application and reflected in the Settlement Agreements, the Government Directives, and available updated financial information. In final argument Hydro proposed the final approval of the rates which had been approved on an interim basis effective January 1, 2007. No party took exception to the rates proposed by Hydro.

The Board's financial consultants Grant Thornton reviewed the Revised Application and the underlying information and confirmed that the revised forecast revenue requirement (before return on rate base) appropriately incorporates the impact of the agreed changes.

As discussed throughout this Decision and Order the Board has accepted that the proposed rates appropriately reflect the Settlement Agreements, the Government Directives and the updated financial information and fairly balance the interests of both the utility and consumers. The Board will therefore approve Hydro's proposed rates for NP and the Industrial Customers.

In the interest of ensuring an efficient and streamlined implementation of rates and Rules and Regulations for Hydro's Rural customers, the Board will not approve rates for these customers at this time. Some of these rates cannot be approved until after final approval of NP's customer rates since the rates are based on NP's rates. In addition, as discussed earlier, the Board is not approving the Rules and Regulations for Hydro's Rural customers as a result of the Board's findings in relation to the Burgeo School and Library. The Board has also not approved the proposed RSP rules and instead will require Hydro to refile the RSP rules with revisions. The Board will therefore require Hydro to refile the proposed rates and Rules and Regulations for its Rural customers and the revised RSP rules within fifteen days of approval by the Board of final rates for NP customers. The refiling should identify all changes, deletions, and additions to the previous rules and regulations for Rural customers and the previous RSP rules, and should be supported with reference back to the specific proposals underlying the change.

The Board will approve final rates for Utility and Industrial Customers, as set out in Schedule A, to be effective January 1, 2007. Hydro will be required to apply to the Board for approval of final rates and Rules and Regulations for its remaining customers and for approval of the RSP rules, within fifteen days of the Order approving final rates for customers of NP.

IX. REQUEST FOR AN AWARD OF COSTS

The Industrial Customers have requested that the Board make an Order awarding them the costs of their participation in this rate application, including their costs of participation in the settlement process. In written submissions the Industrial Customers argued that their participation in the settlement process contributed to a conclusion of the general rate application which was less costly to all parties, and which was consistent with the Board's direction that the parties seek opportunities to achieve a more timely and efficient rate application process. The Industrial Customers further stated at pg. 7 of their written submission:

> *"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 Application process, to which the settlement process was integral, in a responsible and meaningful way, and contributed to the Board's understanding of the issues in contention. The Industrial Customers submit they should accordingly be entitled to recover their costs of that participation. Given the means of cost recovery available to all other major participants in the process, the Industrial Customers submit that a refusal to grant their costs of participation would be unfair. In the wider context, the Industrial Customers would respectfully submit that the denial of costs associated with settlement processes could act as a disincentive to parties' investment of the time, costs and other resources necessary to full and meaningful participation in future alternate dispute resolution."*

In support of this request the Industrial Customers filed a separate submission setting out the amount being sought and including documentation to support the cost claim. According to this submission the total costs incurred by the Industrial Customers related to their participation in this Application is $279,606.41, which includes outside legal fees and consultant costs. To address the issue of costs included on the submitted statements of account of legal counsel that may not be solely related to the general rate application, the Industrial Customers proposed a 5% discounting of the total costs incurred, which would result in a total cost claim of $265,626.09.

In its final written submission Hydro indicated that it is proposing to amortize its hearing costs including the cost of the Board, the costs of the Consumer Advocate and any other costs awarded by the Board over a three-year period commencing in 2007, an estimate of which has been included in the 2007 test year revenue requirement included in the Revised Application. In oral argument Hydro stated its position that the Industrial Customers *"…should receive a similar proportion of the bill that they submitted as they received in the last hearing and for the same reason, that they made a responsible contribution."* Hydro suggested that providing the same pro-rated amount would address disincentive concerns and ensure that the same portion of their costs are recovered as would have been expected under the same test applied in a fully contested hearing.

In response to Hydro's argument that an award of costs in this proceeding should be based on past awards, the Industrial Customers submitted that the exercise of the Board's discretion with respect to costs is not one that ought to be circumscribed by percentages or by what might have been the percentage of the award made by the Board in a previous hearing. The Industrial Customers argued that the Board's discretion should be based on a review of the costs and their substantiation as submitted.

NP and the Consumer Advocate did not comment on the Industrial Customers' claim for costs in their written submissions. In oral argument the Consumer Advocate confirmed that, from his perspective, the Industrial Customers significantly contributed to the process and the agreements reached, and that he didn't see any distinction between a contested hearing and the negotiation process, from the point of view of awarding costs.

As set out in s. 90(1) of the *Act*, an award of costs for any proceeding shall be in the discretion of the Board. The Board will make its determination on the Industrial Customers' request for an award of costs based on their contribution to this proceeding and the resulting impact on the Board's obligation and ability to deliver on its mandate in considering the Application.

Based on the results of the negotiation and settlement process and the comments of all the parties with respect to the positive contribution of the Industrial Customers to this process, the Board is satisfied that the Industrial Customers have contributed in a significant and meaningful manner to this proceeding. The Board will make an award of costs to the Industrial Customers.

With respect to the quantum of the award the Board has reviewed the detailed documentation filed with the Board to support the Industrial Customers' claim for costs. The total costs submitted by the Industrial Customers is $279,606.41, covering a period from January 16, 2006 to February 8, 2007. Based on a review of the supporting documentation covering the period following the Application filing the Board is satisfied that an award of $195,000 is fair and reasonable in the circumstances. This adjusted amount excludes costs that in the Board's view were not directly related to the general rate application or not necessary for the full participation of the Industrial Customers in this proceeding.

Hydro will be required to pay the costs of the Industrial Customers' in the amount of $195,000.

PART THREE. SUMMARY OF BOARD DECISIONS

I. COST OF SERVICE

1. The Board accepts the 2007 test year cost of service as filed by Hydro in its Revised Application as the basis for final rates.

II. REVENUE REQUIREMENT

2. The Board accepts the proposed 2007 test year costs of $320,372,000 (before return on rate base) as filed by Hydro in its Revised Application.

III. RATE STABILIZATION PLAN (RSP)

3. The Board accepts Hydro's proposed methodology for the allocation of the CFB Goose Bay Revenue Credit during the extended phase-in of uniform Labrador Interconnected rates. Hydro will be required to file supporting calculations with each annual application for approval of changes to Labrador Interconnected rates. The Board will accept on a final basis the monthly amount of the automatic rate adjustment in the Rural Rate Alteration.

4. Hydro will be required to revise the RSP rules to remove reference to the specific amounts in the Rural Rate Alteration calculation for the years beyond 2007.

5. Hydro will be required to distribute the balance of the reserve account established in Order No. P. U. 46(2006) in accordance with the special adjustment to the RSP Hydraulic Production Variation Balance as set out in Schedule B. Hydro will be required to revise the RSP rules to exclude reference to this one-time adjustment.

6. Hydro will be required to revise the RSP rules to remove reference to the AAM.

7. Hydro will be required to file for the Board's approval, within fifteen days of the Order approving final rates for customers of NP, revised RSP rules in accordance with the findings of the Board as set out in this Decision and Order.

8. Hydro will be required to file with the Board no later than May 31, 2007 a copy of the terms which are proposed for the RSP review, setting out the terms of reference, the specific review objectives, a list of participants, a planned timeline, and an outline of the review process.

IV. RATE BASE

9. The Board has reviewed the report "Property and Assets Review" completed and filed by Hydro as part of this proceeding and is satisfied that a valuation of the property and assets of Hydro is not required at this time.

10. The Board will not require Hydro to discontinue the use of regulated equity in favour of book equity.

11. The Board accepts Hydro's proposals for the forecast 2007 average rate base of $1,489,323,000 and return on rate base of 7.44%, within a range of 7.29% to 7.59%, as set out in its Revised Application.

V. RATE ISSUES

Utility Rates

12. The Board accepts Hydro's proposals in relation to Utility rates as reflected in the Revised Application.

Industrial Customer Rates

13. The Board accepts Hydro's proposals in relation to Industrial Customer rates as reflected in the Revised Application.

Rural Rates, Rules and Regulations

14. The Board accepts that a preferential rate for the Burgeo School and Library should be continued. Hydro will be required to report to the Board no later than June 30, 2007 as to the final resolution of the necessary credit/refund related to this change.

15. Hydro will be required to refile the Rules and Regulations for its Rural customers for the approval of the Board.

16. The Board accepts the proposed changes to the Rules and Regulations in relation to the periodic adjustment of the rates of Hydro's Rural Isolated Domestic customers (excluding Government Departments) for consumption greater than the lifeline block, Hydro's Isolated Rural General Service customers (excluding Government Departments).

17. The Board accepts Hydro's proposed changes to the Rules and Regulations in accordance with the Government Directive. Hydro will be required to file with the Board by November 30th in each of 2007 and 2008 an application for rates in the subsequent year for these customers in accordance with the two-year plan, which shall also be filed with the application.

VI. LABRADOR INTERCONNECTED SYSTEM

18. The Board accepts Hydro's proposals in relation to the 2007 rates of the Labrador Interconnected customers as reflected in the Revised Application. Hydro will be required to file for the approval of the Board, no later than November 30th of each year, the rates for the subsequent year for the Labrador Interconnected customers in accordance with the planned phase-in for the period 2008 to 2011 inclusive.

VII. OTHER ISSUES

Automatic Adjustment Mechanism

19. The Board will not approve Hydro's proposal for an Automatic Adjustment Mechanism at this time.

Reliability Policy and Initiatives

20. Hydro will be required to include, as part of its quarterly reports, beginning with its second quarter 2007 report, an update on the progress of the development of a comprehensive maintenance plan for its assets and associated reliability standards.

Peer Group Benchmarking

21. Hydro will be required to file a report no later than October 31, 2007 updating the progress, as of September 30, 2007, of the development of an acceptable peer group for financial KPIs.

Energy Conservation Initiatives

22. Hydro will be required to file, no later than June 30, 2008, a report outlining its five-year strategic plan with respect to energy conservation initiatives, which should include a description, timing and cost of the program elements to be implemented by Hydro and a copy of the CDM Potential Study.

Integrated Resource Planning

23. The Board will not establish at this time a process with respect to the commencement of an IRP exercise.

Oil Purchasing and Hedging

24. The Board will not make any Order with respect to an oil purchasing or hedging program for Hydro.

VIII. IMPLEMENTATION

Rates

25. The Board will approve final rates for Utility and Industrial Customers, as set out in Schedule A, to be effective January 1, 2007. Hydro will be required to apply to the Board for approval of final rates and Rules and Regulations for its remaining customers and for approval of the RSP rules, within fifteen days of the Order approving final rates for customers of NP.

IX. COSTS

26. Hydro will be required to pay the costs of the Industrial Customers' in the amount of $195,000.

PART FOUR. BOARD ORDER

IT IS THEREFORE ORDERED THAT:

Rate Base and Rate of Return

1. **Pursuant to Section 78 of the *Act* the Board approves the forecast average rate base for the 2007 test year of $1,489,323,000.**

2. **Pursuant to Section 80 of the *Act* the Board hereby allows a rate of return on rate base, based on the 2007 test year, of 7.44%, within a range of 7.29% to 7.59%.**

Rates, Rules and Regulations

3. **Pursuant to Sections 70 and 75 of the *Act* the Board hereby approves, on a final basis, the interim rates approved in Order Nos. P.U. 41(2006) and P.U. 3(2007) for Utility and Industrial Customers, as set out in Schedule A of this Decision and Order, effective for consumption on and after January 1, 2007.**

4. **Hydro shall, within fifteen days of the Order approving final rates for customers of NP, apply to the Board for approval of final rates and Rules and Regulations for its Rural customers, and RSP Rules.**

5. **Hydro shall distribute the balance of the reserve account established in Order No. P.U. 46(2006) in accordance with the provisions of the special adjustment to the RSP Hydraulic Production Variation Balance, as set out in Schedule B of this Decision and Order.**

Reporting

6. **Hydro shall file with the Board no later than May 31, 2007 a copy of the terms which are proposed for the RSP review, setting out the terms of reference, the specific review objectives, a list of participants, a planned timeline and an outline of the review process.**

7. **Hydro shall include in its quarterly reports, beginning with its June 30, 2007 report and ending with its December 31, 2008 report, an update on the progress of the development of a comprehensive maintenance plan and associated reliability standards.**

8. **Hydro shall file with the Board no later than October 31, 2007 a report updating the progress, as of September 30, 2007, of the development of an acceptable peer group for financial KPI's.**

9. Hydro shall file with the Board no later than June 30, 2008 a report outlining its five-year strategic plan with respect to energy conservation initiatives, including a description, timing, and cost of the program elements to be implemented by Hydro and a copy of the CDM Potential Study.

Costs

10. Hydro shall pay the expenses of the Board arising from this Application, including the expenses of the Consumer Advocate incurred by the Board, pursuant to Sections 90(2) and 117 of the *Act.*

11. Hydro shall pay costs of the Industrial Customers in the amount of $195,000 pursuant to Section 90(1) of the *Act.*

Dated at St. John's, Newfoundland and Labrador this 12th day of April 2007.

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Robert Noseworthy
Chair & Chief Executive Officer

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Darlene Whalen, P.Eng.
Vice-Chair

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Cheryl Blundon
Board Secretary