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HAND DELIVERED

February 9, 2007

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

Attention: Ms. Cheryl Blundon
Board Secretary

Ladies & Gentlemen:

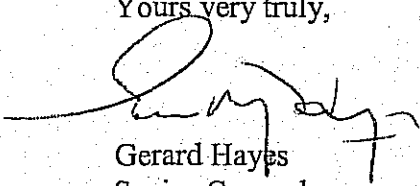
Re: 2006 Newfoundland & Labrador Hydro General Rate Application

Enclosed are the original and 10 copies of Newfoundland Power's Brief of Argument.

An electronic and paper copy will be forwarded to each registered intervenor directly.

If you have any questions regarding the enclosed, please contact the undersigned at your convenience.

Yours very truly,


Gerard Hayes
Senior Counsel

Enclosures

c. Gillian Butler, Q.C., & Geoffrey Young
Newfoundland & Labrador Hydro

Thomas Johnson
O'Dea Earle Law Offices

Joseph Hutchings, Q.C.
Poole Althouse

Paul Coxworthy
Stewart McKelvey



Join us in the fight against cancer.

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

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

**BRIEF OF ARGUMENT
OF
NEWFOUNDLAND POWER INC.**

FEBRUARY 9, 2007

Contents

| | Page |
|--|------|
| 1.0 Introduction..... | 1 |
| 2.0 The Negotiated Agreements..... | 1 |
| 3.0 Other Issues | 2 |
| 3.1 Automatic Adjustment Formula | 2 |
| 3.2 Integrated Resource Planning..... | 5 |
| 3.3 Reliability Policy and Initiatives | 5 |
| 3.4 Peer Group Benchmarking..... | 8 |
| 3.5 Oil Purchasing/Hedging | 8 |
| 3.6 Conservation Initiatives..... | 8 |

1 **1.0 Introduction**

2 The following issues arise in this proceeding:

3 A. The Negotiated Agreements.

4 B. Other Issues:

5 i) Automatic Adjustment Formula

6 ii) Integrated Resource Planning

7 iii) Reliability Policy and Initiatives

8 iv) Peer Group Benchmarking and Tracking and Reporting of Additional
9 Performance Indicators

10 v) Oil Purchasing/Hedging

11 vi) Conservation Initiatives.

12

13 **2.0 The Negotiated Agreements**

14 The four negotiated agreements (the "Agreements") reflect a reasoned consensus of
15 the parties in relation to the issues addressed therein, including Hydro's revenue
16 requirement.

17

18 Hydro's revenue requirement has been tested through a process that includes:

19 1) pre-filed testimony;

20 2) approximately 650 Requests for Information;

21 3) extensive negotiation among the parties;

22 4) testimony before the Board.

23

24 Newfoundland Power submits that the Board should determine the various matters
25 addressed in the Agreements, including Hydro's revenue requirement, in accordance
26 with the terms of the Agreements.

1 **3.0 Other Issues**

2 **3.1 Automatic Adjustment Formula**

3 Newfoundland Power supports Hydro's proposals with respect to its automatic
4 adjustment formula (the "Formula").

5
6 The only point in issue appears to be Dr. Cannon's proposal that the cost of debt to be
7 used in the Formula in years beyond the test year be determined based upon forecasts
8 of debt costs for those years to be determined in this hearing.

9
10 Newfoundland Power does not support Dr. Cannon's proposal.

11
12 The *Electrical Power Control Act, 1994* ("EPCA") mandates the Board to set rates
13 based on forecast costs for one or more test years. The forecast test year method has
14 been expressly approved by the Newfoundland and Labrador Court of Appeal¹ and the
15 Supreme Court of Canada.²

16
17 In a general rate proceeding, the Board tests all cost components of the revenue
18 requirement for the test year based upon forecast costs for that year. In this
19 proceeding, costs have been tested (and agreed by the parties) for the 2007 test year.

20
21 Dr. Cannon's proposal to use forecast values for the cost of debt in the Formula in years
22 beyond the 2007 test year would adjust only one component of test year costs in future

¹ Reference re Section 101 of the Public Utilities Act (Nfld.) (1998), 164 Nfld. & P.E.I.R. 60 (C.A.)

² Atco Gas and Pipelines Ltd. v. Alberta (Energy and Utilities Board), [2006] 1 S.C.R. 140; Northwestern Utilities Ltd. v. Edmonton (City), [1979] 1 S.C.R. 684

1 years while leaving all other test year costs unchanged. This is not in accordance with
2 determining costs on a test year basis.

3
4 There is no evidence in this proceeding that any Canadian public utility jurisdiction with
5 an automatic adjustment formula utilizes forecast future costs of debt in its formula
6 mechanism.

7 Reference: Transcript, January 25, 2007, page 154, lines 10 to 25.

8
9 Utilizing forecast values for the cost of debt for use in the Formula for years beyond the
10 test year is not in accordance with generally accepted sound public utility practice.

11
12 The automatic adjustment mechanism permits a periodic adjustment of the just and
13 reasonable return on rate base based on changes in the estimated cost of common
14 equity. This avoids frequent cost of capital hearings, which are time consuming and
15 expensive, thereby realizing regulatory cost savings for customers and contributing to
16 regulatory efficiency.

17 Reference: Order No. P.U. 16 (1998-99), page 103; Order No. P.U. 19 (2003),
18 pages 64 to 65.

19
20 Utilizing forecast debt costs creates an illusion of precision. Interest forecasts can
21 change significantly in a short period of time.

22 Reference: Transcript, January 25, 2007, page 29, line 23 to page 34, line 18; page
23 151, line 16 to page 152, line 17.

1 Changing one component of the cost of service, without considering other changes in
2 the cost of service, may result in inappropriate adjustments. Forecast reductions in
3 interest expense may never materialize or may be offset by increases in other
4 expenses.

5 Reference: Transcript, January 25, 2007, page 35, line 13 to page 38, line 23.

6
7 In this proceeding, the evidence indicates that other costs of Hydro, including
8 depreciation and wages for skilled labour, are likely to increase in future years.

9 Reference: Transcript, January 25, 2007, page 55, line 1 to page 56, line 2.

10
11 Revising the debt component of a utility's costs for years beyond the test year
12 potentially leads to the forecasting of changes in other costs, such as fuel, depreciation,
13 salary costs, transportation costs and other operating expenses. To ensure a just and
14 reasonable return, if future debt costs are to be forecast, a utility should also be
15 permitted to forecast other future expenses and have them approved by the Board for
16 recovery in rates in future years.

17 Reference: Transcript, January 25, 2007, page 152, line 18 to page 153, line 24.

18
19 Such an approach would be less efficient than using the proposed Formula within the
20 generally accepted forecast test year method. It would add unnecessary complexity to
21 rate proceedings, increasing the regulatory burden for the parties and increasing the
22 regulatory costs to be borne by consumers. This is not in accordance with sound public
23 utility regulatory policy.

Hydro's proposal for the Formula incorporates a mechanism whereby the Board can monitor all costs, including interest costs, and convene a hearing if it determines that it is necessary or desirable to re-examine Hydro's cost of service.

Reference: Application, Exhibit MGB-1, pages 7 to 10; Transcript, January 25, 2007, page 7, line 2 to page 9, line 9.

Newfoundland Power supports Hydro's proposals with respect to the Formula.

3.2 Integrated Resource Planning

Newfoundland Power agrees with the other parties that examination of the appropriateness and methodology for an integrated resource planning process should be deferred until after the provincial government has released the Provincial Energy Plan and all stakeholders have had an opportunity to consider its effects and implications.

The Board may, if it wishes, specifically recognize that any party may apply to the Board for further consideration of this issue in the future.

3.3 Reliability Policy and Initiatives

Hydro's composite reliability statistics indicate that its reliability performance is below CEA and Newfoundland Power averages.

Reference: CA-30 NLH (1st Revision).

1 Hydro has established a corporate objective of trying to improve its 5-year average
2 distribution reliability indices by 20% in 2007.

3 Reference: CA-30 NLH (1st Revision).
4

5 Hydro intends to pursue this corporate objective within its agreed revenue requirement
6 in relation to maintenance expenses and in accordance with Board approvals for any
7 capital expenditures. The objective is a corporate target that reflects a focus on cost
8 effective reliability in providing electrical service to Hydro's customers. It does not alter
9 the actual processes followed by Hydro in the management, maintenance and
10 replacement of the electrical system.

11 Reference: Transcript, January 23, 2007, page 7, line 14 to page 13, line 10.
12

13 Hydro tracks the reliability performance for individual distribution feeders. Hydro's
14 maintenance expenditures and capital expenditures are determined by examining
15 individual feeders and their components. Such decisions involve a high degree of
16 engineering judgment.

17 Reference: Transcript, January 23, 2007, page 43, line 18 to page 45, line 18;
18 page 121, line 9 to page 126, line 13.
19

20 Capital expenditures have to be justified during the capital budget approval process.

21 Reference: Transcript, January 23, 2007, page 45, line 19 to page 46, line 25;
22 page 121, line 9 to page 126, line 13.
23

1 Planned maintenance and replacement can actually reduce costs for customers by
2 avoiding costly, unplanned outages.

3 Reference: Transcript, January 23, 2007, page 126, line 14 to page 127, line 25.

4

5 There is no evidence in the record of this proceeding that minimum system reliability
6 criteria would enhance Hydro's maintenance and replacement processes.

7

8 Implementation of such criteria would raise a host of practical difficulties. Would the
9 same reliability criteria apply in different parts of the province? Is a customer in St.
10 Anthony entitled to the same minimum reliability standard as a customer in St. John's?
11 What standards would apply on isolated diesel systems? Would severe weather
12 impacts be normalized in some manner?

13

14 Minimum criteria, without reference to appropriate engineering judgments, may not
15 necessarily reflect what is necessary or appropriate to ensure reasonable service in
16 different parts of the service territory.

17 Reference: Transcript, January 23, 2007, page 13, line 11 to page 15, line 1.

18

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

3.4 Peer Group Benchmarking

Newfoundland Power does not take issue with Hydro's proposals with respect to benchmarking and reporting of key performance indicators.

The evidence indicates that considerable care must be taken in attempting to draw meaningful conclusions from comparisons with other utilities. The limitations on available data and differences in service conditions make it difficult to use composite averages or to draw comparisons with other utilities.

Reference: Transcript, January 23, 2007, page 24, line 8 to page 31, line 11.

3.5 Oil Purchasing/Hedging

There is no evidence in this proceeding that any change in Hydro's existing oil purchasing practices is necessary or desirable.

3.6 Conservation Initiatives

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

1 reliable power. The coordinated approach with other stakeholders will ensure that
2 conservation benefits are maximized and programs are delivered in an effective
3 manner.

4 Reference: Transcript, January 23, 2007, page 138, line 12 to page 145, line 9.

5

6 Newfoundland Power supports Hydro's proposed conservation initiatives.

7

8

9 **DATED** at St. John's, Newfoundland and Labrador this 9th day of February, 2007.

10

11

12

NEWFOUNDLAND POWER INC.

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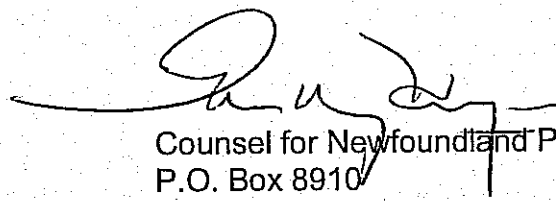
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