August 8, 2006

Consumer Advocate's Submission to Board of Commissioners of Public Utilities - Newfoundland Power Inc. 2007 Capital Budget

The Consumer Advocate takes exception to a number of issues in Newfoundland Power's 2007 Capital Budget Plan, as follows:

- The justification for proceeding immediately with the Rattling Brook refurbishment is not firmly supported;
- Newfoundland Power has not taken all steps available to smooth year-to-year capital budget plan expenditures; i.e., additional programs could be deferred beyond 2007 in order to mitigate the impact of the Rattling Brook refurbishment;
- Newfoundland Power is doing little to promote demand management and energy conservation; and
- The Distribution Reliability Initiative does not adequately incorporate consumer value in the decision-making process.

Each issue is discussed in greater detail below.

Timing of Rattling Brook Refurbishment

Newfoundland Power's application to proceed immediately with the Rattling Brook Refurbishment as outlined is not firmly supported.

The company's response to CA-1.0 NP demonstrates that the Rattling Brook facility has been running nearly full-out over the past several years and particularly over the last two years.

Notable is the relatively modest amount of monies that have been expended on the Rattling Brook penstock in recent years in order to patch and plug leaks. As reported in response to CA-30.0 NP, the company's <u>total expenditures</u> in respect of penstock maintenance from 2002 to present were as follows:

2002 - $13,000.00
2003 - $60,000.00
2004 - $20,000.00
2005 - $13,000.00
2006 - $40,000.00

The foregoing expenditures include penstock repairs and plugging expenditures occasioned after de-watering the penstock which has occurred four times during the past five years (PUB-14.0 NP, p. 1, line 32).

The company states (C.B.A. Vol. 2, Appendix H, p. H-2) that it estimates that penstock and surge tank maintenance costs are to be reduced by only $10,000.00 per year to reflect the penstock and surge tank rehabilitation initiatives it has proposed.

Before embarking upon the immediate replacement of the penstock and incurring the attendant large capital expenditure, the Board should be satisfied that deferral is not an option. The company acknowledges in response to CA-37.0 NP that certain types of leaks (of which there would undoubtedly be many along the penstock) can indeed be plugged using wooden plugs. The company states that in the low pressure end of the Rattling Brook penstock (the top 1250 metres) leaks of less than 75mm (3 inches) in diameter can sometimes be plugged without having to de-water the penstock. In the high pressure end of the penstock (the lower 450 metres) it may be possible to plug leaks under 38mm (1.5 inches) without de-watering.

The company has not established in this application that it has done all that it can reasonably do to deal (without de-watering) with leaks that do exist along the penstock before embarking upon the immediate replacement of the penstock at a projected cost of $11,705,000 (C.B.A. Vol 2, p. 11).

None of this is to suggest that the replacement of the penstock can be deferred indefinitely by taking these measures. However, a further period of time could be potentially purchased through these means particularly if taken in conjunction with steps to shore up the supports for the penstock which are the most deteriorated. Certainly it would be better than taking no steps at all to combat the leaks that exist.

From the record on this application it is clear that the risk of catastrophic failure of the penstock and surge tank is considered remote (PUB 3.2 NP, lines 20-22 and 31). Indeed in the Acres Report of November, 2003 (C.B.A. Vol 2, Appendix B) it is noted that the penstock was then 45 years old and that generally woodstave penstocks have a life of 50 years. Acres' recommendation that the penstock be "replaced in the near future" was on the basis that it was expected that leakage problems would worsen causing operational difficulties and increasing maintenance costs. The risk of catastrophic failure is not referred to as a justification for the replacement of the woodstave penstock in the Acres report. As regards the steel portion of the penstock, Acres expressly states that failure due to pitting corrosion will not be catastrophic.

Given the remoteness of catastrophic failure of the penstock and surge tank, it must be observed that Newfoundland Power is seeking to replace the penstock when presently the price for hot rolled plate (CA-26.0 NP) is quite high relative to 2001, 2002 and 2003 prices. Newfoundland Power states that the North American market price for steel has increased 184% over the period January 2001 to June 2006. Indeed, the price increase has been dramatic since early 2004. The price of steel is well known to be cyclical and it causes concerns that this project is being undertaken at a time when the price is nearly at its highest over the past five years and in the absence of reputable price forecasts for the coming year or two.

It bears noting that the company in its application in the Capital Budget Plan section (C.B.A. Vol 1, p. 8, Table 4) summarizes the proposed 2007 capital projects by classification as set out in the Provisional Guidelines issued by the Board in 2005. In that summary, the company indicates that none of the 26 capital projects in the plan are classified as "mandatory" (one of the capital projects in the plan is considered "justifiable" while the other 25 projects are considered normal). Accordingly, it can be said that Newfoundland Power did not consider itself obliged to carry out the Rattling Brook refurbishment by reason of safety issues.

Given the acknowledged remoteness of the risk of catastrophic failure of the penstock and surge tank, in our submission there is no evidential basis to warrant the Board assessing the company's application by reference to the additional costs that may be borne in the event that the penstock failed catastrophically (compared to the replacement of the penstock in a planned and orderly manner).

The company has stated in its responses to Requests for Information (see ex. PUB 11.0 NP, p. 4, lines 17-18) that the inability to routinely de-water the penstock for operational reasons constitutes a continuing and serious operation limitation on the penstock. Older woodstave penstocks tend to leak if they have been de-watered and in the case of Rattling Brook, the facility has been operated for some time with a view to avoiding de-watering unless it is essential. Nonetheless, it has been de-watered either partially or fully four times since 2000 (for durations ranging from less than 6 hours to 6 days) and was put back into service each time albeit with varying degrees of plugging activity following the same as detailed in PUB 11.0 NP. It is noted that when the penstock had to be de-watered (for reasons other than the Acres inspection and assessment) to make repairs to either the surge tank manhole or a significant leak at the upper end of the woodstave penstock the de-watering exercise took no more than one day. It is submitted that if steps were taken to plug and patch leaks that can now be undertaken without de-watering the penstock, the amount of time necessary to plug leaks following a de-watering event would be reduced. In addition, the taking of steps now to plug the more significant leaks that presently exist would decrease the chances of those leaks developing into problems that would necessitate a de-watering event.

Smoothing of Year-to-Year Capital Expenditures

The capital budget for 2007 is about $10 million, or close to 20%, higher than in previous and forecast years. As Newfoundland Power states on page 19 of the 2007 Capital Budget

Plan, "with the exception of the Rattling Brook Hydro Plant Refurbishment Project in 2007, the planned expenditures are expected to remain relatively stable for all asset classes, and consistent with expenditures incurred during the 2002 through 2006 period". Newfoundland Power indicates that it accepts the Board's view of the desirable effects of year-to-year capital expenditure stability (page 18 of 2007 Capital Budget Plan), but it is not evident that Newfoundland Power has taken all steps available to mitigate the effects of the Rattling Brook refurbishment on 2007 expenditures.

Newfoundland Power has suspended the Distribution Reliability Initiative for 2007 to balance overall capital expenditures due to the upward pressure of the Rattling Brook project (page 17 of the 2007 Capital Budget Plan). More such cuts are necessary to bring 2007 expenditures in line with historical and forecast figures. For example, consideration should be given to suspending until 2008 other "preventative capital maintenance programs" such as the Substation Strategic Plan (page 14 of 2007 Capital Budget Plan) and the Transmission Line Rebuild Strategy (page 15 of 2007 Capital Budget Plan).

If the Board decides that Newfoundland Power should proceed with the Rattling Brook refurbishment in 2007, the Consumer Advocate recommends that the Board order Newfoundland Power to suspend all non-essential programs until 2008 in an effort to reduce the capital budget in the 2007 calendar year to historical levels of approximately $52 million (see Chart 3 – Capital Expenditures, page 10 of 2007 Capital Budget Plan).

Demand Management and Energy Conservation Initiatives

It is difficult to understand why a distribution and supply utility such as Newfoundland Power does not have cost information available for energy efficiency initiatives (line 19, CA-13.0 NP). During these times of high primary energy and electricity prices, and public awareness of the environment, energy efficiency should be a high priority. In fact, Newfoundland Power states on page 4 of the 2007 Capital Budget Plan that "the Company incorporates energy efficiency considerations in its capital management practice". Why is Newfoundland Power not also promoting energy efficiency programs for its customers? There is not a single item in the 2007 Capital Budget relating to customer energy efficiency programs.

Customer energy efficiency programs can be economic, particularly in Newfoundland when the oil-fired Holyrood Generating Station with its very high energy production costs is operating during most of the year. Energy efficiency programs are consistent with sustainable development and environmental initiatives such as greenhouse gas reduction, and provide consumers a measure of control over their electricity bills.

The Consumer Advocate urges the Board to order that a comprehensive energy efficiency study be undertaken by an experienced firm to identify cost effective programs for retail consumers in the Province.

Distribution Reliability Initiative

Newfoundland Power has suspended the Distribution Reliability Initiative for 2007 (page 17 of 2007 Capital Budget Plan). They state their intent to re-commence the program in 2008. The program is summarized in PUB-21 NP as follows:

- Analyzing reliability data for the previous 5 year period;

- Identifying the 15 worst performing feeders in terms of SAIDI, SAIFI and customer minutes;
- Carrying out an engineering assessment on those feeders; and
- Based on the data and engineering assessments, proposing reliability based projects for the upcoming budget.

The question posed in CA-44.0 NP is "how is the target SAIDI tied to the value customers place on reliability?" The response states that "Newfoundland Power manages its business with due regard for its customers' expectations of reliability and price. But it does not employ the linkage suggested by the question to do so".

It is important that this linkage between customer value and reliability be established. Utilities typically over-emphasize the value of reliability to customers, and invest too much to upgrade an aspect of service that customers already find satisfactory.[1] It would appear that Newfoundland Power is spending money to improve reliability without knowing if customers are content with current levels of reliability, and whether or not they are willing to pay higher rates for improved reliability. Newfoundland Power needs to identify the number of hours of service outages that customers are willing to accept, and needs to understand the correlation between amounts it spends on improving reliability, and the resulting improvement in reliability. It is very difficult for the Board to approve expenditures when it does not have such information.

[1] See enclosed article entitled, "McKinsey sees utilities overspending on reliability more than customers care" in the August 4, 2003 edition of Electric Utility Week at p. 19-20.

The Consumer Advocate recommends that the Distribution Reliability Initiative be reviewed with the goal of incorporating customer value measures prior to re-commencing the program in 2008.

Respectfully Submitted by:

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Electric Utility Week

August 4, 2003

University ties are key theme in Westar suit that also links Wittig to Boesky scandal

Tangled ties with the University of Kansas, long an undercurrent in the Westar Energy saga, boiled over late last week in a lawsuit that cites university-related links among key players as a major factor in the company's woes.

The suit also links ex-Westar boss David Wittig, now a convicted felon, to a former Wall Street mentor who was convicted of felony charges tied to the financial scandal surrounding Ivan Boesky.

The explosive material is contained in a totally new version of a shareholder derivative complaint (In the US District Court for the District of Kansas at Topeka, Case No. 03-CV-4081-JAR), which first became publicly available late July 31. The original suit was filed April 16.

The links between KU, Wittig and the majority of the board during his tenure have always been a subplot in the broader story of Westar's financial collapse and were developed somewhat further in the company's internal report about past management misconduct (EUW, 19 May, 1).

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With a twist, Senate gets energy bill out the door, sets up unusual dynamic for House negotiation

Struggling to meet an Aug. 4 recess date and avoid controversial Democrat-sponsored electricity amendments, Senate Republicans last week championed a return to the energy bill that passed in October 2002 but failed in later conference with the House. The apparently wily maneuver enabled leadership of the sharply divided Senate, which Republicans control by only two votes, to get an energy bill on the road to signature by President Bush.

"I'm a bit shocked and surprised that the Democrats agreed to it," said one utility representative. "It keeps alive the possibility of getting a major energy bill to the Rose Garden." Republicans said they believe they can work out differences between the 2002 Democrat-drafted bill and the bill written this year by Senate Energy and Natural Resources Committee Chairman Pete Domenici (R-N.M.) in the fall when they negotiate with the House, which passed an energy bill in April.

Both last year's and this year's Senate bills took similar tacks on major items—Public Utility Holding Company Act repeal,

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Northern Plains governors seek sanity in ongoing battle over Missouri River

One thing has not changed in the 200 years since Lewis and Clark first traversed the Missouri River's 2,341 miles—different folks have different ideas of how the vast waterway should be used.

Three upper plains governors think it is time to bring those interests together, and electric utilities will be watching closely.

The famed Lewis and Clark Expedition team were the first white men seen by most Native Americans who lived along the river from its junction with the Mississippi River at St. Louis to its origin in the Rocky Mountains of Montana.

Neither group knew about power generation, flood control, reservoirs, inland barge navigation, large-scale agricultural irrigation, recreational water use or habitats for endangered species of fish and birds.

For the past 60 years, however, those uses have shared the river under the Pick/Sloan Plan of 1944 and the Missouri River Bank Stabilization and Navigation Project of 1945.

There have been fights for almost that long about which uses should take precedence, culminating recently in dueling federal courts whose conflicting rulings threw thousands of megawatts

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tolling agreement, a 222-MW deal with Black Hills Corp. for power from its Las Vegas Cogen plant.

Industry analysts last week said the contract sale may provide troubled Allegheny with some upside potential in the coming months.

Chris Ellinghaus, energy analyst for Williams Capital Group, said the deal would enhance Allegheny's flagging liquidity, eventually "providing the resources to allow the company to restructure tolling agreements in the West power book that are draining earnings and cash flow." He reiterated Williams' "buy" rating on Allegheny shares.

"The contract sale, along with the [$300-million] recent convertible placement [announced last week], resolve [the company's] near-term liquidity issues and should allow the company time to successfully restructure," he said in a research note.

While the DWR contract sale allowed the company to distance itself from bankruptcy, Ellinghaus cautioned "an investment in [Allegheny] is highly speculative, given the company's liquidity needs. We ultimately see earnings potential that supports the stock at significantly higher levels with improvement likely in 2004, but recognize that full realization of Allegheny's restructuring is not likely until 2005." Mike Worms, analyst for Harris Nesbitt Gerard, said Allegheny benefits from the deal because it will bring in needed cash and concentrate the company on its core businesses. "It is obviously a good deal for them," he said.

In a statement issued last Monday, Standard & Poor's said it considers Allegheny's sale of the contract "to be positive for liquidity, but the announcement does not affect the rating or outlook on the company."

"Although the sale of the CDWR contract will eliminate a primary source of cash flow volatility for the company and represents an important step towards restoring the company's creditworthiness, Allegheny has many other significant near-term challenges and the outlook on the company is likely to remain negative until it can bring its financial statement filings up to date and exhibit the financial strength to meet its bank loan covenants and upcoming debt maturities," the credit rating agency said.

MUNICIPALIZATION

Progress Florida gets to retain Casselberry franchise, other cities still in negotiations

After tough negotiation, the city commission of Casselberry, Fla., last week approved a new 30-year franchise agreement with Progress Energy Florida that gives the community the highest franchise fee it pays in the state, 6%, and a "favored nation" clause that entitles the city to a better deal if Progress gives a better one to any other municipality.

The city also gets a direct reimbursement of $1.75-million for expenses it incurred while the franchise was in dispute. And Progress will pay property taxes directly rather than deduct them from franchise fee payments as in the previous franchise.

To get at what Casselberry has said was the primary reason it contested renewal of the franchise, it won a provision in the agreement that requires a reliability study every five years by outside consultants to evaluate Progress' service and binds the utility to rectify reliability problems identified.

Casselberry was one of a handful of cities in southwest Florida that had refused to renew their franchise agreements with the utility, primarily, they said, because of reliability problems. But Casselberry's concerns were addressed in the new deal, according to Tony Segreto, the city's public works director. "It was a good deal," he said. "They offered us more than they have anyone else in the state."

Progress is still in negotiation with the cities of Longwood, Winter Park and Belleair to renew their franchise agreements.

Longwood city commissioners voted once to approve a 30-year franchise agreement and a legal settlement with the utility that would pay the city $440,000. The agreement must be approved again in an Aug. 4 vote. "We are cautiously optimistic with Longwood," said a Progress spokesman.

Winter Park has scheduled a Sept. 9 public referendum to municipalize, while Belleair is in the middle of arbitration hearings over the value of its grid in preparation for municipalization.

PLANNING

McKinsey sees utilities overspending on reliability more than customers care

Utilities over-emphasize the value of reliability to customers, and are investing too much to upgrade an aspect of service that residential customers already find satisfactory, according to consulting firm McKinsey & Co.

An article in the third-quarter issue of *The McKinsey Quarterly*, entitled "What Power Consumers Want," asserts that utilities can reduce their network investments and make cheaper service improvements that customers value more.

The article found that electricity distributors regularly undertake big projects such as burying lines, upgrading transformers and rearranging network architecture so outages affect fewer households. In most cases, they are prodded by regulators, who require utilities to meet reliability targets, and impose heavy fines if they fall short. McKinsey notes that one unnamed Asian utility pursued a project worth hundreds of millions of euros to reduce annual interruptions from less than five minutes to less than two.

"But it is doubtful that residential customers who have reliable service—those in most developed markets and in some advanced emerging ones—want (or would be willing to pay for) service improvements of any type," the article states. Most residential customers in a recent survey under-estimated the duration of their utility's interruptions, it notes. Further, the respondents said they would accept two hours of outages annually, even though their utility's interruptions average only 70 minutes.

"This easygoing attitude may seem surprising, but the average consumer is asleep one-third of the day and not at home for another third," the article notes. "Moreover, although power may be interrupted, on average, for two hours a year, most customers suffer no outages at all."

Further, investments do not always improve reliability. McKinsey found "no clear correlation between the amounts spent to improve the reliability of distribution networks, and the duration of power cuts in each region, even when the regions compared had similar terrains and climates." That is because more efficient distributors can make themselves more reliable at lower cost. In addition, "returns on reliability investments...diminish beyond a certain threshold, which most distributors have already passed," the authors state.

Finally, more than half of interruptions are beyond utilities' control, because they stem from generation constraints, outages in the transportation network, or excavations by gas and water utilities. "More investment in distribution networks can't solve these problems," the article says.

Therefore, utilities "should take the time to find out what people genuinely value," McKinsey advises. Customers in the survey said they would prefer quicker connections for new properties, more frequent and accurate billing, and shorter call-center wait times. "If distributors can show that customers actually want these cheaper improvements, instead of the more expensive ones needed to improve the reliability of service, regulators might relax their present tough standards," the article says.

At the same time, utilities may be able to reduce reliability-upgrade costs by better evaluating proposed investments. By re-designing maintenance procedures—fielding additional repair crews, for instance—they can often reduce the duration of power outages significantly more cheaply than by making infrastructure improvements.

Utilities urged to push for uniform rules on power supply purchasing

PacifiCorp, Calpine and the Natural Resources Defense Council are jointly urging utility regulators nationally to provide uniform rules for how electric utilities should acquire new power supplies for customers.

The proposal was made at a meeting of the National Assn. of Regulatory Utility Commissioners in Denver. Currently utility commissions in various states differ in how they deal with approving utilities' proposed electric resource portfolios.

The group is taking this unusual step because with the demise of the merchant power industry, utilities are taking the lead in providing power either by building their own plants or buying power from independent power producers.

Creating a transparent process and providing incentives for developing resource portfolios could shield utility consumers and shareholders alike from unreasonable costs and risks, said Don Furman, PacifiCorp senior vice president of regulation and external affairs. Moreover, with transparency, a state commission is more likely to look favorably on rate recovery when a utility solicits resources, a company spokesman said.

"A common approach to resource procurement rules shared across the states is particularly important for utilities and resource developers with business in multiple states," Furman said.

The group recommended that the commissions create a public process for upfront regulatory review and approval or disapproval of utilities' proposed electric portfolios. They want to ensure that utilities are compensated for the costs and risks taken in managing power portfolios for customers and eliminate unintended and unnecessary financial disincentives for utility investments in energy efficiency. They are urging commissions to set procurement requirements based upon reliability and economic considerations.

The group also recommends using a public process to identify resource procurement requirements and the specific resource criteria that will meet those requirements, including long-term energy efficiency improvements and short-term demand reduction options.

A combination of market based and regulatory initiatives is the best solution to ensure utilities are able to deliver reliable electric service, they said.

The NRDC, a non-profit environmental advocacy organization, said it joined PacifiCorp and Calpine because their plan identifies steps toward reviving long-term investment in more efficient and cleaner technologies, which are crucial to making environmental progress n the power industry.

A Calpine spokesman said, "In this post-Enron market, companies like Calpine no longer are willing to build on a purely merchant basis. "We need long term contracts in place before we obtain capital. We would like to see a fair and consistent playing field and solicitations that have an unbiased outcome free from affiliate abuse or insider trading."

Midwest Gen to operate three coal plants, 580 MW, despite Exelon contract release

Midwest Generation, citing an improving outlook for less expensive coal-fired generation, has decided to continue operating three older coal units representing 578 MW of generating capacity in northern Illinois next year despite Exelon's recent announcement it will not buy power from them in 2004.

In late June, Exelon, parent company of Commonwealth Edison, Illinois' largest electric utility, decided not to exercise its contractual right to purchase 262 MW from Will County Unit-3, 216 MW from Crawford Unit-7 and 100 MW from Waukegan Unit-6 (EUW, 30 June, 5).

The three units all were built in the 1960s and 1970s.

Under a five-year purchase power agreement entered into by Exelon and Midwest Gen in late 1999, following Midwest Gen's acquisition of seven power plants from ComEd, Exelon is allowed to exercise call options on certain amounts of power