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HAND DELIVERED

August 14, 2006

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: Newfoundland Power's 2007 Capital Budget Application**

Enclosed are the original and 14 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,



Peter Alteen  
Vice President, Regulatory Affairs  
& General Counsel

Enclosures

c. Geoffrey Young  
Newfoundland & Labrador Hydro

Thomas Johnson  
O'Dea Earle Law Offices



Join us in the fight against cancer.

**IN THE MATTER OF** the *Public Utilities Act*, (the "Act"); and

**IN THE MATTER OF** capital expenditures and rate base of Newfoundland Power Inc.; and

**IN THE MATTER OF** an application by Newfoundland Power Inc. for an order pursuant to Sections 41 and 78 of the Act:

- (a) approving its 2007 Capital Budget of \$62,166,000; and
- (b) fixing and determining its average rate base for 2005 in the amount of \$745,446,000.

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

**AUGUST 14, 2006**

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**1. INTRODUCTION**

Newfoundland Power's 2007 Capital Budget was filed with this Board on April 28, 2006.

The approximately \$62.2 million budget is larger than recent Newfoundland Power capital budgets, principally due to the inclusion of the proposed refurbishment of the Rattling Brook Hydroelectric Plant ("the Rattling Brook Project").

The Rattling Brook Project, at a proposed expenditure of \$18.8 million, constitutes approximately 30% of the total planned capital expenditure for 2007.

The 2007 Capital Budget Application (the "Application") seeks an Order of the Board: (1) pursuant to Section 41(1) of the Public Utilities Act, approving proposed 2007 capital expenditures totaling \$62,166,000, and (2) pursuant to Section 78 of the Public Utilities Act, fixing and determining Newfoundland Power's average rate base for 2005 in the amount of \$745,446,000.

**2. OVERVIEW**

To provide context for the Board's consideration of the Application, this submission will:

First, review the legislative framework under which the Application is brought;

Second, address specific compliance requirements;

Third, summarize the process engaged in by the Board and participants in the consideration of the Application;

Fourth, address specific matters raised in the Consumer Advocate's Submission; and

Finally, conclude with Newfoundland Power's formal submissions with respect to the Application.

**3. LEGISLATIVE FRAMEWORK**

Section 37(1) of the *Public Utilities Act* states that a public utility shall provide service and facilities that are reasonably safe and adequate and just and reasonable. Section 37(1) is a cornerstone of Newfoundland Power's obligation to serve its customers.

Section 3(b) of the *Electrical Power Control Act, 1994* states that all sources and facilities for the production, transmission, and distribution of power in the province should be managed and operated in a manner that would result in:

- i. the most efficient production, transmission, and distribution of power,
- ii. consumers in the province having equitable access to an adequate supply of power, and
- iii. power being delivered to customers in the province at the lowest possible cost consistent with reliable service.

Section 3(b) does not create a hierarchy between these three principles; rather, each is equally important in the management and operation of electrical facilities in the province.

Section 41(1) of the *Public Utilities Act* requires that Newfoundland Power submit to this Board "an annual capital budget of proposed improvements and additions to its property" for the Board's approval.

1 Section 41(3) of the *Public Utilities Act* prohibits a utility from proceeding with an  
2 improvement or addition in excess of \$50,000 or a lease in excess of \$5,000 per year  
3 without the Board's prior approval.

4  
5 The focus of this proceeding is whether Newfoundland Power's proposal for \$62.2  
6 million in capital expenditures in 2007 is reasonably required for it to meet its statutory  
7 obligation to serve its approximately 230,000 customers.

8  
9 Newfoundland Power submits that its 2007 Capital Budget represents the capital  
10 expenditures necessary to maintain its electrical system and to continue to meet its  
11 statutory obligations under Section 37(1) of the *Public Utilities Act* and Section 3(b) of  
12 the *Electrical Power Control Act, 1994*.

1     **4.       COMPLIANCE MATTERS**

2     **4.1     Board Orders**

3     In Order No. P.U. 30 (2005) (the “2006 Capital Order”), the Board required specific  
4     information to be filed with the Application. The Application complies with the  
5     requirements of the 2006 Capital Order.

6  
7     In Order No. P.U. 35 (2003) (the “2004 Capital Order”), the Board required specific  
8     information, and in particular a 5-year capital plan, to be provided with the Application.  
9     The Application complies with the requirements of the 2004 Capital Order.

10  
11    In Order No. P.U. 19 (2003) (the “2003 Rate Order”), the Board required that evidence  
12    relating to deferred charges and a reconciliation of average rate base to invested capital  
13    be filed with the Application. The Application complies with the requirements of the  
14    2003 Rate Order.

15  
16    **4.2     The Provisional Capital Budget Application Guidelines**

17    In the Provisional Capital Budget Application Guidelines dated June 2, 2005 (the  
18    “Provisional Guidelines”), the Board outlined certain directions on how to define and  
19    categorize capital expenditures. Although compliance with the Provisional Guidelines  
20    necessarily requires the exercise of a degree of judgment, the Application, in  
21    Newfoundland Power’s view, complies with the Provisional Guidelines while remaining  
22    reasonably consistent and comparable with past filings.

- 1 Section 3 of the *2007 Capital Budget Plan* provides a breakdown of the overall 2007
- 2 Capital Budget by definition, classification, costing method and materiality segmentation
- 3 as described in the Provisional Guidelines.

1    **5.      PROCESS**

2    **5.1    *Technical Conference***

3    The Provisional Guidelines contemplate the holding of a Technical Conference to be  
4    used in concert with the Request for Information (“RFI”) process to gain a full  
5    understanding of the scope and nature of capital projects. Following the filing of the  
6    Application on April 28, 2006, a Technical Conference was requested by the Board in  
7    relation to the Rattling Brook Project.

8  
9    The Technical Conference was held on July 5, 2006 in the Board’s hearing room. Prior  
10   to the Technical Conference, Newfoundland Power invited participants to attend a site  
11   visit at the Rattling Brook Hydro Plant. The site visit was conducted on July 4, 2006,  
12   and was attended by the Chair of the Board and representatives of Board staff and the  
13   Consumer Advocate.

14  
15   **5.2    *Proceedings of Record***

16   On July 12, 2006, the Board and the Consumer Advocate issued a total of 73 RFIs to  
17   Newfoundland Power. Newfoundland Power responded to all RFIs on July 24, 2006.

18  
19   No intervenor evidence was filed in the proceeding, and no intervenor requested a  
20   formal hearing of the Application.

1    **5.3    Consumer Advocate's Submission**

2    The Consumer Advocate filed written submissions in the proceeding on August 8, 2006.

3    The written submissions addressed (1) the timing of the Rattling Brook Refurbishment,

4    (2) smoothing of year-to-year capital expenditures, (3) demand management and

5    energy conservation initiatives, and (4) Newfoundland Power's distribution reliability

6    initiative.

7

8    Following is Newfoundland Power's response to the Consumer Advocate's Submission.

**6. Response to Submission**

**6.1 Timing of Rattling Brook Refurbishment**

**6.1.1 General**

The Rattling Brook Plant is Newfoundland Power's largest hydroelectric plant, producing an average of 69.8 GWh of energy annually. The Rattling Brook Project as proposed in the 2007 Capital Budget includes the following urgent requirements, which account for approximately 93% of the total 2007 cost estimate for the project:

1. the replacement of the woodstave portion of the penstock;
2. the refurbishment of the surge tank;
3. the replacement of the main valves;
4. bearing cooling water system upgrades;
5. powerhouse heating and ventilation upgrades;
6. switchgear and controls upgrades;
7. forebay communication/distribution line upgrade; and
8. interest during construction, project management and insurance.

The remaining components of the project, which account for approximately 7% of the total 2007 project cost estimate, must be completed in 2007 because of their interdependence with the work that does require urgent attention in 2007.

Reference: Volume 1, Application, Schedule B, p. 2 of 65; Volume 2, *Rattling Brook Hydro Plant Refurbishment*; PUB-9.0 NP.

1 The levelized cost of energy production at Rattling Brook following completion of the  
2 project will be 2.9 cents per kilowatt hour. This compares very favourably to a levelized  
3 cost of energy production at Newfoundland & Labrador Hydro's Holyrood Thermal  
4 Generating Station of 8.8 cents per kilowatt hour. If the energy produced at the Rattling  
5 Brook Plant were not available, it would have to be replaced with energy produced at  
6 Holyrood.

7 Reference: Volume 2, Appendix H, *Feasibility Analysis*, p. H-3.

8  
9 The optimization of the penstock diameter and the replacement of the main valves  
10 proposed as part of the Rattling Brook Project will together provide an additional 6.2  
11 GWh of energy and 2.9 MW of capacity, using the same volume of water currently used  
12 in the plant.

13 Reference: Volume 2, *Rattling Brook Hydro Plant Refurbishment*, p. 4 and p. 8;  
14 Volume 2, Appendix H, *Feasibility Analysis*, p. H-2.  
15

16  
17 The woodstave portion of the Rattling Brook penstock is at the end of its useful life and  
18 must be replaced to ensure the safe and reliable operation of the plant. Engineers have  
19 recommended its replacement because of its deteriorated condition and the significant  
20 leaking that hampers the normal operation of the plant. The penstock condition  
21 continues to worsen.

22 Reference: Volume 2, Appendix B, *SGE Acres: Surge Tank and Penstock*  
23 *Replacement*, PUB-11.0 NP.

1 Newfoundland Power has maximized the life of the woodstave portion of the penstock  
2 by continuing to plug and patch the penstock. The condition of the woodstave portion of  
3 the penstock is such that leakage is an ongoing occurrence. Due to its advanced state  
4 of deterioration, leakage of the woodstave portion of the penstock is expected to  
5 worsen.

6 Reference: Volume 2, Appendix B, *SGE Acres: Surge Tank and Penstock*  
7 *Replacement*, CA-30.0 NP.  
8

9  
10 As leakage of the woodstave portion of the penstock worsens, there will be increased  
11 requirements for maintenance and increasing limitations on plant operations.

12 Reference: Volume 2, Appendix B, *SGE Acres: Surge Tank and Penstock*  
13 *Replacement*, CA-30.0 NP.  
14

15  
16 The ability to plug and patch leaks in a woodstave penstock without de-watering the  
17 penstock is dependent on the size of the leak.

18 Reference: CA-37.0 NP.  
19

20 When a leak is too large to be plugged, it may be possible to safely divert the leakage,  
21 as was done with the large existing leak in the steel portion of the penstock. However,  
22 when the volume of water or the location of the leak threatens the integrity of the  
23 penstock or other plant infrastructure, de-watering is unavoidable.

24 Reference: CA-30.0 NP.

1 De-watering a woodstave penstock of the age and condition of the Rattling Brook  
2 penstock has the potential to worsen leakage. Leakage from a penstock can undermine  
3 the penstock supports by washing out the bedding material on which they rest.

4  
5 Newfoundland Power's experience with leakage following de-watering of the Rattling  
6 Brook penstock indicates the condition of the penstock is worsening.

7 Reference: PUB-11.0 NP; CA-30.0 NP.

8  
9 *6.1.2 Sufficiency of Maintenance Efforts*

10 There is no evidence on the record that Newfoundland Power's efforts to plug leaks in  
11 the woodstave portion of the penstock have been insufficient. Nor is there evidence on  
12 the record that increasing maintenance expenditures would enable Newfoundland  
13 Power to defer the replacement of the woodstave portion of the penstock, or that  
14 increasing efforts to plug leaks that can be plugged without de-watering would limit the  
15 occurrence of leaks that would necessitate de-watering.

16 Reference: Consumer Advocate's Submission, pp. 2-3.

17  
18 Significant leaks can occur in areas immediately adjacent to areas that have already  
19 been patched.

20 Reference: CA-36.0 NP.

1 The maintenance costs referred to by the Consumer Advocate as “relatively modest”  
2 were costs incurred to repair leakage as necessary to reasonably maintain the Rattling  
3 Brook plant in operation. For 2006, the amount of \$40,000 is the year-to-date penstock  
4 maintenance cost as of July 24, 2006. The cost to year end is estimated at \$60,000,  
5 provided the penstock does not need to be de-watered again.

6 Reference: Consumer Advocate’s Submission, p. 2; CA-30.0 NP.

7  
8 More extensive efforts at refurbishing the Rattling Brook woodstave penstock, short of  
9 replacement, are not feasible. Assessment of the penstock indicates that, due to its  
10 advanced level of deterioration, it is not a candidate for more extensive refurbishment,  
11 such as the sort of “life extension” carried out at the Nipissing Generating Station in  
12 Ontario.

13 Reference: CA-38.0 NP.

### 14 15 *6.1.3 Steel Costs*

16 The proposed budget for the replacement of the Rattling Brook penstock is necessarily  
17 based on estimates, including estimates of the cost of hot-rolled plate steel. The actual  
18 market price of hot-rolled plate steel at the time it is procured may be higher or lower  
19 than current estimates. There is no evidence on the record that the price of hot-rolled  
20 plate steel may reasonably be expected to decrease in the future.

21 Reference: Consumer Advocate’s Submission, p. 4; CA-21.0 NP; CA-26.0 NP.

1 Newfoundland Power submits that the relatively high current price of hot-rolled plate  
2 steel when compared to 2001 does not alter the soundness of either the engineering  
3 judgment or economic analysis underlying the decision to replace the Rattling Brook  
4 penstock. The engineering judgment is based largely on condition assessments  
5 performed by independent engineers (SGE Acres) and Newfoundland Power's  
6 engineering staff. The levelized cost of energy production at currently forecast steel  
7 prices is 2.9 cents per kilowatt hour.

8  
9 Furthermore, to base a decision on replacement of the penstock upon steel prices  
10 would effectively result in a view of future commodity markets supplanting engineering  
11 judgment as a principal basis for capital maintenance. Such a proposition appears  
12 novel and is not supported by evidence.

13  
14 *6.1.4 Classification of Project*

15 The Provisional Guidelines define a "mandatory" project as one that the utility is obliged  
16 to carry out by either "legislation, Board order, safety issues or risk to the environment."  
17 While there are safety issues associated with the deteriorated condition of the wood  
18 stave penstock, Newfoundland Power has not classified the Rattling Brook Project as a  
19 "Mandatory" project because safety is not the principal justification for the project.

20 Reference: Consumer Advocate's Submission, p. 4; Provisional Capital Budget  
21 Application Guidelines, p. 4; PUB-3.0 NP.

1 The *Public Utilities Act* effectively obliges Newfoundland Power to at all times ensure  
2 the safe operation of its facilities, including the Rattling Brook Plant.

3 Reference: *Public Utilities Act*, RSNL 1990, c. P-47, s. 37(1).

4  
5 Newfoundland Power has classified the Rattling Brook Project as “Normal Capital  
6 (Identified Need)”. The Provisional Guidelines set out requirements for information to  
7 be filed with the Board in support of projects classified in this manner. The material filed  
8 in support of the Rattling Brook Project complies with these requirements.

9 Reference: Provisional Capital Budget Application Guidelines, p. 5; Volume 2, *Rattling*  
10 *Brook Hydro Plant Refurbishment*.  
11

12  
13 *6.1.5 Deferral*

14 There is no evidence on the record that it is possible to further defer the replacement of  
15 the Rattling Brook penstock by increasing efforts to plug existing leaks without de-  
16 watering the penstock and by shoring up deteriorated supports.

17 Reference: Consumer Advocate’s Submission, p. 3.

18  
19 Leaks that can be plugged without de-watering the penstock are repaired as necessary  
20 to ensure they do not imperil the plant infrastructure, or public or employee safety. The  
21 occurrence or recurrence of leaks that can be plugged is not a principal reason for  
22 replacing the penstock in 2007. Newfoundland Power proposes to replace the  
23 woodstave portion of the penstock in 2007 because it is in an advanced and  
24 progressing state of deterioration.

25 Reference: Volume 2, *Rattling Brook Hydro Plant Refurbishment*, PUB-3.0 NP.

1 The Rattling Brook Plant is currently operated with a view to avoiding the de-watering of  
2 the penstock unless absolutely necessary. The inability to routinely de-water the  
3 penstock for operational reasons constitutes a continuing and serious operating  
4 limitation on the penstock.

5 Reference: PUB-11.0 NP.

6  
7 *6.1.6 Catastrophic Failure*

8 The risk of catastrophic failure of the Rattling Brook penstock, in the sense of a failure  
9 that imperils life safety, is remote.

10 Reference: PUB-3.0 NP.

11  
12 There is no reliable method to calculate the probability of penstock failure based on  
13 condition.

14 Reference: PUB-6.0 NP.

15  
16 The condition of the Rattling Brook penstock is such that significant leakage may occur  
17 that may necessitate the de-watering of the penstock and trigger events that may render  
18 it impossible to return the plant to service until the penstock is replaced.

19 Reference: PUB-6.0 NP; PUB-11.0 NP; CA-30.0 NP.

20  
21 For each year the Rattling Brook Project is deferred, the probability of plant failure  
22 increases. Plant failure would result in (i) increased capital costs as a result of the need  
23 to replace the plant on an unplanned basis, and (ii) increased energy costs due to loss

1 of plant availability. Deferral of the Rattling Brook Project beyond 2007 will threaten  
2 Newfoundland Power's ability to safely provide least-cost energy to its customers.  
3 Reference: PUB-9.0 NP; CA-31.0 NP.

## 4 5 **6.2 Smoothing of Year-to-Year Capital Expenditures**

6 Newfoundland Power's 2007 Capital Budget represents the capital expenditures  
7 necessary to maintain the electrical system and enable it to continue to meet its  
8 statutory obligations under Section 37 (1) of the *Public Utilities Act* and Section 3 (b) of  
9 the *Electrical Power Control Act, 1994*.

10  
11 There is no evidence on the record that there are "non-essential programs" included in  
12 the 2007 Capital Budget that can be suspended until 2008 without jeopardizing  
13 Newfoundland Power's ability to meet its statutory obligations.

14 Reference: Consumer Advocate's Submission, p. 5-6.

15  
16 The capital expenditures proposed for 2007 in accordance with the Transmission Line  
17 Rebuild Strategy are necessary to replace deteriorated infrastructure in order to ensure  
18 the continued provision of safe, reliable electrical service.

19 Reference: Volume 1, Application, Schedule B, p. 14 of 65; 3.1 *Transmission Line*  
20 *Rebuild*.

21  
22  
23 The Ten-Year Substation Refurbishment and Modernization Plan, as described in  
24 Volume 1, 2.1 *Substation Strategic Plan*, will improve productivity in the Company's  
25 substation capital and maintenance work. A delay in implementing the Substation

1 Strategic Plan will postpone the opportunity for these productivity improvements,  
2 thereby increasing cost.

3 Reference: Volume 1, Application, Schedule B, p. 7 of 65; *2.1 Substation Strategic*  
4 *Plan*; CA-51.0 NP.  
5

6 Newfoundland Power anticipates that, following the significant increase due to the  
7 Rattling Brook Project in 2007, the level of annual capital expenditure is expected to be  
8 relatively stable and consistent with recent historic levels of expenditure.

9 Reference: Volume 1, *2007 Capital Budget Plan*, Appendix A, p. 1 of 11.  
10

### 11 **6.3 Demand Management and Energy Conservation Initiatives**

12 Newfoundland Power incorporates energy efficiency considerations in its capital  
13 management practice. The Application contains projects that (i) maximize the efficient  
14 use of existing resources such as the Rattling Brook penstock replacement, (ii) minimize  
15 system losses through the purchase of energy efficient transformers, and (iii) reduce  
16 peak load such as the replacement of Kenmount Road's HVAC system with an energy  
17 efficient HVAC system.

18 Reference: Volume 1, *2007 Capital Budget Plan*, p. 4.  
19

20 Newfoundland Power's customer-focused conservation and demand management  
21 ("CDM") programs and activities were most recently detailed in the *2005 Demand Side*  
22 *Management Report* filed with the Board on June 30, 2006.

**6.4 Distribution Reliability Initiative**

There is no evidence supporting the assertion that 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.<sup>1</sup>

Reference: Consumer Advocate's Submission, p. 8.

Newfoundland Power manages its business with due regard for its customers' expectations of reliability and price. Newfoundland Power's approach to capital investment balances the maximization of asset lives with the proactive replacement of deteriorated or inefficient plant. This approach has delivered tangible benefits for customers through both lower cost and improved electrical system reliability.

Reference: CA-44.0 NP.

---

<sup>1</sup> The submission by the Consumer Advocate of an August 4, 2003 issue of *Platts Electric Utility Week* which comments on a study by McKinsey and Co. (which was not provided) does not provide sufficient evidentiary basis for the proposition put by the Consumer Advocate. On August 14, 2003, 10 days after the publication date of the commentary, approximately 50 million people were affected by a blackout in northeastern North America. This blackout, which was attributed to electrical network failure, has had an impact on customers', utilities' and regulators' views on reliability.

## 7. CONCLUSIONS

### 7.1 Capital Projects

#### 7.1.1 General

The projects presented in Newfoundland Power's 2007 Capital Budget Application are necessary to: respond to customer growth and changes in customer requirements; replace deteriorated, defective or obsolete equipment; address safety and environmental issues; and maintain or improve customer service levels and operational efficiency gains.

With the exception of the matters raised in the Consumer Advocate's Submission, which matters are addressed above, no specific challenge has been made to the numerous engineering judgments and assessments that form the basis of the capital expenditures proposed in Newfoundland Power's 2007 Capital Budget.

Newfoundland Power's proposed capital expenditures for 2007 are necessary to provide service to customers that is safe and adequate and just and reasonable, and they are consistent with the provision of least cost electrical service.

#### 7.1.2 Newfoundland Power's Capital Management Practices

To provide a broad context for the Board's consideration of the Application, Newfoundland Power's 2007 Capital Budget Plan provides overviews of (i) the Company's capital management practice and how it is reflected in its annual capital budgets, (ii) the 2007 capital budget and (iii) the 5-year capital outlook through 2011.

The 2007 Capital Budget is somewhat unique in that a single Generation project, the Rattling Brook Project, constitutes approximately 30% of the total planned expenditure. Accordingly, the *2007 Capital Plan* contains an overview of the Company's capital management practices with special emphasis on Generation assets.

Reference: Volume 1, *2007 Capital Budget Plan*.

### *7.1.3 Sound Engineering Judgment*

The provision of service and facilities which are "reasonably safe and adequate and just and reasonable" as required by Section 37(1) of the *Public Utilities Act* requires the exercise of judgment. In particular, the timing, necessity and appropriateness of the investment to meet the obligation to serve on a least cost basis involves sound engineering judgment.

To assist the Board in determining whether the engineering judgments reflected in the 2007 Capital Budget are sound, it is submitted that there was no evidence presented to the Board in this proceeding that:

- contradicts the engineering judgments reflected in the capital projects presented in the 2007 Capital Budget;
- demonstrates reasonable alternatives that were not considered by Newfoundland Power; or
- demonstrates that not proceeding with a particular capital project represented is a preferable alternative.

1    **7.1.4 Submission**

2    Newfoundland Power submits that the 2007 Capital Budget contained in the Application  
3    represents the capital expenditures required to meet its statutory obligations, including  
4    the delivery of electrical power at the lowest possible cost consistent with reliable  
5    service. Pursuant to Section 41 of the *Public Utilities Act*, the 2007 Capital Budget  
6    should be approved in its entirety by the Board.

7  
8    **7.2    Rate Base**

9    **7.2.1 General**

10   Newfoundland Power has requested that the Board fix and determine the 2005 average  
11   rate base for the purpose of regulatory continuity and certainty, in the same manner as  
12   the Board has exercised this regulatory supervisory power since 1999.

13  
14   Newfoundland Power's actual average rate base for 2005 is shown in Schedule D to the  
15   Application.

16  
17   **7.2.2 Submission**

18   Based upon the evidence before the Board and pursuant to section 78 of the *Public*  
19   *Utilities Act*, the Board should fix and determine Newfoundland Power's average rate  
20   base for 2005 at \$745,446,000.

**RESPECTFULLY SUBMITTED** at St. John's, Newfoundland and Labrador, this 14<sup>th</sup> day  
of August, 2006.

**NEWFOUNDLAND POWER INC.**



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