

PART THREE. SUMMARY OF BOARD DECISIONS

I. CAPITAL STRUCTURE

Government Guarantee

1. The Board accepts that the Government guarantee plays a key role in supporting Newfoundland and Labrador Hydro's (NLH) ability to maintain a sound credit rating in the financial markets of the world and to access needed capital at reasonable rates.

Dividend/Capital Structure

2. The Board finds that a dividend policy of 25% of annual net income is most supportive of NLH's stated objective of moving toward a capital structure of 80/20 within a reasonable time frame. For purposes of determining the 2004 test year revenue requirement, NLH will be ordered to adjust the forecast dividend payment in 2004 to 25% of net income from the proposed 75% payout, incorporating the impact of this adjustment on the forecast return on equity and interest expense.

NLH as an Investor Owned Utility

3. The Board finds insufficient justification at this time to warrant treatment of NLH comparable to an investor owned utility for purposes of setting its financial targets. The onus is on NLH in future applications to clearly demonstrate through its operations and financial plans how it will achieve financial targets similar to an investor owned utility and what impacts this will have on its customers. The Board will continue to recognize NLH as a Crown owned utility afforded the benefit of a debt guarantee provided by its shareholder, Government, which sustains NLH's access to the capital markets.

Return on Equity

4. The Board concludes that an appropriate return on equity for NLH for the purposes of determining the weighted average cost of capital for the 2004 test year is 5.83%.

II. FORECASTING: PRODUCTION AND FUEL COSTS

Test Year Hydraulic Production

5. The Board accepts NLH's proposal to use the 30-year average for the estimation of hydraulic production for the 2004 test year, which will result in a total forecast hydraulic production of 4,582.15 GWh.
6. The Board will direct NLH to file its next general rate application using the full historic hydraulic data flow record with evidence demonstrating how the following outstanding issues have been addressed:
 - i. correction of the internal inconsistencies in the data series; and
 - ii. selection of an appropriate computer model for simulation.

Test Year Thermal Production

7. The Board accepts the 2004 test year forecast of thermal production of 1,780.61 GWh.

Holyrood No. 6 Fuel Conversion

8. The Board finds that a conversion factor for No. 6 fuel at Holyrood of 630 kWh/bbl is appropriate for the 2004 test year. This conversion factor will also be used in the Rate Stabilization Plan.

Fuel Price Forecasting

9. The Board accepts the 2004 test year forecasts for fuel prices as proposed by NLH in its October 31, 2003 revised filing for determining the 2004 test year fuel costs.

III. REVENUE REQUIREMENT**Depreciation**

10. The Board accepts NLH's 2004 test year depreciation expense for the purposes of determining the 2004 test year revenue requirement subject to any adjustments arising from this Decision and Order, including:
- i. a reduction of 5.0% in the approved 2004 capital budget; and
 - ii. an adjustment to the forecast 2004 capital retirements to 0.39% of its total capital assets.

Fuel Costs

11. The Board accepts NLH's current fuel purchasing policies and practices.

No. 6 Fuel

12. The Board will direct NLH to reflect a fuel conversion factor of 630 kWh/bbl for No. 6 fuel at Holyrood in its 2004 test year fuel costs.

Diesel Fuel

13. The Board accepts NLH's 2004 test year diesel fuel cost of \$6,801,000.

Other Fuels

14. The Board accepts NLH's 2004 test year costs for other fuels of \$757,000.

Purchased Power

15. The Board accepts NLH's 2004 test year purchased power expense of \$33,594,000.

Salaries and Fringe Benefits

16. The Board will direct NLH to reduce its 2004 test year salary expense by \$500,000 to reflect a higher vacancy allowance.

System Equipment Maintenance

17. The Board will require NLH's 10-year plan of maintenance expenditures for the Holyrood Generating Station to be updated annually to reflect changing operating circumstances.

18. The Board accepts NLH's 2004 test year system equipment maintenance expense of \$17,440,000.

Transportation

19. The Board will direct NLH to reduce its 2004 test year transportation expense by \$185,000.

Miscellaneous Expenses

20. The Board accepts NLH's 2004 test year miscellaneous expense of \$4,185,000.

Other Cost Categories

21. The Board accepts NLH's 2004 test year expenses for travel, office supplies, insurance, equipment rentals and building rentals and maintenance, totalling \$8,977,000.
22. The Board will allow an increase in the 2004 test year professional services expense of \$200,000 to reflect the amortization over a three year period of additional regulatory costs.

Loss on Disposal of Capital Assets

23. The Board accepts NLH's 2004 test year expense of \$1,266,000 for loss on disposal of capital assets.

Capitalized Expenses

24. The Board will direct NLH to increase its 2004 test year capitalized expense by \$2,000,000.

Non-Regulated Operations and Inter-Company Charges

25. The Board accepts NLH's treatment of non-regulated expenses and inter-company charges in determining its 2004 test year revenue requirement.
26. The Board will direct NLH to file a report on the appropriateness of discontinuing the use of regulated equity in favour of book equity as part of its next general rate application.

Interest Expense

27. The Board accepts NLH's 2004 test year interest expense, subject to any adjustments arising from this Decision and Order.

Productivity Allowance

28. The Board will not impose a productivity allowance for NLH's 2004 test year revenue requirement in light of other decisions taken in this Decision and Order.

IV. RATE STABILIZATION PLAN

29. The Board will direct NLH to complete a review of the operation of the Rate Stabilization Plan for the period January 1, 2004 to December 31, 2005. A report on this review setting out an assessment of the impact on customers should be filed with the Board no later than June 30, 2006.

V. RATE BASE

Fixing and Determining Rate Base

30. The Board will fix and determine the 2002 rate base at \$1,356,207,000.
31. The Board will require NLH 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.

Forecast Average Rate Base and Return on Rate Base

32. The Board will require NLH to file a revised calculation of rate base and rate of return on rate base for the 2004 test year which reflects the findings of the Board in this Decision and Order.

Range of Return on Rate Base and Excess Earnings Account

33. As part of its revised filing of rate base and rate of return on rate base NLH will be required to file for the Board's consideration a proposal for a range of return on rate base and a definition of an "*excess earnings*" account. This proposal should include an analysis of several alternate ranges along with the associated impacts.

Automatic Adjustment Formula

34. The Board will not implement an automatic adjustment mechanism for NLH's rates at this time. NLH will be required to submit a report containing a proposal for such a mechanism with analysis as to the impacts for consideration at its next general rate application.

VI. COST OF SERVICE

35. The Board accepts the proposed changes to the Cost of Service methodology with respect to the assignment of Hydro Place costs, NLH's municipal taxes and Board assessments, and with respect to the functionalization of general plant assets.

GNP Generation Assets

36. The Board accepts NLH's proposed assignment of the generation assets on the Great Northern Peninsula as common plant.

GNP Transmission Assets

37. The Board accepts NLH's proposed assignment of transmission assets on the Great Northern Peninsula to Hydro Rural.

Doyles-Port aux Basques Transmission Assets

38. The Board accepts NLH's proposed assignment of transmission assets on the Doyles-Port aux Basques system as specifically assigned to Newfoundland Power Inc. (NP).

Burin Peninsula Transmission Assets

39. The Board does not accept NLH's proposal to assign all costs associated with the Burin Peninsula transmission assets as common. The Board will direct NLH to separate costs for TL219 and TL212. Costs associated with TL219 will be specifically assigned to NP and costs associated with TL212 will be assigned common.

Treatment of NP Generation

40. The Board accepts NLH's treatment of NP's hydraulic and thermal generation in the Cost of Service study.
41. The Board will direct NLH to commission an independent study, to be filed with its next general rate application, of the treatment of NP's generation. This study should assess the value of NP's generation to the system and make recommendations on how the generation should be accounted for, both operationally and financially, in the Cost of Service study and rate design. NLH will be permitted to recover its reasonable costs associated with this study and may accumulate these costs in a deferral account to be dealt with at its next general rate application.

NP Demand Forecasts

42. The Board accepts the demand and energy forecasts for NP as proposed by NLH for use in the 2004 test year Cost of Service study.

VII. LABRADOR INTERCONNECTED SYSTEM

43. The Board finds that NLH's proposals for uniform rates for the Labrador Interconnected System are not unjustly discriminatory and rejects the complaint of the Towns of Labrador City and Wabush.
44. The Board accepts NLH's proposed five year plan to implement uniform rates for Labrador Interconnected customers as set out in its Application. The Board will direct NLH to file for approval a revised Schedule of Rates for each proposed rate change set out in the five year plan.
45. The Board accepts the proposal that NLH will adjust the Rural Rate Alteration Component of the Rate Stabilization Plan based on its projection of the five year phase-in of Labrador rates and the revenue credit available from secondary energy sales to CFB Goose Bay with the provision that it be applied only to the portion of the revenue credit applicable to NP and that the rates of the Labrador Interconnected customers not be negatively affected by this adjustment.

VIII. RURAL SYSTEMS

Rural Deficit

46. The Board will require NLH to submit, in conjunction with its annual financial report, an annual report on the rural deficit which should include the following:
- i. the total rural deficit and a breakdown of its components by system (Island Interconnected Rural, Island and Labrador Isolated Rural, and L'Anse au Loup);
 - ii. a five year forecast of the rural deficit by system;
 - iii. the number of communities and customers served in each system;
 - iv. the cost per kWh per system, showing a comparison with cost per kWh for the Island Interconnected System (less rural) and the Labrador Interconnected System;
 - v. the deficit per customer and the cost recovery ratios for each system; and
 - vi. a summary of any specific initiatives undertaken to reduce the capital or operating costs in each system.

Lifeline Block for Rural Isolated Domestic Customers

47. The Board will direct the implementation a Seasonal Lifeline Block for NLH's Rural Isolated Domestic customers, both Island and Labrador, as set out below:

Seasonal Lifeline Block for NLH Diesel Systems		
Month	Existing Lifeline (kWh)	Alternative Seasonal Lifeline Including Hot Water (kWh)
January	700	1,000
February	700	1,000
March	700	900
April	700	900
May	700	800
June	700	800
July	700	700
August	700	700
September	700	700
October	700	800
November	700	900
December	700	1,000
Total kWh	8,400	10,200
Monthly Average kWh	700	850

48. Rural Isolated Domestic customers will continue to pay the same rate as NP's domestic customers for consumption within the Seasonal Lifeline Block. The existing block structure for these customers for energy consumption above the Seasonal Lifeline Block will be maintained. The existing policy of automatically adjusting the rates for consumption above the lifeline block by the average rate change approved by the Board for NP will continue to apply.

Preferential Rates

49. The Board accepts NLH's proposals for preferential rates for certain customers on the Island Interconnected and Isolated Systems as being in accordance with Government directives.

Rates for Isolated General Service Customers

50. The Board will approve NLH's proposal for the phase-in of a demand-energy rate structure, including the consolidation of rate classes and the elimination of the lifeline block, for general service customers on the isolated diesel systems over a three year period. The Board will direct NLH to file for approval a revised Schedule of Rates for each proposed rate change set out in the three year plan. Rates for these customers will continue to be adjusted by the average rate of change granted to NP in any general rate application.

Energy Tax Proposal

51. The Board will not recommend taxing legislation with respect to the recovery of the rural deficit, as proposed by the Towns of Labrador City and Wabush.

IX. RATES ISSUES/RATE DESIGN**Wholesale Demand-Energy Rate for NP**

52. The Board finds that the introduction of a demand-energy rate by NLH for NP's purchased power is appropriate.
53. The Board will require NLH to file, no later than July 31, 2004, using the embedded Cost of Service for the 2004 test year adjusted for this Decision and Order, an application for the demand-energy rate to be implemented for NP on January 1, 2005. The application and supporting documents will fully address, among other things:
- i. The degree of risk to be assumed by NLH;
 - ii. The expected relationship between the risk assumed by NLH and the response in terms of conservation efforts by NP;
 - i. An appropriate weather normalization mechanism, with quantification of the intrinsic error in the formula;
 - ii. The treatment of NP's generation as has been determined by this Decision and Order;
 - iii. Appropriate costing and billing determinants;
 - iv. The use of adequate metering, or, in its absence at any supply points, an appropriate estimation formula;
 - v. The effects of variations in NP's hydraulic generation and native load, individually and together; and
 - vi. The effects of varying levels of demand and energy rates for a range of usage patterns.

In the meantime, NLH will continue to charge NP an energy-only rate as proposed in its Application, revised to reflect the findings of the Board in this Decision and Order.

Interruptible “B” Contract for Abitibi Consolidated Company of Canada-Stephenville

54. The Board will not order NLH to reinstate the Interruptible B rate for Abitibi Consolidated Company of Canada-Stephenville or to make a similar rate available to the Industrial Customers.

Rules and Regulations for Service

55. The Board accepts NLH’s proposed changes to the Rules and Regulations for Rural Customers.

Rate Change/Implementation

56. In order to finalize rates to be implemented as a result of this Decision and Order, NLH will be required to incorporate the decisions of the Board by:
- i. adjusting its revenue requirement and calculation of rate base and rate of return on rate base;
 - ii. revising its October 31, 2003 Cost of Service study for the 2004 test year;
 - iii. revising its proposed Schedule of Rates for the various customer classes based on the updated Cost of Service; and
 - iv. addressing the consumption on which the rates will be effective for the bills of NP, the Industrial Customers, Labrador Interconnected firm customers, Island Interconnected Rural Customers and Isolated Rural Customers;
- and filing the above with the Board for approval.

X. OTHER ISSUES

Regulatory Oversight – Planning, Performance Measures and Reporting

57. The Board will require NLH to incorporate the following Key Performance Indicators (KPIs) into its annual reporting 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 administration 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.
58. The Board will direct NLH to propose to the Board for approval a “peer group” of utilities for the purposes of external benchmarking of its KPIs.

59. The Board will direct NLH to file by December 31, 2004 a report outlining:
- i. a comprehensive description of NLH's strategic and business planning processes;
 - ii. a description of how corporate goals and strategies are communicated and operationalized, including how specific operational targets are identified and linked to corporate goals and strategies; and
 - iii. a description of how management performance and employee incentives are tied to achieving targeted goals, outcomes and efficiencies.
60. The Board will direct NLH to file annually, commencing with its 2004 annual financial report, a report outlining:
- i. a strategic overview highlighting core strategies, corporate goals and achievements;
 - ii. appropriate historic, current and forecast comparisons of reliability, operating, financial and other key targeted outcomes/measures, including the KPIs as set out above; and
 - iii. initiatives targeting productivity or efficiency improvements, including status of ongoing projects and improved performance resulting from completed projects.

Marginal Cost Study

61. The Board will direct NLH to undertake and file with the Board no later than June 30, 2006 a marginal cost study. NLH will be permitted to recover its reasonable costs associated with this study and may accumulate these costs in a deferral account to be dealt with at its next general rate application.

Future Supply/Integrated Resource Planning

62. The Board has authority and responsibility to ensure that adequate planning occurs for the production, transmission and distribution of least cost reliable power in the Province. While the Board will make no order at this time with respect to Integrated Resource Planning, the utilities may be required by the Board, consistent with its mandate, to participate in a generic process to address issues and benefits associated with Integrated Resource Planning.

Demand Side Management/Conservation

63. The Board encourages NLH to continue to raise consumer awareness and develop/implement programs aimed at energy efficiency and conservation. The Board will not direct NLH at this time respecting demand side management initiatives but will consider the manner and timing of a generic proceeding which will address demand side management options and impacts on the overall system.

XI. HEARING COSTS

64. The Board will make an award of costs to the Industrial Customers and the Towns of Labrador City and Wabush. The Board will require the Industrial Customers and the Towns of Labrador City and Wabush to file detailed statements of costs with the Board no later than May 28, 2004.

PART FOUR. THE ORDER**IT IS THEREFORE ORDERED THAT:****REVISED REVENUE REQUIREMENT AND COST OF SERVICE**

1. NLH shall file a revised total revenue requirement and cost of service study for the 2004 test year based on its October 31, 2003 filing, incorporating the determinations of the Board in this Decision and Order, including:
 - i. The forecast dividend payout shall be reduced for rate setting purposes to 25% of net income;
 - ii. The allowed rate of return on equity for the purposes of determining the weighted average cost of capital shall be 5.83%;
 - iii. The fuel conversion factor for No. 6 fuel at Holyrood shall be 630 kWh/bbl;
 - iv. The approved 2004 Capital Budget shall be adjusted for rate setting purposes to reflect a reduction of 5.0%;
 - v. The forecast 2004 capital retirements shall be increased to 0.39% of total capital assets;
 - vi. Salary expenses shall be reduced by \$500,000;
 - vii. Transportation expense shall be reduced by \$185,000;
 - viii. Professional services expense shall be increased by \$200,000;
 - ix. Capitalized expenses shall be increased by \$2,000,000; and
 - x. Costs associated with TL219 shall be specifically assigned to NP and costs associated with TL212 shall be assigned common.

RATE BASE AND RETURN ON RATE BASE

2. NLH shall file for the approval of the Board a revised calculation of rate base and rate of return on rate base for the 2004 test year based on the approach and methodology proposed in its Application, incorporating the determinations of the Board in this Decision and Order.
3. As part of its revised filing of rate base and rate of return on rate base NLH shall file for the approval of the Board:
 - i. a proposal for a range of return on rate base including an analysis of several alternate ranges with impacts; and
 - ii. a definition of an "excess earnings" account to be included in the company's system of accounts to which earnings above the maximum of the allowed range of rate of return on rate base will be credited.
4. The rate base for the year ending December 31, 2002 is hereby fixed and determined at \$1,356,207,000.

RATES, RULES AND REGULATIONS

5. NLH shall file for the approval of the Board a revised Schedule of Rates, Rules and Regulations to be effective as of July 1, 2004, addressing the consumption on which the rates will be effective, and incorporating the determinations of the Board in this Decision and Order, including:
 - i. Rates charged to NP shall be on an energy-only basis.
 - ii. Rates charged to Rural Isolated Domestic customers for consumption of electricity:
 - (a) within the Seasonal Lifeline Block, as accepted by the Board in this Decision and Order, shall be the same rates charged to NP's domestic customers; and
 - (b) above the Seasonal Lifeline Block shall continue as historically structured and determined.
 - iii. The Rules shall include a statement of the policies for automatic changes in rates for all of NLH's rural customers whose rates and rate changes are tied to NP's rates and rate changes as and when approved by the Board.

6. NLH shall file for the approval of the Board a revised Schedule of Rates no later than November 30 for each subsequent year for rate changes proposed in accordance with:
 - i. The five-year implementation of uniform rates on the Labrador Interconnected System; and
 - ii. The three-year phase-in of a demand-energy rate structure for Rural Isolated General Service customers.

7. The Complaint of the Towns of Labrador City and Wabush is dismissed.

8. The adjustment of the rural rate alteration component of the RSP based on the phase-in of Labrador rates and the revenue credit from secondary energy sales to CFB Goose Bay shall be applied only to the portion of the revenue credit applicable to NP and shall not negatively affect the rates of the Labrador Interconnected customers.

9. NLH shall file no later than July 31, 2004, based on the revised cost of service study for the 2004 test year, an application with supporting documentation as set out in this Decision and Order for a demand-energy rate to be implemented for NP as of January 1, 2005.

REPORTING

10. NLH shall file as part of its next general rate application;
 - i. a report on the discontinuance of the use of regulated equity in favour of book equity;
 - ii. a report with respect to the review of its property and assets;
 - iii. a report setting out a proposal for an automatic adjustment mechanism with analysis as to impacts; and

- iv. an independent study of the treatment of NP's generation assessing the value of NP's generation to the system, with recommendations on how this generation should be accounted for in the cost of service study and rate design.
11. NLH shall file with the Board on or before June 30, 2006:
 - i. a report on the operation of the Rate Stabilization Plan for the period January 1, 2004 to December 31, 2005; and
 - ii. a system-wide marginal cost study.
 12. NLH shall file a ten year plan of maintenance expenditures for the Holyrood generating station with its annual capital budget application, until otherwise directed by the Board.
 13. NLH shall file with its annual financial report, commencing in 2004 until otherwise directed by the Board, an annual report on the rural deficit addressing the following:
 - i. the total rural deficit and a breakdown of its components by system (Island Interconnected Rural, Island and Labrador Isolated Rural, and L'Anse au Loup);
 - ii. a five year forecast of the rural deficit by system;
 - iii. the number of communities and customers served in each system;
 - iv. the cost per kWh per system, showing a comparison with cost per kWh for the Island Interconnected System (less rural) and the Labrador Interconnected System;
 - v. the deficit per customer and the cost recovery ratios for each system; and
 - vi. a summary of any specific initiatives undertaken to reduce the capital or operating costs in each system.
 14. NLH shall file a report no later than December 31, 2004 proposing a "peer group" of utilities for the purposes of external benchmarking of its KPIs.
 15. NLH shall file no later than December 31, 2004 a report outlining:
 - i. A comprehensive description of NLH's strategic and business planning processes;
 - ii. A description of how corporate goals and strategies are communicated and operationalized including how specific operational targets are identified and linked to corporate goals and strategies; and
 - iii. A description of how management performance and employee incentives are tied to achieving targeted goals, outcomes and efficiencies.
 16. NLH shall file with its annual financial report, commencing in 2004 until otherwise directed by the Board, an annual report outlining:
 - i. A strategic overview highlighting core strategies, corporate goals and achievements;
 - ii. Appropriate historic, current and forecast comparisons of reliability, operating, financial and other key targeted outcomes/measures including the additional KPIs accepted in this Decision and Order; and

- iii. **Initiatives targeting productivity or efficiency improvements, including status of ongoing projects and improved performance resulting from completed projects.**

OTHER ISSUES

17. **NLH shall file its next general rate application using the full historic hydraulic data flow record with evidence as to how the following issues have been addressed;**
 - i. **Correction of the internal inconsistencies in the data series; and**
 - ii. **Selection of an appropriate computer model for simulation.**
18. **NLH may accumulate the costs associated with the marginal cost study and the independent study of the treatment of NP generation in a deferral account to be addressed at NLH's next general rate application.**

HEARING COSTS

19. **NLH shall pay the expenses of the Board arising from this Application, including the expenses of the Consumer Advocate incurred by the Board, pursuant to Section 117 of the *Act*.**
20. **The Industrial Customers shall submit a detailed statement of costs no later than May 28, 2004 for the consideration of the Board in making an award of costs to the Industrial Customers.**
21. **The Towns of Labrador City and Wabush shall submit a detailed statement of costs no later than May 28, 2004 for the consideration of the Board in making an award of costs to the Towns.**

Dated at St. John's, Newfoundland and Labrador this 4th day of May 2004.

Robert Noseworthy,
Chair & Chief Executive Officer.

Darlene Whalen, P.Eng.,
Vice-Chair.

G. Fred Saunders,
Commissioner.

G. Cheryl Blundon,
Board Secretary.