Board of Commissioners of Public Utilities - Historical Review of the Rate Stabilization Plan of Newfoundland and Labrador Hydro

January 1st 1986 – December 31st 2009

Contents

Introduction

Newfoundland and Labrador Hydro's ("Hydro" or "the Company") Rate Stabilization Plan ("RSP") was established effective January 1, 1986 with the objective of providing rate stability to customers and providing a mechanism to eliminate volatility in Hydro's revenue requirement due to events beyond its control. As established, the RSP provided for adjustments to recover differences between the forecast test year costs used to set rates and the actual costs attributable to:

- differences in the price of No.6 Fuel;
- variations in hydraulic production; and
- variations in load.

The plan was modified in 1993 to include an adjustment to account for any variation in Hydro's rural revenues which may arise as Hydro's rural rates are changed, in accordance with Government policy, to reflect Newfoundland Power's rates. This provision was incorporated into the RSP as part of the 1993 generic cost of service hearing.

During 2001, the balance in Hydro's RSP increased to approximately $85.0 million as compared to $34.7 million in 2000. This dramatic increase in the RSP balance, together with the forecast cost of No. 6 fuel, generated significant concern and discussion with respect to the RSP during Hydro's 2001 General Rate Hearing. As a result of the Board Order P.U.7 (2002-2003), further changes were made in 2002 flowing from Hydro's 2001 General Rate Hearing. These changes are discussed in further detail in this report.

During the 2003 General Rate Hearing, the parties involved reached a settlement agreement on further proposed changes to the RSP. These changes included: allocating 25% of the hydraulic portion to be refunded to, or recovered from customers, each year; the introduction of the fuel rider, and changing the allocation of the fuel element of the load variation component to the customer class that caused the change in load. In P.U. 40 (2003) the Board approved the changes as outlined in the settlement agreement. These changes, along with several other modifications included in the settlement agreement and Board Order, are discussed in further detail in this report.

The Company filed a General Rate Application in 2006 and included in this application proposals for further changes to the RSP. These proposals were subject to the settlement negotiation process. The changes in the settlement agreements dated October 20, 2006 and November 23, 2006 were approved by the Board in P.U. 46 (2006) and P.U. 8 (2007).

The scope of our engagement with respect to the Rate Stabilization Plan is to provide a report that will document the history of the Plan from its inception in 1985 to the end of 2009, including the following:

- History of the Plan including an outline of any changes to the methodology over the years and the authorization for these changes;
- Provision of a schedule of the annual results allocated between the Industrial Customers and Newfoundland Power since the inception of the Plan; and
- Description of the impact that the changes had on the annual balances of the Plan for the Industrial Customers and for Newfoundland Power, and any changes in the distribution of the costs and the benefits that have resulted from the changes that have taken place.

This report will highlight the changes that occurred in the RSP over the years and the results of these changes which the Board and other stakeholders may wish to consider in assessing whether further changes to Hydro's RSP are appropriate.

Appendix A of this report provides a schedule of the annual activity of the RSP and the annual balances allocated between the Industrial Customers and Newfoundland Power. This schedule begins in 1986, the year of the RSP implementation, up to and including December 31, 2009.

The Implementation of the Rate Stabilization Plan

Prior to the establishment of the RSP in 1986, Hydro used two separate accounts, a water equalization provision and a fuel adjustment charge, to adjust for variations in hydraulic and thermal production costs as compared to the test year forecasts that were used in the calculation of the rates Hydro charged its customers.

The water equalization provision was used to adjust costs of production due to variations in hydraulic generation which were caused by fluctuations in water availability. The fuel adjustment charge was a mechanism designed to pass on actual fuel costs to customers one month after they were incurred. This method of recovery resulted in significant volatility in electricity costs to customers, particularly in the winter months when consumption would be at its highest. During the early eighties fuel prices experienced substantial increases. This resulted in the public expressing discontentment due to significant increases in their monthly electricity bills as a result of the operation of the fuel adjustment charge.

In August, 1985 Hydro filed a referral to the Board of Commissioner of Public Utilities ("the Board") of proposed rates for the supply of electric power to Newfoundland Light & Power Co. Limited ("NP") and the Board of Trustees of The Power Distribution District of Newfoundland and Labrador ("PDD"). Included in this referral Hydro, as a means to address consumer concerns and reduce volatility in its revenue requirement, proposed the implementation of a RSP. The RSP would reduce volatility and improve stability of rates but ultimately all variations in costs would be borne by consumers. The RSP consolidated both the hydraulic and fuel adjustment charge accounts into a single plan.

In its report dated November 8, 1985 to the Government of Newfoundland and Labrador on the rate proposals filed by Hydro, the Board recommended that the RSP presented by Hydro be accepted, with some changes.

The components and details of the RSP that were implemented as of January 1, 1986 are as follows:

- Water Variation Provision: This component was similar to the Water Equalization Provision that was in operation prior to the RSP. Costs/savings were accrued, or being charged, to the provision depending upon whether hydro production was above or below average. The variation in cost due to water conditions was determined by comparing the monthly normal hydro generation, as used in the 1986 final cost of service, with actual monthly hydro generation. This variation in gigawatt hours was converted to the equivalent barrels of oil needed to produce the equivalent energy from thermal production and then multiplied by the price per barrel of oil included in the cost of service. In the 1986 cost of service oil was priced at $30 per barrel. This provision is referred to as the Hydraulic Production component in the monthly RSP reports.

- Fuel Cost Variation Provision: This component was used to account for the variations in the price of Bunker "C" fuel oil. It would compare the price per barrel of Bunker "C" included in the cost of service to the actual price per barrel for thermal production. Adjustments to the provision

were calculated by multiplying the number of barrels of oil used for thermal production each month by the monthly fuel cost variation.

- Load Variation: This component was not approved as presented by Hydro in its rate proposals filed in August, 1985. Hydro presented a "coverage cap", which it proposed would prevent the company from over earning in situations where there was a decrease in load in comparison to the cost of service. The company proposed that Hydro's interest coverage on its retail customers be capped at 1.20, and any revenue in excess of this would be refunded to customers the following year when the financial statements had been finalized.

The Board's recommendations indicated that "any earnings variation because of a difference between the estimated load and the actual load be included in the Rate Stabilization Plans of Hydro and NLP." (Page 88, Report to the Government of Newfoundland and Labrador on Rate Proposals Filed by Newfoundland and Labrador Hydro on August 6, 1985). The implementation of the Board's recommendations was discussed in a letter to the Board dated March 26, 1986 from Mr. Cyril Abery, President and Chief Executive Officer of Hydro. Based on this letter the load variation would be determined by comparing the monthly cost of service sales with the actual monthly sales, and multiplying the difference in gigawatt hours by the Holyrood mill rate based on the cost of fuel per barrel used in the cost of service study. The total revenue received due to the load variation would be deducted to determine the adjustment to be made to the load variation provision.

In the letter dated March 26, 1986 Mr. Abery also proposed that variations arising from changes in the actual volume of secondary energy purchased for resale to retailers in comparison to the cost of service would also form part of the RSP. He indicated that this type of variation impacted directly on the load which Hydro would have to service from its own plants and hence impact Hydro's earnings.

The load variation component of the RSP includes two components; a revenue component and a fuel component. These two components together adjust for the net contribution attributable to a variation in energy sales. With respect to the revenue component, if the actual energy sales are less than the cost of service sales the difference flows through the plan as a charge to the particular customer group (i.e. retail verses industrial), and vice versa, if the sales are greater than the cost of service sales, the difference is a credit for the particular customer group in the plan. The adjustment amount is determined by multiplying the difference in actual versus cost of service energy sales for each customer group by its respective energy mill rate. The fuel component of the load variation is calculated by taking the total sales in kWhs from both customer groups, comparing it to the total cost of service kWh sales and multiplying the difference by the thermal generation energy mill rate which is based on the cost of service oil price per barrel. If the actual sales are less than the cost of service, the fuel component is a credit to the plan and if the actual sales are greater this component is a charge to the plan.

For example, in December 1986 the actual energy sales were greater than the cost of service sales for the retail group by 27.02 GWh and the industrial group sales were less than the cost of service

by 4.78 GWh. The revenue component adjustment for the retail group was a credit to the plan of $1,145,000 (27.02 GWh x 4.237¢/kWh), and the fuel component adjustment was a charge to the plan of $1,351,000 ((27.02 x 5.0¢/kWh). The revenue component adjustment for the industrial group was a charge to the plan of $104,000 (4.78 GWh x 2.168¢/kWh) and the fuel component adjustment was a credit to the plan of $239,000 ((4.78 x 5.0¢/kWh).

Beginning in January, 1986 the cost of financing the RSP was calculated using Hydro's embedded cost of debt and added to the balance in the plan on a monthly basis.

The Board also accepted Hydro's recommendation of a $50 million cap (positive or negative) on the plan that would obligate the Company, in the event that the cap was reached or exceeded, to come to the Board to review the operation of the plan.

Changes Recommended by the Board in its November 8, 1985 Report

In its report to the Government of Newfoundland and Labrador on November 8, 1985, the Board recommended the acceptance of Hydro's RSP with the following changes:

(a) One third of the balance in the RSP at the end of June each year commencing in 1987 would be amortized over the next twelve months. The amortization would be billed to NP on a kWh basis calculated using the kWh sold in the previous 12 months. This recovery would be debited or credited to the RSP on a monthly basis.
(b) Hydro was required to inform the Board of the amounts being accrued in each month, the balance accrued to date and the status of the amount being amortized.
(c) NP was required to calculate a rate adjustment per kWh by dividing the sum of the annual amortization to be billed by Hydro plus any balance in NP's rate stabilization account referred to in (d), by the total kWh sold in the previous twelve months and calculate the charge to be included in customers' bills in the following twelve months, and apply to the Board for approval of the July 1 rate adjustment resulting from this annual calculation.
(d) Under or over collections by NP would be carried forward in an interest bearing rate stabilization account.
(e) NP would report to the Board monthly the amount collected to date and the balance remaining.
(f) As noted above in the description of the load component, the Board recommended that any earnings variation because of a difference between the estimated load and the actual load be included in the RSP of Hydro and NP. This was recommended so that Hydro's earnings would not vary.

The Board was of the opinion that this plan would limit the amount of the RSP through the yearly adjustment. The rate adjustment would be made at the end of June so that the impact of a possible increase would be less severe than if the rate change happened in the winter. The Board indicated that the rate adjustment would be automatic and would not require a Hydro referral and a subsequent pass through hearing by NP.

Introduction of the Industrial Customers to the RSP

When the RSP was originally recommended for approval in the November 9, 1985 report, it only included the retail customers, not the Industrial Customers. However, in a letter dated March 26, 1986 from Mr. Cyril Abery to Mr. Gordon MacDonald, Chairman of the Board of Commissioners of Public Utilities, Mr. Abery proposed for the Board's approval the establishment of two separate RSPs, one for Hydro's retail customers (NP and PDD) and one for the Industrial Customers. Based on this letter it was noted that this was proposed as a result of discussions that Hydro had with NP due to concerns that NP had addressed regarding the approach used to determine the monthly balance in its RSP. The Board, however, did not give formal approval for this plan because at that time its authority was limited to hearing applications that had been referred to it by Hydro and making recommendations to the Provincial Government regarding the issues brought forward in those applications. The 1985 application and report dealt only with the rates to be charged by Hydro to NP and PDD, not to the Industrial Customers.

Mr. Abery indicated that the by establishing two segregated RSPs for retail and Industrial Customers it would allow Hydro to reflect the revenue that would have been collected from each customer group, had the actual results of load, hydro production and fuel price changes been known at the time the cost of service was prepared and filed with the Board. Hydro believed that this would result in the retail and Industrial Customers being treated fairly and independently of each other as it was based on the cost of service methodology approved by the Board.

The letter also indicated that Hydro felt that this proposed approach would be consistent with the recommendations made by the Board in its report dated November 8, 1985 and it would also satisfy the concerns expressed by NP.

Allocation of the Monthly Plan Activity

According to the March 26, 1986 letter from Hydro, it was noted that the calculation of the plan balances for the retail and Industrial Customers would be prepared monthly. The letter indicated that Hydro would recalculate the 1986 cost of service by customer, replacing the 1986 costs with the actual costs as they became available, related to any changes which may occur in both firm and secondary loads, hydro production and/or fuel prices. The difference between the revised cost of service derived using the actual costs and the 1986 final cost of service filed with the Board would indicate the adjustment to be made in the balance of the two plans.

The letter goes on to explain that the adjustment to the balance of the plan for each group, retail and industrial, would be derived monthly by comparing the revised cost of service for the specific group with the 1986 final cost of service filed with the Board for the same customer group net of revenue received due to any changes in firm energy sales.

March 6, 1989 Hydro Referral to the Board

On March 6, 1989, Hydro issued a referral to the Board for proposed rates to be charged to retail customers. This was approximately three years after the implementation of the RSP. According to the Board's June 1, 1989 Report to the Government of Newfoundland and Labrador relating to its recommendations on Hydro's proposed rates to be charged to retail customers, the only changes that Hydro proposed for the RSP was to rebase the cost of service price per barrel of oil from $30.00/bbl to $18.00/bbl and to use the blended price of oil in its tanks at the end of each month. The latter was considered to be fine-tuning and would have a minimal impact. The Board recommended that the RSP remain as it was with the exception of the two changes noted above.

According to pages 46 and 47 of the Board's June 1, 1989 report, Hydro was of the opinion "that the RSP was operating the way it was designed to operate and was proving to be a satisfactory tool". NP agreed that the Plan "…was operating as designed to do but questioned whether or not the amount in it by the end of June should be reduced by a one time payment to customers."…" and Mr. Joseph Hutchings, who was appointed by the Board to represent the general interest of the various classes of retail users of electricity, agreed with the other parties that "…the Plan was a good one and was working well."

February 6, 1990 Hydro Referral to the Board

On February 6, 1990, Hydro filed a referral to the Board of proposed rates for the supply of electric power to NP and rural customers. Based on the information included in the Board's June 11, 1990 Report to the Government of Newfoundland and Labrador, there was an issue of $8,941,000 in losses relating to PDD from April 1, 1989 to December 31, 1989 that was not covered by the Government subsidy. The Government fully subsidized PDD each year until March 31, 1989. However, beginning with the calendar year 1989 to 1991 the subsidy was going to be reduced each year, and in 1992 it would be eliminated. The RSP also had a positive balance of $40.1 million on June 30, 1989 and was projecting a positive balance of $19 million on June 30, 1990 (i.e. balance owing to ratepayers).

In its submission, Hydro submitted that these costs relating to the loss of the Government subsidy be deferred and recovered over a five year period. NP and the Consumer Advocate argued that some of the $19 million projected surplus balance in the RSP be used to eliminate this amount rather than deferring it over five years. Although the Board considered the possibility of charging the deficit caused by the reduction of the subsidy to the equity of Hydro, it, according to the report dated June 11, 1990 prepared by the Board, was prevented from making this recommendation by Section 4.3 of The Electrical Power Control (Amendment) Act ("EPCA").

Hydro was of the opinion that the surplus in the RSP should not be used to offset the deferred costs relating to the reduction of the subsidy. They indicated that the purpose of the RSP was to smooth variations caused by variations in fuel prices, climatic conditions and load and that it had performed extremely well over the previous four years in achieving this purpose.

The Board recommended in its June 11, 1990 Report to Government that the $8,941,000 loss for PDD from April 1, 1989 to December 31, 1989 be charged to the RSP. The Board was of the opinion that this offset would not interfere with the integrity of the RSP and it was the most suitable way of dealing with the unforeseen loss of the Government subsidy.

November 12, 1991 Hydro Referral to the Board

On November 12, 1991, Hydro filed a referral to the Board of proposed rates for the supply of electric power to NP and rural customers. Based on the information included in the Board's April 13, 1992 Report to the Government of Newfoundland and Labrador that summarized the information presented to the Board and the Board's recommendations on the rates proposed by Hydro in its referral, there were two items included in the referral that impacted the operation of the RSP. Firstly, Hydro made a referral that the purchase price of Bunker "C" oil used for the purpose of the RSP be decreased from $18 per barrel to $14 per barrel effective January 1, 1992.

Secondly, under a provision of the EPCA Chapter 40 of the 1989 Statutes of Newfoundland Hydro was permitted to defer costs it incurred during 1991 which would, unless recovered from its customers, cause Hydro to recover less than the interest coverage approved as a result of the 1990 Rate Referral. This deferral was estimated to be $9,015,000 and Hydro was recommending in its referral that this balance be written off against the balance in the RSP allocated to Newfoundland Power as of January 1, 1992.

In addition to these two Hydro referrals, NP had submitted during the hearing that the extra revenue Hydro would receive because of rate adjustments received by NP between Hydro hearings should flow to the RSP between Hydro rate referrals and flow back to customers. Hydro's rural rates on the Island Interconnected and Isolated systems have been primarily based on NP rates. Therefore, when a rate adjustment for NP had been approved by the Board, Hydro's rural customers received the same rate change without a rate referral having been filed by Hydro.

Purchase Price of Bunker "C" Oil

In its April 13, 1992 Report to Government, the Board recommended that the purchase price of Bunker "C" oil used for the purpose of the RSP be changed to $12.50 per barrel. This recommendation differed from Hydro's $14 per barrel due to falling oil prices from the time the referral was filed with the Board and the conclusion of the hearing.

The $9 million of Costs Deferrals in the 1991 Revenue Shortfall

As noted on page 38 of the Board's Report to Government, during 1991 Hydro operated under the authority of the EPCA Chapter 40 of the 1989 Statutes of Newfoundland and revised January 1, 1990. Section 4.1 (c) states the following:

> "4.1 Notwithstanding the other provisions of this Act, the Hydro Corporation shall include in its forecast costs filed with the Public Utilities Board
>
> > (c) the costs incurred after March 31, 1989, including fees or charges paid to the Crown, which have been deferred by the Hydro Corporation and which would, unless recovered from its customers, cause the Hydro Corporation to recover less than the minimum margin of profit approved by the Public Utilities Board under clause B of subparagraph (i) of paragraph (d) of section 3 in the year in which the costs were incurred."

Under this provision, Hydro was permitted to defer costs that were in accordance with this Section of the EPCA however the EPCA was amended in December, 1991 to eliminate Hydro's right to the deferral of costs incurred after 1991. Hydro explained that if the deferred costs were to be recovered in the 1992 test year, the proposed rate increase to NP would be approximately 11%. However if the deferral was recovered through the RSP, then the proposed rate increase would be approximately 3.8%. Therefore, the recovery of the deferral through the RSP would lessen the impact of the rate increase that Hydro required from NP in 1992.

NP had indicated during the hearing that Hydro's proposal to offset the deferral in the RSP was reasonable. It also proposed that that the July 1st RSP adjustment be based on the balance in the RSP account on December 31 of the previous year and, to facilitate this request, NP proposed that the deferral be rolled into the RSP on December 31, 1991.

The Board recommended in its April 13, 1992 Report to Government that costs of up to $9,015,000 incurred in 1991 be deferred and written off against the balance in the RSP allocated to NP as of December 31, 1991.

Revenue from NP Rate Changes

Hydro's rural rates on the Island Interconnected and Isolated systems have been primarily based on NP rates. Therefore, when a rate adjustment for NP has been approved by the Board, Hydro's rural customers received the same rate change without a rate referral having been filed by Hydro.

During the hearing, NP submitted that the extra revenue Hydro would earn because of rate adjustments received by NP between Hydro hearings should flow to the RSP and flow back to customers. They indicated that this would effectively reduce the subsidy being paid by NP and Industrial Customers until the next Hydro rate referral rather than increasing Hydro's net income.

Hydro did not consider NP's proposal to be appropriate; it proposed that any earnings in excess of its test year interest coverage be refunded to customers. NP did not agree with the cap on the interest coverage, as this approach allowed Hydro, when it was not in an over-earning situation, to apply the additional revenue against expenses that were not included in the forecast revenue requirement upon which rates were set and ratepayers would not see the direct benefit of the additional revenue. Also, as a result of the 1990 NP pass through of Hydro's rate increase, the Board approved the inclusion of a provision in NP's Rate Stabilization Account ("RSA") to ensure it did not over or under collect revenue as a result of Hydro's rate increase.

According to page 100 of the April 13, 1992 Report to Government, the Board agreed with NP that the extra revenue received as a result of rate adjustment between rate referrals should be credited to the RSP.

The Board recommended that at the upcoming hearing on Hydro's cost of service methodology, it should present for the Board's consideration a provision to be included in the RSP which would credit the RSP with any additional revenue received as a result of NP's rate adjustments.

June 26, 1992 Referral to the Board

On June 26, 1992, Hydro filed a referral to the Board for the proposed cost of service methodology, and a proposed method for adjusting its RSP to take into account the variation in Hydro's rural revenues resulting from variations in the rates set by the Board to be charged by NP to its customers. The latter was a recommendation of the Board resulting from the November 12, 1991 rate referral.

In its pre-filed evidence and during the hearing, Hydro presented a provision to be included in the RSP so that the plan would be credited with the additional revenue received by Hydro as a result of NP's rate adjustments between rate referrals. The provision presented, as noted in the Board's February, 1993 Report to Government (page 63), was as follows:

> 1 "The additional revenue be calculated on a monthly basis;
> 2 The additional revenue be determined by rate class, using the individual components of each rate;
> 3 The additional revenue be calculated using the actual billings for each month less the revenue which would have resulted from rates in existence in the test year when the cost of service was approved;
> 4 This policy become effective with the next NP rate alteration, subsequent to the conclusion of this hearing, and
> 5 The policy applies to all alterations (increase and decreases) to NP rates that could result in a change in Hydro's rural revenues."

According to the information in the Board's 1993 Report to the Government of Newfoundland and Labrador, NP agreed with Hydro's proposal, however NP noted that Hydro should develop a mathematical approach with all variables defined which would explain how the automatic adjustments were to be calculated and it should be set out in its Rules and Regulations. NP noted that this was a practice that they followed.

The Board recommended that the provision set out above be included in the RSP along with NP's proposal that a mathematical equation with all variables defined be included in Hydro's Rules and Regulations.

2001 General Rate Review

On May 31, 2001, Hydro filed an Application with the Board for a general rate review. This Application began the first comprehensive review of Hydro since it became fully regulated in 1996. Included in this Application were several proposed changes to the operation of the RSP as well as rebasing the variables (price of fuel, Holyrood efficiency factors, test year Hydraulic production, etc.) included in the RSP as a result of an updated cost of service. During the hearing of this Application there was extensive discussion relating to the RSP, including the complexity of the plan, the balance outstanding and the recovery of this balance, and the future operation of the plan.

Hydro proposed a number of changes to the operation of the RSP. They were as follows:

a) Hydraulic Production Variation

- Addition of mini-hydro plants to the calculation of hydraulic production variation.
- Holyrood conversion factor to be changed from 605 kWh/bbl to 610 kWh/bbl.
- The forecast hydraulic production included in Hydro's test year cost of service would also require a change in the calculation of the Hydraulic Production Variation. In its Application, Hydro's proposed 2002 test year forecast of hydraulic production of 4,285.00 GWh from 4,205.32 GWh.

b) Load Variation

- Interruptible energy no longer included in the plan. Barrels related to this energy were also proposed to be excluded from the fuel price variation calculation (along with the existing exclusion for barrels related to emergency sales).

c) Customer Splits:

- No longer base the RSP split on Test Year Cost of Service Study; instead use the 12 month-to-date invoiced /bulk transmission energy used, as well as Test Year Rural Deficit Allocation.

d) Rate Calculation

- Energy rates to be established on the same basis as the customer split, i.e. 12 month-to-date invoiced /bulk transmission energy.

e) Other

- The purchase price of No.6 Fuel used for the purposes of the RSP be changed from $12.50 per barrel to $20 per barrel to be effective January 1, 2002.
- Change the finance charge from Hydro's embedded cost of debt to Hydro's weighted average cost of capital ("WACC").
- Increase the RSP cap for NP from $50 million to $100 million.

P.U. Order No. 7 (2002-2003)

As a result of the hearing related to Hydro's 2001 General Rate Review on June 7, 2002 the Board issued Order No. P.U. 7 (2002-2003) which included a number of orders related to Hydro's proposals and other issues that arose during the hearing.

The Board approved all of the proposals noted above with the exception of the following:

a) Holyrood Fuel Efficiency Factor: The Board ordered an efficiency factor of 615 kWh/bbl as opposed to the 610kWh/bbl as proposed by Hydro.

b) 2002 Test Year Hydraulic Forecast: The Board ordered a test year hydraulic forecast of 4,425 GWh as opposed to the 4,285 GWh proposed by Hydro.

c) Purchase Price of No. 6 Fuel: The Board also ordered that the cost of service price for No. 6 fuel to be used in the RSP for calculating the fuel price variation would be an annual average fuel price of $25.47/bbl as opposed to $20/bbl that was proposed by Hydro. The price set by the Board was based on the monthly 2002 fuel forecast prices that were filed in Table 1 of R.J. Henderson's, 2nd Supplementary Evidence. The Board also ordered Hydro to file updated 12 month fuel forecasts as part of its quarterly reporting to the Board.

d) Retail Cap: The Board ordered the elimination of the $50 million cap as opposed to increasing the cap to $100 million as proposed by Hydro.

Recovery of the Balance in the RSP

According to Hydro the method of recovering the balance in the RSP that was set in 1985 had been working well. The balance was recovered from the customers over a three year period using a declining balance method. However, during the hearing there was discussion as to whether a shorter time frame should be considered due to the increasing balances in the plan. In its final argument submission, Hydro indicated that it was not opposed to a shorter time frame but did note the impact on customers of using an accelerated recovery method.

As a result of trying to balance the issue of matching the recovery of costs in the period that the costs were incurred and the overall impact on customer rates, the Board's orders included the following:

- The Board did not allow any additional recovery of the existing RSP balance until 2003. The RSP mill rate for the Industrial Customers was reset to the rate that was effective January 1, 2001 for the remainder of 2002 and the RSP mill rate for NP remained at the rate that was effective July 1, 2001. The NP mill rate would be in effect until July 1, 2003.
- The existing balances in the RSP were fixed as of the end of the month prior to the effective date of rate implementation based on the current methodology. This occurred August 31, 2002 for NP and the Industrial Customers, and this balance became known as the "Old Plan". Any balances that would accumulate in the plan after August 31, 2002 would be known as the "New Plan".

- The recovery of the "Old Plan" was to be recovered over a five year period commencing in 2003 using a straight line recovery method. Interest was accumulated and maintained on the balance using the WACC.
- The recovery or credits of balances that accumulated in the "New Plan" would be calculated using a straight line method over a two year period. This would be effective January 1, 2004 for the Industrial Customers and July 1, 2004 for NP.

2003 General Rate Review

On May 21, 2003, Hydro filed an Application with the Board for a general rate review. This Application did not include any major proposals with respect to the operation of the RSP other than rebasing the price of fuel, hydraulic production, Holyrood efficiency factor and load forecast as a result of the updated cost of service included with the Application. However, while the hearing was ongoing representatives for Hydro, NP, the Industrial Customers and the Consumer Advocate were engaged in settlement discussions separate from the hearing, and without participation of Board staff or Board Counsel, relating to certain amendments to the RSP.

On November 13, 2003, Hydro filed proposed amendments to the RSP (Consents #2 and #3) requesting that the Board approve these amendments to be effective January 1, 2004. The parties that participated in the settlement discussions consented to the filing of the proposed amendments with the exception of the Industrial Customers, who took no position with respect to the amendments of the provisions that related to the recovery of the plan balances. On December 15, 2003, the Board issued Order No. P.U. 40 (2003), ordering that the proposed amendments be effective as of January 1, 2004. The RSP continued to include the four main elements, that being, hydraulic, fuel, load and rural rate alteration; however there were changes within the components. The amendments also included changes in the calculation of the recovery or refund of plan balances.

Hydraulic Variation Component

The calculation of the hydraulic variation component did not change but it would be tracked separately from the other components. However only 25% of the annual balance in the hydraulic variation component, plus 100% of financing charges for that year, would be recovered from or refunded to customers each year. This amount, which is defined as the "Hydraulic customer assignment" would be removed from the Hydraulic Variation Account at the end of each year.

As indicated in Hydro's Rules and Regulations relating to the formulae used to calculate the activity in the RSP, the hydraulic customer assignment would be allocated among the Island Interconnected customer groups of NP, Industrial Customers and the Rural Island Interconnected. The allocation would be based on percentages derived from 12 months-to-date kWh for: Utility Firm and Firmed-Up Secondary invoiced energy, Industrial Firm invoiced energy and Rural Island Interconnected bulk transmission energy.

The portion of the hydraulic customer assignment that would be allocated to the Rural Island Interconnected will be re-allocated between NP and the regulated Labrador Interconnected customers in the same proportion that the Rural Deficit is allocated in the approved Test Year Cost of Service study. The Labrador Interconnected portion is written off to Hydro's net income.

The portion of the hydraulic customer assignment allocated to NP and the Industrial Customers would be included with the RSP balances for each of these groups as of December 31st of each year.

The reason provided for this proposed change was that, due to the nature of the hydraulic cycle, it had been contemplated that this part of the RSP may never have to be recovered from or refunded to customers. However, after Hydro's analysis, using historical data of the amount that could potentially

accumulate in this component and the possible effect on Hydro's risk and its balance sheet, it was agreed by the parties that 25% of the balance, plus 100% of financing charges for that year, be assigned annually to customers for collection or refund.

Fuel Cost Variation Component

The calculation of the activity for the fuel component did not change, however it was noted that the large balances accumulating in the RSP in recent years were the result of significant differences between the test year price of fuel and the actual price of fuel. Prior to the start of this hearing the test year price of fuel was an annual average price of $25.47/bbl and the actual average price of fuel in December 31, 2003 was $31.05.

The parties involved in the settlement discussions agreed that a mechanism was needed to address this issue on a go forward basis. A fuel rider, which takes into account the forecast price of fuel was the mechanism proposed in Consent # 2 and approved by the Board. The determination of the fuel rider is included under the "Fuel Price Projection" in Hydro's Rules and Regulations relating to the RSP.

A fuel price projection is calculated using forecast oil prices provided by the PIRA Energy Group and the current US exchange rates to determine the fuel rider for the rate adjustments. This would occur in April each year for NP, to be included with the RSP adjustment effective July 1st and for the Industrial Customers it would occur in October each year to be included with the RSP adjustment effective January 1st.

The calculation basically determines the difference between the average forecast price for the following 12 months and the test year price and multiplies this difference by the number of barrels of fuel forecast to be consumed at the Holyrood generating station for the test year.

According to the Rules and Regulations, the Industrial Customer allocation of the forecast fuel price change will be based on the 12 months to date kWh as of the end of September and is the ratio of the Industrial Firm invoices energy to the total of: Utility Firm and Firmed-Up Secondary energy, Industrial Firm invoiced energy and the Rural Island Interconnected bulk transmission energy. The NP customer allocation is calculated in the same manner with the exception of the allocation being based on the 12 months to date kWh as of the end of March.

Load Variation Component

The change in this component of the RSP was to treat the fuel costs component of the load variation in the same manner as the revenue component. The revenue variation component is assigned to the customer class which caused the variation, however previously the fuel cost variation was treated as common costs and shared proportionately among the customer classes regardless of the class that caused the variation. It was allocated using customer energy ratios.

By treating the fuel costs in the same manner as the revenue variation, it meant that the fuel cost variation resulting from the load variation would be assigned fully to the appropriate customer class, and as a result the customer class that caused the change in the load would be assigned the cost or recovery of the fuel associated with the change.

Rural Rate Alteration

This component of the RSP is calculated to account for changes in Rural revenues which occur as a result of changes in NP rates. This is due to the fact that Rural rates on the Island Interconnected and Isolated systems are primarily based on NP rates.

During this hearing, there was a mediation agreement titled "Parties Agreement on Cost of Service and Rate Design Issues", filed with the Board, that included settlement on various items included in Hydro's application. Included in this agreement was an additional provision to be added to the Rural Rate component of the RSP: "Hydro will adjust the Rural Rate Alteration component based on its projection of the 5 year phase-in of Labrador rates and the revenue credit available from secondary energy sales to CFB Goose Bay." This component was referred to as the "Rural Labrador Interconnected Automatic Rate Adjustments" and is contained in Section 1.3 (b) of Hydro's Rules and Regulations relating to the RSP.

Recovery of Plan Balances – Current and Historical Plans

As a result of the amendments included in the Consents which were subsequently approved in P.U. 40 (2003), the activity of the RSP commencing in January 2004 was allocated to a new plan that would be known as the "Current" plan. The balances in the "old" plan that accumulated up to August 31, 2002 and the balance that accumulated in the "new" plan for the period September 1, 2002 to December 31, 2003 were combined into a plan that would be known as the "Historical" plan.

The "Current" Plan

The recovery of the balance in this plan would occur over a one year amortization period rather than a two year amortization. The adjustment rate would be established to target a zero balance in the customer plans at the end of each recovery period. This change was recommended to help alleviate increasing balances in customer RSP balances.

The RSP adjustment rate would be comprised of two components. The first component was set to recover the customer balances annually and would be calculated as follows:

- NP customers: This balance would be the existing plan balance as of March 31st, less any projected recovery/refund of the balances for April, May and June, plus the estimated financing costs (using WACC) of the plan balance to the end of the next recovery period.

- Industrial Customers: This balance would be the existing plan balance on December 31st plus the projected financing costs of the plan balance for the next twelve months.

The second component of the adjustment rate would be the fuel rider that was previously discussed in this report. The total adjustment rate would be the rate derived from the plan balance plus the fuel rider. The Industrial Customers' rate is effective January 1st of each year and the NP rate is effective July 1st.

The "Historical" Plan

This plan was the result of the combination of the NP and Industrial Customers' balances outstanding up to August 31, 2002 and the balances that accumulated in the plan from September 1, 2002 to December 31, 2003.

As a result of the negotiations between the parties, it was proposed that to reduce the immediate impact on customers' rates, both of these RSP balances would be added together and would be recovered over a four year period commencing January 1, 2004 for the Industrial Customers and July 1, 2004 for NP. This proposal was approved by the Board in P.U. 40 (2003).

Rebasing of Variables

As part of the updated cost of service included in this Application, a number of variables included in the operation of the RSP are rebased or set as a result of the new test year. The variables that were approved by the Board for the 2004 test year were as follows:

a) Price of No. 6 Fuel: average annual price of $26.59/bbl
b) Holyrood Conversion Factor: 630kWh/bbl
c) Hydraulic Production: 4,582.15 GWh
d) Load Forecast: 6107.50 GWh

Ongoing Monitoring

As a result of the changes approved in P.U. 40 (2003), the Board directed Hydro to complete a review of the operation of the RSP for the period January 1, 2004 to December 31, 2005. The Board indicated in the Order that the review should assess the effectiveness of the revised RSP, including an assessment of the impact on customers in terms of rates based on the outstanding plan balance as of December 31, 2005. The Board directed Hydro to file this report to the Board no later than June 30, 2006.

2006 General Rate Review and Other RSP Activity During 2006

On August 3, 2006, Hydro filed a general rate application with the Board for approval, among other items, of the rates to be charged for the supply of power and energy to its customers as of January 1, 2007. As previously noted in P.U. 14 (2004), the Board ordered Hydro to prepare a report on the operation of the RSP for the period January 1, 2004 to December 31, 2005. Hydro filed this report on June 30, 2006 and, as part of its August 2006 application, Hydro requested that the changes proposed in the June 30, 2006 report be approved by the Board. Hydro also included other proposals for the Board's approval in addition to those included in the June report.

As part of the hearing process of the application there were several settlement agreements filed by the parties participating in this process. These agreements were the result of a negotiation process related to various issues presented in the application. The first agreement, "Agreement of Cost of Service, Rate Design and Rate Stabilization Plan" was filed October 6, 2006 and on November 23, 2006 the "Revenue Requirement Agreement", the "Supplementary COS, Rate Design and Other Issues Agreement" and the "Labrador Interconnected Rates Agreement" were filed with the Board.

June 30, 2006 Report – Review of the Operation of the RSP

The changes proposed by Hydro in this report were as follows:

- Fuel rider: When new test year base rates are implemented, if the fuel rider forecast is more current, a fuel rider which incorporates the new forecast should be implemented at the same time as the change in base rates.
- Load variation: Change the customer allocation for the load variation provision such that both the revenue and fuel components of the load variation are allocated between NP and the Industrial Customers based on the customer energy ratios. In Hydro's 2003 general rate application, the parties agreed that both the revenue and fuel components would be assigned where the load variation occurred (i.e. assigned to the customer class caused the load variation).
- Historical Plan Balances: Hydro indicated a willingness to extend the recovery period for the historical RSP, provided that there is an agreement among customers and there was consideration given to the issue of intergenerational equity.
- Aur Resources (i.e.: Teck Cominco): If the Board granted this company the proposed exemption from the historical RSP adjustment rate for 2006, this exemption should continue until the Industrial customer Historical Plan is eliminated.
- Diesel Fuel Impacts: Hydro believed that the variations in the uncontrollable price of diesel fuel presented an unreasonable net income risk to Hydro. As a result of this risk Hydro believed it should have some protection of this risk through the RSP.

Other Proposals in the 2006 General Rate Application

The application also included other proposals related to the operation of the RSP. These were as follows:

- Change the treatment of NP's allocated share of the CFB Goose Bay Revenue Credit whereby NP's portion of this credit would be removed from NP's base rates and refunded to NP though the RSP based on secondary revenue.
- Changes to the RSP to reflect the operation of the proposed annual automatic adjustment mechanism for Hydro's rate of return on rate base.

October 20, 2006 Parties Agreement

This Agreement titled, "The Parties' Agreement on Cost of Service, Rate Design and Rate Stabilization Plan" included agreement on several of the RSP issues to be put forward for the Board's approval.

The Parties agreed with Hydro's proposal relating to the fuel rider, that when new test year rates are implemented, if the fuel rider forecast is more current, a fuel rider which incorporates the new forecast should be implemented at the same time as the change in base rates. In P.U. 8 (2007), the Board accepted this approval in principle since it could not be used until the next general rate application (Hydro's RSP adjustment rates for January 1, 2007 were already implemented). The Board indicated in its Order that to ensure the purpose and language of this provision is appropriate for the next test year, this item should be discussed in the RSP review that was also included in this Agreement.

The Parties also agreed that the current provisions of the RSP should continue as approved for all hydraulic, fuel and load related components and all recovery related calculations with the exception of the following three issues which were not agreed upon:

1. Whether the potential effects of the variations in rural diesel fuel costs and rural power purchase costs on Hydro's net income should be protected by the operation of the RSP;
2. Whether there should be any limitations on the potential effects of the full or partial closure of the CFB Goose Bay facility on Hydro's net income; and
3. The disposition of the forecast hydraulic production variation balance in the RSP.

The Agreement also indicated that the Parties agreed that the RSP would be reviewed with the intent to review the design objectives of the current RSP. The Agreement indicated that no later than October 31, 2007, Hydro would host a Technical Conference, to be attended by the Parties and others as determined by the Parties, to discuss the re-design of the RSP and the Industrial Customer rate design. The Board agreed that a review of the RSP design would be appropriate and ordered in P.U. 8 (2007) that Hydro file with the Board, no later than May 31, 2007, a copy of the terms which are proposed for the RSP review, setting out the terms of reference, the specific review objectives, a list of participants, a planned timeline, and an outline of the review process.

November 23, 2006 – Parties Agreement on Revenue Requirement

In this Agreement, the Parties agreed on the disposition of the Hydraulic Production Variation balance as of December 31, 2006 and put forward the following proposals for the Board's consideration and approval:

Newfoundland Power

- Effective December 31, 2006, NP's portion of the actual RSP Hydraulic Production Variation balance as of December 31, 2006 would be allocated to NP's Historical RSP Balance
- Effective January 1, 2007, Hydro would decrease the RSP rate charged to NP as a result of the reduction in NP's Historical RSP balance as noted above. This would enable Hydro to amortize the collection of the reduced Historical RSP balance over 18 months (January 1, 2007 to July 1, 2008) and recognized that the RSP rates would be reset on July 1, 2008 in accordance with the normal operation of the RSP.
- Effective January 1, 2007, NP would reduce the RSA adjustment it charged its customers to reflect the change in the RSP rate noted above.

Industrial Customers

- The normal annual 25% allocation of the Industrial Customers' share of the actual Hydraulic balance as of December 31, 2006 would be incorporated in customer rates effective January 1, 2007 in accordance with the existing RSP rules, and
- The portion of the Industrial Customers' share of the actual Hydraulic credit balance, net of the allocation outlined above would be transferred, effective December 31, 2006, to the Industrial Customers' Historical RSP and used to reduce any charge, or increase any credit, which would otherwise be applied effective January 1, 2008 to the rates of the Industrial Customers under the current RSP rules.

November 23, 2006 – Parities Agreement on COS, Rate Design and Other Issues

In this Agreement, the Parties (including Hydro) agreed to withdraw two proposals that had been put forward by Hydro in its Application. The first withdrawn proposal related to the proposed change to the treatment of NP's allocated share of the CFB Goose Bay Credit. The Parties indicated that the current treatment of the CFB Goose Bay Revenue Credit would continue for the purpose of this Application, except to the extent of the proposed modification included in the agreement "Labrador Interconnected Rates" that was also filed on November 23, 2006. The second withdrawn proposal related to the introduction of a new provision in the RSP which would collect additional Rural Diesel fuel and power purchase costs from NP or similarly refund the savings to NP.

It was agreed by the Parties that these proposals would be discussed as part of the RSP review that was agreed to in the October 20, 2006 Agreement.

November 23, 2006 – Parties Agreement on Labrador Interconnected Rates

In this Agreement the Parties, with the exception of the Industrial Customers who took no position on this issue, put forward the following proposal to the Board relating to the operation of the RSP:

- "A sufficient portion of the CFB Goose Bay Revenue Credit will be used to maintain existing rates paid by the Rural customers on the Labrador Interconnected system for 2007. The revenue shortfall to Hydro from maintaining existing rates will be recovered through the RSP. The RSP rules pertaining to the Rural Rate Alteration (Rural Labrador Interconnected Automatic Rate Adjustments) will be modified to reflect the foregoing and to facilitate the phasing in of the CFB Goose Bay revenue credit for secondary energy sales to reduce the Rural Deficit. The modified RSP rules will be submitted to the Board for approval."

Government Directive

On September 29, 2006, the Government of Newfoundland and Labrador ("the Government") issued an Order in Council to the Board pursuant to section 5.1 of the EPCA, which directed the Board as follows:

> *"The Board of Commissioners of Public Utilities is directed to adopt a policy that, if Newfoundland and Labrador Hydro applied to the Board on or before October 1, 2006 for a change in the Industrial Customers Rate Stabilization Plan which is not on the normal schedule for adjustments to that Plan, such change being associated with the withdrawal of a significant industrial customer and including a contribution to the historic portion of the Plan to offset implications of this withdrawal, the Board shall approve the application and, if the application is made on or before September 22, 2006 , the Board shall apply procedures so that changes in Industrial Customer electricity rates are implemented no later than October 1, 2006;…"*

Hydro did file an application to the Board on September 22, 2006 for approval of the revised 2006 Industrial Firm Energy rates that reflected changes to the Industrial Customers' RSP as a result of the closure of Abitibi Consolidated – Stephenville Division and the Order in Council noted above. These changes were approved by the Board in P.U. 31 (2006) as directed by the Government and the revised rate became effective as of October 1, 2006. The approved adjustments to the Industrial Customers' RSP were as follows:

- The calculation of the fuel rider was revised to adjust the 2004 Test Year barrels of No. 6 fuel forecast to be consumed at the Holyrood Generating Station to reflect a reduction in load resulting from the closure of Abitibi Consolidated Inc – Stephenville Division;
- A modification of the calculation of the Historical Plan RSP recovery rate to reflect a $10 million contribution from the Government to the plan on account of the closure of Abitibi Consolidated Inc – Stephenville Division; and
- The Industrial Customer kWh sales (2004 Test Year) were adjusted to reflect the closure of Abitibi Consolidated Inc – Stephenville Division.

Order No. P.U. 46 (2006)

Hydro filed a Revised Application on December 6, 2006 that incorporated the Settlement Agreements and the Government Directives and it filed a further application on December 20, 2006 requesting Board approval of the revisions to the RSP rules to reflect the intent of the December 6, 2006 Government Directive related to the rural rate alterations, the Settlement Agreements and the Revised Application.

Due to the timing of this hearing the Board was not in a position to issue a final order before January 1, 2007. However, on December 29, 2006, the Board issued P.U. 46 (2006). In this Order the Board did not approve all of the proposed changes but approved those which were appropriate in the context of the approval of interim rates that were to be effective January 1, 2007. The Board approved the following on an interim basis:

> "i. Changes to the monthly amount of the 2007 automatic rate adjustment for the Rural Labrador Interconnected system resulting from the phase-in of the CFB Revenue Credit from secondary sales to CFB Goose Bay to the rural deficit, leaving the CFB Revenue Credit applied to the rural deficit in Hydro's final 2007 test year cost of service and future years to be determined later by final Order of the Board; and
>
> ii. The use of a reserve account to maintain the December 31, 2006 RSP Hydraulic Variation balance, net of the normal 25% December 31, 2006 allocation, with normal RSP financing charges applied, until the balance is disposed of later by final Order of the Board."

Order No. P.U.8 (2007)

This Decision and Order of the Board in the matter of Hydro's 2006 General Rate Application was issued April 12, 2007.

In this Order the Board indicated that it was satisfied that the allocation of a portion of the CFB Goose Bay Revenue Credit during the extended phase-in of uniform Labrador Interconnected rates was reasonable and consistent with regulatory principles and approved Hydro's proposed methodology for this allocation. However, the Board included in the Order that Hydro would be required to file supporting calculations with each annual application for approval of changes to Labrador Interconnected rates. The Board noted that the RSP rules submitted by Hydro included specific elements of the rates beyond 2007 for the Labrador Interconnected customers, since the Board indicated that future rates would require approval of the Board upon application by Hydro. The Board also ordered Hydro to revise the RSP rules to remove reference to the specific amounts in the Rural Rate Alteration for the years beyond 2007.

The Board also approved the distribution of the balance of the reserve account established in P.U. 46 (2006) in accordance with the special adjustment to the RSP Hydraulic Production Variation balance that was proposed in the Settlement Agreements. This one-time adjustment was set out in Schedule B of this Order and Hydro was required to revise the RSP rules that were submitted to exclude the reference to this one-time adjustment. Since this Order was not issued until April 12, 2007, Hydro

adjusted the 2007 opening balances for NP's Current RSP Plan and Historical Plan, as well as the 2007 opening balance of the Industrial Customer's Historical Plan to reflect the distribution of the Hydraulic Plan balance as of December 31, 2006.

The changes to the rules in the RSP that Hydro submitted for approval also included references to the proposed Automatic Adjustment Mechanism ("AAM") that Hydro had proposed for the setting of future rates. The Board did not approve the use of an AAM at this time and therefore Hydro was ordered to revise the RSP rules to remove the reference to the AAM.

Rebasing of Variables

As part of the updated cost of service included in this Application, there were a number of variables that are included in the operation of the RSP that were rebased or set as a result of the new test year. The variables that were approved by the Board for the 2007 test year were as follows:

a)	Price of No. 6 Fuel:	average annual price of $55.11/bbl
b)	Holyrood Conversion Factor:	630kWh/bbl
c)	Hydraulic Production:	4,472.07GWh
d)	Load Forecast:	5,820.10GWh

Order No. P.U. 32 (2006)

On September 18, 2006, Hydro filed an application to the Board requesting approval to recover, through the RSP, the cost of No. 6 fuel burned at the Holyrood Generating Station with a sulphur content not exceeding 1% by weight instead of the lower cost of fuel with a sulphur content of 2% which was previously included in rates.. This approval was required in order for Hydro to be in compliance with a Certificate of Approval issued by the Department of Environment and Conservation which prohibited Hydro from burning any fuel with sulphur content greater than 1% by weight.

On October 20, 2006, the Board issued P.U. 32 (2006) approving the recovery by Hydro of the cost of burning 1% sulphur content No. 6 fuel at Holyrood through the RSP effective immediately.

RSP Activity During 2007

Order No. P.U. 1 (2007)

On January 20, 2006, the Board issued P.U. 1 (2006) approving interim rates for Aur Resources Inc. (now known as Teck Cominco), a new industrial customer that began operating at the Duck Pond Mine in Central Newfoundland. These interim rates included the Historical Plan balance portion of the RSP. On January 18, 2007, the Board issued P.U.1 (2007) approving the exclusion of the portion of the rate relating to the Historical Plan balance of the RSP, and Hydro was also ordered to refund or credit Aur Resources the difference between the rates approved in P.U. 1 (2006) and the rates approved in this Order.

As a result of this Order, the 2007 opening balance of the Industrial Customer Historical Plan balance was increased by $129,103 to reflect the refund of $125,726 to Aur Resources for amounts collected from January 20, 2006 to December 31, 2006 and the related financing charges of $3,377.

Rural Rate Alteration

Beginning January 2007, the Rural Rate Alteration included a monthly amount of $92,560. This amount related to the phase-in of the credit from secondary energy sales to CFB Goose Bay to the Rural deficit. This was included in the November 23, 2006 Settlement Agreement "Labrador Interconnected Rates" and approved by the Board in P.U.8 (2007). The RSP Regulations received final approval in Order P.U. 14 (2007) which was issued May 17, 2007.

Historical Plan Balance – Industrial Customers

As ordered in P.U. 40 (2003) as a result of the Settlement Agreement filed in relation to the 2003 General Rate Hearing, the balances in the "new" and "old" plans were consolidated as of December 31, 2003 and the balance was to be recovered over a four year period. As of December 31, 2007, there was a credit balance in the Industrial Customers' portion of the Historical Plan balance of $1,382,494 and, in accordance with Section E of the RSP rules, this balance was transferred to the Industrial Customers' Current Plan. The recovery of NP's portion of the Historical Plan Balance continued until June 30, 2008.

RSP Activity During 2008

Industrial Customers' RSP Rate

In accordance with Section C of the RSP Regulations, Hydro is required to calculate a fuel price projection that includes forecast fuel price changes and determine the annual fuel rider for the rate adjustments. This is required to be calculated in October of each year for the Industrial Customers.

The amount of the forecast fuel price change and the details of an estimate of the fuel rider based on 12 months to date kWh sales to the end of September is required to be reported to the Industrial Customers', NP and the Board by the 10th working day in October.

The RSP adjustment rate including the fuel rider for Industrial Customers' is to be calculated each year with an effective date of January 1st. On December 20, 2007, Hydro filed an application with the Board requesting that the rates currently in place for the Industrial Customers' would continue on an interim basis. The Board issued P.U. 34 (2007) approving that the rates for the Industrial Customers that were in effect for 2007 would continue after January 1, 2008 until the Board ordered final rates for the Industrial Customers in 2008. These interim rates continued throughout 2008. Therefore, the fuel rider has not been included in the Industrial Customers' RSP adjustment rate, as 2007 rates were based on a 2007 test year with no fuel rider component.

It is important to note that the 2007 RSP adjustment rates that were set as of January 1, 2007 were as follows:

- The RSP adjustment rate for the Current Plan was a refund of 2.0 cents per kWh
- The RSP adjustment rate for the Historical Plan was a recovery of 1.215 cents per kWh.

As a result of the completion of the Industrial Customer Historical Plan balance, these rates were combined to a refund rate of 0.785 cents per kWh on the Current plan balance effective January 1, 2008. The refund rate for Teck Cominco continued at 2.0 cents per kWh as this company was excluded from the recovery of the Historical plan.

Rural Rate Alteration

Beginning January 2008, the Rural Rate Alteration included a monthly amount of $32,433. This amount related to the phase-in of the credit from secondary energy sales to CFB Goose Bay to the Rural deficit. This received final approval in Order P.U. 33 (2007) which was issued December 21, 2007.

Historical Plan Balance – NP Customers

The recovery of NP's portion of the Historical Plan Balance concluded June 30, 2008. At this time there was a credit balance in the Plan of $2,238,025 that was transferred to the Current Plan in accordance with Section E of the RSP Regulations.

RSP Activity During 2009

Industrial Customers' RSP Interim Adjustment Rate

On December 11, 2008 Hydro filed an Application to the Board for approval to continue the existing RSP adjustment rates with the exception of Teck Cominco. The rates for this industrial customer would increase to the same level as the other Industrial Customers as the Historical Plan balance no longer existed. The Application also requested a revision to the RSP rules and regulations for Hydro's Industrial Customers to remove the reference to the Historical Plan balance.

On December 17, 2008 the Industrial Customers made a submission to the Board requesting that the interim rates be continued, with the existing differential for Teck Cominco, until March 31, 2009. The Industrial Customers' request was made to allow time for parties to request information and file evidence, and they suggested that Hydro should be required to file an application for final rates at least thirty days prior to the expiration of the interim rates.

On December 24, 2008, the Board issued P.U. 37 (2008) allowing the Industrial Customers rates to continue on an interim basis until March 31, 2009 and the Order also required Hydro to file an application by January 30, 2009 to finalize the interim rates for the Industrial Customers.

On January 16, 2009 Hydro filed an application requesting an extension of the filing deadline for an application to finalize rates until June 30, 2009 and approval to continue using interim rates for the Industrial Customers until the Board is able to deal with the application when it is filed.

The Board issued P.U. 6 (2009) on January 30, 2009 approving the continuation of the interim rates until the Board issues an Order with respect to the finalization of the rates. The Board also approved Hydro's request to extend the filing deadline of the application to finalize the interim rates to June 30, 2009.

On June 30, 2009, Hydro filed an application with the Board concerning the RSP components of the rates to be charged to Industrial Customers. In its application, Hydro indicated that it had updated and completed its analysis of the fuel and load variation caused by the events in the pulp and paper industry that are described below and that the application of the existing RSP rules to calculate rates for Industrial Customers would result in significant and unreasonable rate volatility. Therefore, in this application, Hydro proposed that the rates for Teck Cominco Limited be the same as those in effect for the other Island Industrial Customers and that the existing interim rates currently in effect for these customers' be made final. The Board is currently in the process of scheduling a hearing to address this Application.

Industrial Customer Load Requirements

During the 4th quarter of 2008 to the 2nd quarter of 2009, there were significant announcements and events within the pulp and paper industry in the Province due to a deterioration of the global newsprint market. These events can be summarized as follows:

- On December 4, 2008, Abitibi Consolidated Inc announced it would be closing the paper mill in Grand Falls-Windsor as of March 31, 2009. As a result of the announced closure on December 16, 2008, the Government of Newfoundland and Labrador introduced and passed into law the *Abitibi –Consolidated Rights and Assets Act.* As a result of this legislation, the hydro electric generating assets owned by Abitibi were repatriated. In its June 30, 2009 Application, Hydro indicated that the impact of the repatriation of these assets on Island Interconnected electricity rates could not be estimated at this time.
- On January 7, 2009, Kruger Inc., owner of the Corner Brook Pulp and Paper mill, announced its intention to reduce its newsprint production by 25,000 tonnes in the first half of 2009. It indicated that this downtime would be spread across its three Canadian mills which included the mill in Corner Brook.
- On June 24, 2009, Kruger announced that it was going to idle its No. 4 paper machine in Corner Brook. This machine was shut down in March, 2009 for what was to have been an eight week period but in this announcement the Company indicated that the shutdown would continue indefinitely. Two paper machines remain active at the Corner Brook mill.

These events have had a significant impact on the load requirements of the Island Industrial Customers. The December 2009 RSP report compiled by Hydro indicates that the actual kWh sales included in the load variation component for Industrial Customers for 2009 was 384,777,985 kWh as compared to the cost of service sales of 894,300,000 kWh. The cost of service sales are based on the 2007 Test Year Cost of Service that was approved in P.U.8 (2007). This significant reduction in load resulted in a credit balance of $25,874,401 (amount owing to Industrial Customers) being added to the Industrial Customers RSP plan balance. The overall outstanding RSP balance owing to Industrial Customers as of December 31, 2009 is $36,874,648.

In the accompanying letter to the June 30, 2009 Application filed by Hydro it made reference to the proposal that Hydro had made in its June 30, 2006 report, "Review of the Operation of the Rate Stabilization Plan" which covered the period January 1, 2004 to December 31, 2005, relating to a change in the method of allocating the load variation component of the RSP. The proposal was stated as follows:

> *"Hydro intends to propose a change in the method of allocating the load variation component of the RSP such that both the revenue and the fuel components of the load variation will be allocated between NP and IC using customer energy allocation ratios. In effect, the customers will be allocated with Hydro's bottom line impact in the same proportion as energy costs are shared in as test year Cost of Service."*

As indicated earlier in this report, this proposal was included in Hydro's 2006 General Rate Application and, as a result of negotiations between the parties involved in this hearing, a Settlement Agreement titled "Parties Agreement on the Cost of Service, Rate Design and Rate Stabilization Plan" indicated that the RSP would be reviewed with the intent to better reflect the design objectives of the RSP. It noted that the review would include whether the load variation component of the RSP was a necessary component in the plan. A Technical Conference was scheduled to be held no later than October 31, 2007 where the redesign of the RSP would be discussed. According to Hydro, discussions were held during 2007 and 2008 with NP, the Industrial Customers and the Consumer Advocate on changes to the RSP rules but there was no consensus during those discussions.

Hydro indicated in its letter dated June 30, 2009 that it was its intention to file this proposed change relating to the load variation with the Board no later than the filing of its next General Rate Application. Hydro also noted in the letter that the June 30, 2009 Application did not contain any proposed changes to the components of the RSP, however the Board might wish to consider the following:

> *"…suspension of the existing load variation allocation rules and holding in abeyance current and future load variation amounts until such time as Hydro can develop a proposal to address the current anomalies in the RSP…."*

Hydro has included the following note on the Plan Highlights of the December 31, 2009 RSP Report:

> *"Disposition of the load variation is one of the issues to be considered by the Public Utilities Board in a pending hearing. This may impact the balances owing to customers in the current plan."*

Rural Rate Alteration

Beginning January 2009 the Rural Rate Alteration included a monthly amount of $5,766 down from $32,433 which was in effect as of January 1, 2008. This amount relates to the phase-in of the credit from secondary energy sales to CFB Goose Bay to the Rural Deficit. This received final approval in Order P.U. 34 (2008) which was issued by the Board December 22, 2008.

Impact of Changes on the Annual Plan Balances for Newfoundland Power and the Industrial Customers

There have been many changes that have occurred with regards to the operation of the RSP since its inception in 1985, nevertheless the RSP still contains the three main components that were originally included, namely the Hydraulic Production Variation, the Fuel Cost Variation and the Load Variation. However, there have been changes that have occurred within the operation of each of these components.

Hydraulic Production Variation

As a result of the proposed amendments that were filed with the Board on November 13, 2003 during the hearing of Hydro's 2003 General Rate Application, the parties involved agreed that only 25% of the annual balance in the hydraulic variation component, plus 100% of financing charges for that year would be recovered from or refunded to customers each year. The remaining portion of the Hydraulic Variation Account would be tracked as a separate plan balance. The reason for this change was that over the nature of the hydraulic cycle this part of the RSP may never have to be recovered from or refunded to customers; theoretically it should work out to zero over the cycle.

Since 2004, when the 25% annual assignment to the customer class was approved by the Board, the Hydraulic Production Variation has been in a credit balance which means the actual hydraulic production has exceeded the cost of service hydraulic production in each year. The annual customer assignment is prorated to the customer class based on the 12 month kWh sales from each class, including the Rural customers which is then reallocated between NP and the Labrador Interconnected customers. This reallocation is based on the same ratio which the Rural Deficit was allocated in the approved Cost of Service Study, which is 89.10% and 10.90% respectively.

Each year the portion allocated to NP is increasing as a result of the lower energy requirements experienced by the Industrial Customers. It is important to note that because the actual Hydraulic Production has exceeded the Cost of Service Hydraulic Production, the portion assigned to the customer classes each year represents an amount owed to customers. Hydro indicated during the 2003 General Rate Hearing that the amount of Hydraulic Production included in the 2004 Test Year Cost of Service is based on the average expected from historical hydrological records and, theoretically, the balance in the Hydraulic Plan should tend to zero over an extended period of time. The portion assigned to the Current Plan each year since 2004 (with the exception of 2006 noted below) is as follows:

	25% Annual Assignment	Assignment to NP	% [1]	Assignment to IC	%	Credit Balance Accumulated in Hydraulic Plan
2004	$ 2,225,594	$ 1,722,445	77.39%	$ 487,788	21.92%	$ 5,521,528
2005	$ 4,261,844	$ 3,393,171	79.62%	$ 839,170	19.69%	$ 10,625,444
2006	$ 6,642,336	$ 5,726,000	86.20%	$ 867,115	13.05%	$ 15,977,692 [2]
2007	$ 6,064,061	$ 5,262,203	86.78%	$ 758,949	12.52%	$ 14,820,468
2008	$ 12,652,056	$ 11,117,816	87.87%	$ 1,440,578	11.39%	$ 30,902,837
2009	$ 13,759,961	$ 12,758,921	92.72%	$ 895,664	6.51%	$ 32,181,286

Note 1: The remaining % of the annual assignment is allocated to the Labrador Interconnected customers and written off to income in Hydro.

Note 2: In P.U. 7 (2008) the Board approved the proposal put forward in the November 23, 2006 Settlement Agreement "Parties Agreement on Revenue Requirement" that the full balance in the Hydraulic Plan as of December 31, 2006 be allocated to each customer and applied to the Historical Plan balances for each customer class. Therefore, starting January 1, 2007 the opening balance in the Hydraulic Plan was zero. The 2006 annual assignment of $5,726,000 for NP was also allocated to its Historical Plan in 2006. The Industrial Customers annual assignment was assigned to its Current Plan.

Fuel Cost Variation

The fuel cost variation component of the RSP began accumulating a significant balance owing from customers starting in the year 2000 when the 12 month year to date balance of this component as of December 31, 2000 was approximately $29 million. At December 31, 2001 the 12 month year to date balance accumulated to approximately $57 million. During 2001, Hydro filed a General Rate Application with a 2002 Test Year Cost of Service. Since 1992 the cost of service price of No. 6 fuel used in the RSP was $12.50/bbl however the price of fuel had increased significantly over the years, and in 2000 the actual price of No. 6 fuel was an average of $30.92 per barrel, and in 2001 the price averaged $29.69 per barrel. This increase of the cost of fuel compared to the 1992 cost of service price led to the significant balances owing from customers. In P.U. 7 (2002-2003), the cost of service price of fuel was set at $26.80/bbl.

Rebasing the fuel price should have helped alleviate the significant balances that were accumulating on an annual basis in this component of the RSP, however as of December 31, 2002 the year to date 12 month balance in the fuel variation component was approximately $46 million and December 31, 2003 the year to date balance was approximately $36.5 million. The actual price of No. 6 fuel in 2002 went from a low of $24.33/bbl to a high of $36.44/bbl and in 2003 the actual price went from a low of $30.77/bbl high to a high of $44.44/bbl. It should also be noted that the price of fuel was not the only factor causing the increasing balances in the fuel variation component. During this time Hydro was also experiencing poor hydraulic results which resulted in lower hydraulic energy production due to low

water levels in its reservoirs. As a result of the low water levels there was a requirement to produce more thermal energy at its Holyrood Generating Station thereby consuming a higher number of barrels than that included in the cost of service.

The parties involved in the settlement discussions resulting in the proposed RSP amendments that were filed on November 13, 2003 during the 2003 General Rate Hearing proposed that a fuel rider mechanism should be put in place to address the differences in the cost of service price of fuel and the actual price of fuel between general rate hearings. This proposal was approved by the Board. This fuel rider was calculated annually for NP and the Industrial Customers, and the result was included in the annual rate adjustment for the Industrial Customers effective January 1st and for NP effective July 1st of each year.

The fuel rider component of the rate adjustment, which is based on forecast fuel prices for the upcoming year, is calculated each year for the Industrial Customers and NP commencing January 1, 2005 and July 1, 2005, respectively. The purpose of the fuel rider is to help alleviate rising balances in the Plan due to changes in fuel prices between Test Years and to provide customers with more appropriate and timely price signals. The tables below summarize the amount of the fuel cost variation that has been collected each calendar year with the use of a fuel rider. The first table is a summary of the Industrial Customers' fuel rider performance since its implementation on January 1, 2005.

Industrial Customers Fuel Rider Performance

	Fuel Cost Variation	Sales (kWh)	Fuel Rider $/kWh	Amount Collected Via Fuel Rider
2005	$ 3,207,375	1,236,901,333	0.00196	$ 2,424,327
2006	3,356,991	749,100,463	0.00640	4,794,243
2007	(722,338)	771,198,558	-	-
2008	3,159,108	690,182,871	-	-
2009	(294,414)	384,777,985	-	-
	$ 8,706,722	3,832,161,210	-	$ 7,218,570

As 2007 was a test year, the RSP adjustment rate that was set for the Industrial Customers effective January 1, 2007 did not include a fuel rider and, as noted previously in this report, this customer class has been charged an interim rate for the RSP adjustment since January 1, 2008 (based on January 1, 2007 rates), therefore there has not been a fuel rider component to this rate since 2006. During 2005 and 2006, while the fuel rider was in operation, the amount collected represented 110% of the fuel price variation. In 2007, the fuel price variation resulted in a credit balance of $722,338. The primary reasons for this balance is that from January to June the actual average No. 6 fuel costs was less than the cost of service fuel cost and during this year the hydraulic production exceeded the cost of service production by 217,363,830 kWh (4,689,433,830 kWh vs. 4,472,070,000 kWh). In 2008, the hydraulic production continued to exceed the cost of service. However increasing oil prices experienced during 2008 (the actual average No. 6 fuel cost was $71.59/bbl whereas the cost of service cost was $55.47/bbl) resulted in a fuel variation of $27,745,268 with the industrial customer's portion of this

variation being $3,159,108 (11.4%). In 2009, the hydraulic production exceeded the cost of service production and fuel prices declined from 2008. From January, 2008 to October, 2008 the actual average No.6 fuel cost per barrel was lower than the cost of service fuel cost, with an average actual cost for the year of $52.51 in comparison to $55.47 average cost of service No. 6 fuel cost per barrel. This activity resulted in a credit balance of $294,414 for the Industrial Customers.

The table below is a summary of the NP's fuel rider performance since its implementation on July 1, 2005.

Newfoundland Power Fuel Rider Performance				
	Fuel Price Variation	**Sales (kWh)**	**Fuel Rider $/kWh**	**Amount Collected Via Fuel Rider**
July 2005 – Dec 2006	$ 10,089,729	2,063,478,775	0.00428	$ 8,831,689
Jan 2006 – June 2006	14,061,261	2,530,607,012	0.00428	$ 10,830,998
July 2006 - Dec 2006	8,106,645	2,086,223,525	0.00938	$ 19,568,777
Jan 2007 – June 2007	(7,564,857)	2,782,169,476	0.00938	$ 26,096,750
July 2007 – Dec 2007	2,556,498	2,208,158,217	0.00054	$ 1,192,405
Jan 2008 – June 2008	15,959,018	2,790,446,773	0.00054	$ 1,506,841
July 2008 – Dec 2008	8,421,747	2,169,226,262	0.00609	$ 13,210,588
Jan 2009 – June 2009	(5,769,325)	2,797,456,158	0.00609	$ 17,036,508
July 2009 – Dec 2009	1,575,336	2,306,580,558	0.00691	$ 15,938,472
	$ 47,436,052	21,734,346,756	-	$ 114,213,028

Since the implementation of the fuel rider, this mechanism collected 241% of the fuel cost variation allocated to NP over the past 4.5 years. Based on the information above, there were periods of time over the 4.5 years where the fuel rider component collected more than the fuel price variation. As indicated previously in this report, the fuel rider for NP is calculated based on forecast oil prices provided by Hydro as of the end of March each year and the rate becomes effective July 1st of each year. The two periods that resulted in a credit fuel price variation occurred in the six months prior to the fuel rider change. In both of these periods the actual cost of No.6 Fuel per barrel was lower than the cost of service however the fuel rider was based on a forecast that predicted an increase in fuel prices over the cost of service. The other reason for the lower fuel price variations in comparison to that collected is the excess of the actual hydraulic production over the cost of service production over the last 5 years and therefore less fuel was required to be burned at the Holyrood Generating Station.

It is worth noting that any over collection of the fuel price variation in a year by the fuel rider becomes a part of the balance that is collected or refunded in the subsequent year. However, the above table does not illustrate a correlation between these two factors.

Load Variation

Although the allocation of the load variation component changed several times over the years, the allocation of the revenue component of the load variation did not change since the inception of the

RSP. The revenue component is allocated based on which customer class caused the change in the load. The allocation of the fuel component of the load variation did experience several changes; these changes can be summarized as follows:

1985 to August 31, 2002: Fuel component was allocated based on the latest Cost of Service that had been approved.

September 1, 2002 to December 31, 2003: Fuel component was allocated based on energy allocation ratios.

January 1, 2004 to Present: Fuel component is allocated on the same basis as the revenue component which is 100% to the customer class that caused the change in load. This change was a result of the proposed amendments that were filed November 13, 2003 based on agreement from all the parties involved in the 2003 General Rate Hearing (Hydro, NP and the Island Industrial Customers).

As noted previously, Hydro did propose in its 2006 General Rate Application that the revenue and fuel component of the load variation be allocated to the customer class using energy allocation ratios, however it was agreed in the settlement negotiations that this would be addressed in the agreed review of the design of the RSP, which to date has not occurred.

The change in allocating the fuel component to the customer class where the change in load occurred was considered to improve the fairness of the allocation of the load variation because the costs would now be allocated between NP and the Industrial Customers based on causality.

The table below presents the allocation of the load variation between customer classes since 2004.

Allocation of Load Variation							
	Revenue Component ($)	Fuel Component ($)	Total Load Variation ($)		Revenue Component ($)	Fuel Component ($)	Total Load Variation ($)
2004				**2007**			
NP	(4,683,406)	3,988,531	(694,875)	NP	(5,684,950)	5,938,791	253,841
IC	(1,869,566)	3,154,692	1,285,126	IC	4,525,209	(10,787,285)	(6,262,076)
			590,251				(6,008,235)
2005				**2008**			
NP	5,115,147	(4,813,948)	301,199	NP	(2,983,192)	2,956,940	(26,252)
IC	2,618,789	(4,350,803)	(1,732,014)	IC	7,503,346	(17,818,525)	(10,315,179)
			(1,430,815)				(10,341,431)
2006				**2009**			
NP	7,325,661	(7,225,568)	100,093	NP	(15,753,937)	15,600,947	(152,990)
IC	15,667,463	(27,209,222)	(11,541,759)	IC	18,730,029	(44,604,431)	(25,874,402)
			(11,441,666)				(26,027,392)

As noted above, since 2006 the Industrial Customer class has experienced credit balances (amounts owing to customers) which have been significant. The amount of variation from 2006 to 2007 decreased because 2007 was a test year which allowed the load forecasts to be rebased based on the approved cost of service. The 2007 load forecasts for the Industrial Customers would have excluded any load requirements for Abitibi Consolidated – Stephenville Division as the closure of that operation occurred in the Fall of 2005. The cost of service load forecast for the Industrial Customers decreased by 440,500,000 kWh from 2006 to 2007. However in 2007 the actual sales were lower than the cost of service and they continue to be significantly lower in comparison to the cost of service. Based on the information in the above table, the net load variation owing to the Industrial Customers group over the past six years is $54,440,304. The actual kWh sales for the Industrial Customers group compared to the cost of service from 2004 to 2009 are summarized below:

Industrial Customers			
	Cost of Service Sales (kWh)	**Actual Sales (kWh)**	**Sales Variance (kWh)**
2004	1,360,529,201	1,432,581,251	72,052,050
2005	1,334,800,000	1,236,901,333	(97,898,667)
2006	1,334,800,000	749,100,463	(585,699,537)
2007	894,300,000	771,198,558	(123,101,442)
2008	894,300,000	690,182,871	(204,117,129)
2009	894,300,000	384,777,985	(509,522,015)

The significant variance in load in 2006 relates to the closure of the Abitibi mill in Stephenville and the significant variance in 2009 relates to the closure of the Abitibi mill in Grand Falls –Windsor as well as the shutdown of one paper machine at Corner Brook Pulp and Paper. These variances will likely continue until the cost of service is updated for the change in load forecast relating to these Industrial Customers, assuming there is no addition of significant Industrial Customer requirements.

The load variation for NP has not been experiencing the same degree of variation as that of the Industrial Customers. Based on the table included on page 34, the net load variation for NP over the past six years is a balance owing from NP of $218,584. The table below summarizes the activity within this customer class for the past six years.

Newfoundland Power			
	Cost of Service Sales (kWh)	Actual Sales (kWh)	Sales Variance (kWh)
2004	4,608,500,000	4,708,712,512	100,212,512
2005	4,772,700,000	4,664,093,036	(108,606,964)
2006	4,772,700,000	4,616,864,312	(155,835,688)
2007	4,925,800,000	4,990,718,593	64,918,593
2008	4,925,800,000	4,959,752,852	33,952,852
2009	4,925,800,000	5,111,194,217	185,394,217

As indicated in the above table, for most of the years, the actual sales have exceeded the cost of service, and on an overall basis for the past six years the net sales variance is a net increase of 120,035,522 kWh. This overall increase is primarily attributable to the increase in growth that NP has been experiencing over the past three years, particularly in the urban areas of the Province, and the fact that the load forecasts have not been rebased since this growth has occurred.

Hydro included an analysis of the various customer load variation methodologies in its June 30, 2006 Report on the operation of the RSP for the period January 1, 2004 to December 31, 2005. In this Report, Hydro concluded that, based on its analysis, changing the customer allocation method so that both the revenue and the fuel are allocated based on customer energy ratios would tend to result in an allocation more aligned with the cost of service treatment. As noted previously, Hydro has indicated in its June 30, 2009 Application that this proposal will be included in its next general rate application.

Refund/Recovery Method

The other component of the RSP that experienced changes over the years was the method of recovering or refunding the balance from (to) customers. The recovery method changed from a three year declining balance recovery to a recovery of the current plan over a two year straight line amortization to a one year recovery period. The plan also split into a "Current Plan" and "Historical Plan", with the Historical plan balance being collected over a 4 year straight line amortization period commencing January 1, 2004 for the Industrial Customers and July 1, 2004 for NP.

Summary of the Operation of the RSP

As previously noted, the RSP was established in 1986 with the objective of providing rate stability to customers and providing a mechanism to eliminate volatility in Hydro's revenue requirement due to events beyond its control, such as the price of No. 6 fuel, variations in hydraulic production and variations in load requirements.

Based on the information included in Appendix A, the RSP appeared to be operating reasonably well until fiscal 2001. During the period of 1990 to 2000, oil prices were increasing as compared to the cost of service price of fuel. However, during this period, Hydro was experiencing hydraulic production in excess of the cost of service which resulted in a credit to the plan which offset a portion of the fuel cost variation.

From 2000 to 2001, the plan balance increased from a balance owing from customers of $34.7million to $85.1 million, and by December 31, 2003, the plan had accumulated to a balance of $155.7 million (owing from customers). During this period, fuel prices continued to increase and exceeded the cost of service price of fuel, even though it had been rebased for the 2002 test year. Compounding this, Hydro also experienced poor hydraulic production due to low water levels in its reservoirs.

Although the Order arising from the 2001 General Rate Application implemented changes to the Plan which included splitting the plan into two sections, creating different collection periods, and changing the recovery/refund period of the newly incurred balance to two years, the problems continued.

More changes occurred during the general rate hearing relating to the 2004 test year primarily due to the significant balance that had accumulated in the plan. During this hearing, the parties involved negotiated changes to the RSP and presented them to the Board for approval. As a result the structure of the split was changed and it became a Current Plan and a Historical Plan. This was done to allow the recovery of the significant balances that had accumulated in the RSP up to December 31, 2003 over a longer amortization period to reduce the impact of overall rates to NP and the Industrial Customers. Approval was also given to recover/refund the balance in the Current plan over one year.

The RSP activity relating to the Current Plan commenced January 1, 2004, and at the end of the year the plan accumulated a balance owing from customers of $3.1 million. Since December 31, 2004, the Current Plan has been in a credit balance and as of December 31, 2009, it has accumulated to a balance owing to customers of approximately $122.0 million (this includes the Hydraulic balance of $32.2 million). This is due to a number of reasons:

- The hydraulic production has exceeded the cost of service production each year since 2004. With the exception of one year, 2006, 25% of this annual balance is allocated to NP and the Industrial Customers each year and the remaining portion continues to grow in the Hydraulic plan.

- Load requirements for the Industrial Customers have decreased dramatically in comparison to the cost of service primarily due to the events that have occurred within the pulp and paper industry in the Province.

- The Industrial customers have been charged interim rates relating to the RSP since January 1, 2008 (based on January 1, 2007 rates). These rates do not reflect the recent activity on the RSP.

- During 2007 and 2009, the RSP adjustment rate for NP included a fuel rider. During those years, however, the fuel cost variance was in a credit balance, which meant for a portion of 2007 and 2009 the actual price of fuel was less than the cost of service. Therefore, NP was paying a fuel rider to alleviate the increasing cost of fuel in excess of the cost of service price but in reality the price had decreased below the cost of service price.

Although the 2006 General Rate Application resulted in a negotiated settlement that included a plan to review the RSP and there was Board approval of this settlement, this review has not been completed.

On June 30, 2009, Hydro filed an application concerning the RSP components of the rates to be charged to Industrial Customers. In this application, the Company has indicated that based on the analysis that it has completed of the fuel and load variations caused by the recent events, the existing RSP rules used to calculate rates for the Industrial Customers would result in significant and unreasonable rate volatility.

Appendix A – Annual RSP activity and balances

Appendix A: RSP History - Activity and Balances

(In thousands of dollars)

		Annual Activity							(Recovery)/	Plan Balances			
		Hydraulic	Fuel Cost	Load	RRA	Financing	Other	Total	Refund	NP	IC	Hydraulic	Total
1986		12,045	(11,814)	(2,506)	-	267	-	(2,008)	-	(1,889)	(119)	-	(2,008)
1987		54,280	(35,044)	(1,582)	-	709	-	18,363	(68)	8,063	8,222	-	16,285
1988		(726)	(34,175)	62	-	170	-	(34,669)	(245)	(18,498)	(131)	-	(18,629)
1989		15,341	(33,097)	1,378	-	(3,508)	-	(19,886)	5,704	(31,004)	(1,807)	-	(32,811)
1990		13,619	3,175	(1,781)	-	(1,666)	8,941	1 22,288	10,010	(4,445)	3,932	-	(513)
1991		(2,757)	(4,853)	(3,054)	-	(326)	-	(10,990)	3,803	(10,530)	2,830	-	(7,700)
1992		(198)	3,469	1,482	-	(111)	6,488	2 11,130	664	593	3,505	-	4,098
1993		(4,668)	7,397	1,834	(26)	746	-	5,283	47	3,825	5,636	-	9,461
1994		(17,077)	3,509	2,315	(120)	32	-	(11,341)	(2,120)	(5,610)	1,575	-	(4,035)
1995		(3,733)	19,015	1,820	(134)	537	-	17,505	(694)	6,900	6,016	-	12,916
1996		(7,419)	21,805	2,441	(140)	2,005	-	18,692	(1,506)	21,002	9,160	-	30,162
1997		(8,545)	24,507	(560)	(478)	3,346	-	18,270	(7,103)	27,644	13,734	-	41,378
1998		(967)	12,068	3,435	122	4,150	-	18,808	(11,227)	33,009	15,776	-	48,785
1999		(15,859)	9,128	5,050	(394)	3,223	-	1,148	(15,427)	21,436	12,892	-	34,328
2000		(16,614)	29,359	521	(880)	2,774	(862)	3 14,298	(13,734)	22,684	12,056	-	34,740
2001		5,243	56,879	(3,506)	125	4,438	-	63,179	(11,152)	60,300	24,768	-	85,068
2002		6,967	46,113	(5,313)	(326)	7,189	184	4 54,814	(13,921)	92,060	32,711	-	124,771
2003		4,130	36,534	(2,846)	(227)	10,333	-	47,924	(16,669)	114,790	40,914	-	155,704
2004	Current	(7,362)	12,665	590	(949)	79	(12)	4 5,015	(1,951)	4,909	3,713	(5,521)	3,101
	Historical					10,459	5	4 10,464	(32,236)	101,660	32,273		133,933
	Total	(7,362)	12,665	590	(949)	10,538	(7)	15,479	(34,187)	106,569	35,986	(5,521)	137,034
2005	Current	(8,646)	16,289	(1,431)	(2,329)	(309)		3,574	(18,660)	120	(1,296)	(10,625)	(11,801)
	Historical					8,768		8,768	(37,835)	79,781	25,086		104,867
	Total	(8,646)	16,289	(1,431)	(2,329)	8,459	-	12,342	(56,495)	79,901	23,790	(10,625)	93,066
2006	Current	(10,678)	25,715	(11,442)	(4,337)	(2,067)		(2,809)	(35,396)	(19,268)	(14,406)	(15,978)	(49,652)
	Historical					6,412	(10,000)	5 (3,588)	(38,285)	53,893	9,101		62,994
	Total	(10,678)	25,715	(11,442)	(4,337)	4,345	(10,000)	(6,397)	(73,681)	34,625	(5,305)	(15,978)	13,342
2007	Current	(19,761)	(5,772)	(6,008)	1,862	(3,097)	(1,383)	6 (34,159)	23,918	(14,659)	(8,829)	(14,820)	(38,308)
	Historical					1,972	(21,585)	7 (19,613)	(32,839)	12,053	-		12,053
	Total	(19,761)	(5,772)	(6,008)	1,862	(1,125)	(22,968)	(53,772)	(8,921)	(2,606)	(8,829)	(14,820)	(26,255)
2008	Current	(26,383)	27,745	(10,341)	(245)	(2,937)	(2,238)	8 (14,399)	(440)	(10,330)	(11,994)	(30,903)	(53,227)
	Historical					191		191	(14,482)	-	-	-	-
	Total	(26,383)	27,745	(10,341)	(245)	(2,746)	(2,238)	(14,208)	(14,922)	(10,330)	(11,994)	(30,903)	(53,227)
2009	Current	(12,006)	(4,523)	(26,027)	(1,152)	(7,026)		(50,734)	(18,301)	(52,940)	(36,875)	(32,181)	(121,996)
	Historical							-	-	-	-	-	-
	Total	(12,006)	(4,523)	(26,027)	(1,152)	(7,026)	-	(50,734)	(18,301)	(52,940)	(36,875)	(32,181)	(121,996)

The information from this table for the years 1986 to 2005 was obtained from the June 30, 2006 report "Review of the Operation of the Rate Stabilization Plan For the Period Janaury 1, 2004 to December 31, 2005". Appendix A: RSP History - Activity and Balances. For the years 2006 - 2009 the information was obtained from the December 31st RSP reports prepared by Hydro.

Note 1: This is the 1989 PDD loss be applied against the RSP.

Note 2: This is the 1991 retail cost deferral.

Note 3: This is the correction of Industrial Rural deficit allocation.

Note 4: These are billing adjustments.

Note 5: This is the $10 million contribution from the Government of Newfoundland and Labrador towards the Industrial Customers Historical balance.

Note 6: This is the balance in the Industrial Customers Historical Account that was transferred to the Current Plan at the expiration of the Historical Plan on December 31, 2007.

Note 7: This represents the Hydraulic Balance as of December 31, 2006 that was allocated to the Historical Plans (NP and the Industrial Customers). This was approved by the Board in P.U. 8 (2007) that was issued April 12, 2007. Hydro revised the opening 2007 balances to account for this allcoation.

Note 8: This is the balance in the NP Historical Account that was transferred to the Current Plan at the expiration of the Historical Plan on June 30, 2008.

Appendix B – Time line of RSP activity

Purpose

Appendix B provides a brief synopsis of the major changes to the RSP from implementation to December 31, 2009. Details on these changes are contained in the report.

January 1, 1986 - The Implementation of the Rate Stabilization Plan

- Implementation of the RSP with the following components:
  - Hydraulic Production Component: Captures impacts of hydro production due to variances between expected average and actual water conditions.
  - Fuel Cost Variation Component: Captures impacts of variances between forecast and actual fuel costs.
  - Load variation: Captures impacts of variance between forecast load and actual load. Consists of 2 components:
    - Revenue component – variance allocated to customer group causing the variance.
    - Fuel component – allocated based on the approved cost of service.

- Cost of financing the RSP based on Hydro's embedded cost of debt, added to RSP on a monthly basis.
- $50 million cap set on the plan before triggering a review.
- Refund/Recovery of RSP balance based on a three year declining balance method.
- Automatic rate adjustments to occur at June 30 of each year.
- Establishment of separate plans for retail customers and Industrial Customers.
- Reporting mechanisms established.

March 6, 1989 Hydro Referral to the Board

- Rebasing of fuel cost and minor adjustment requiring use of blended price of oil.

February 6, 1990 Hydro Referral to the Board

- $8.941,000 loss for PDD from April 1, 1989 to December 31, 1989 charged to the RSP.

November 12, 1991 Hydro Referral to the Board

- Rebasing of fuel cost.
- The 1991 retail cost deferral was written off against the RSP allocated to NP.

June 26, 1992 Referral to the Board

- Rural Rate alteration added to RSP.
- Rules and Regulations updated to include a mathematical approach for automatic adjustments.

2001 General Rate Review – Board Order P.U. 7 (2002-2003)

- Hydraulic Production Variation
  - Addition of mini-hydro plants.
  - Holyrood conversion factor set at 615kWh/bbl.
  - Forecast hydraulic production for the 2002 test year set at 4,425 GWH.
- Load Variation
  - Interruptible energy removed from RSP.
- Customer Splits:
  - Based on 12 month-to-date invoiced /bulk transmission energy as well as Test Year Rural Deficit Allocation.
- Rate Calculation
  - Energy rates established on 12 month-to-date invoiced /bulk transmission energy.
- Rebasing of fuel cost.
- Finance charge based on WACC.
- Elimination of $50 million retail cap.
- Additional recovery of the existing RSP balance delayed until 2003.
- RSP split between old plan (existing balances in the RSP as of August 31, 2002 to be recovered over five years) and the "New Plan" (RSP activity commencing September 1, 2002 to be recovered over two years).

2003 General Rate Review – Board Order P.U. 40 (2003)

- Hydraulic Variation Component: Recovery/refund limited to 25% of the annual balance plus 100% of financing charges.
- Fuel Cost Variation Component: Introduction of the fuel rider based on forecast oil prices.
- Load Variation Component: Allocation of the fuel costs component of the load variation to be based on the customer class that caused the load variation.
- Rural Rate Alteration: Addition of the Rural Labrador Interconnected Automatic Rate Adjustments (re: CFB Goose Bay).
- Recovery of Plan Balances – Current and Historical Plans
  - The "Current" Plan
    - RSP activity commencing January 1, 2004.
    - Recovery of the balance over a one year amortization period.
  - The "Historical" Plan
    - RSP activity prior to January 1, 2004
    - Recovered over a four year period commencing January 1, 2004 for the Industrial customers and July 1, 2004 for NP.

2003 General Rate Review – Board Order P.U. 14 (2004)

- Rebasing of fuel, Holyrood conversion factor, hydraulic production and load forecast.

2006 General Rate Review and Other 2006 RSP Activity

- Agreement in principal on use of fuel rider forecast during test year.
- Agreement for review of RSP with respect to design objectives.
- Agreement on the disposition of the Hydraulic Production Variation balance as of December 31, 2006.
- Labrador Interconnected Rates - allocation of a portion of the CFB Goose Bay Revenue Credit during the extended phase-in of uniform Labrador Interconnected rates to maintain existing rates. The revenue shortfall to Hydro from maintaining existing rates to be recovered through the RSP.
- Rebasing of fuel, Holyrood conversion factor, hydraulic production and load forecast.
- Approval to recover the cost of burning 1% sulphur content No. 6 fuel at Holyrood through the RSP.
- Approved, as directed by a Government Directive, of the following adjustments to the Industrial Customers RSP as a result of the closure of Abitibi Consolidated Inc – Stephenville Division:
  - Revisions of calculation of the fuel rider
  - Modification of the calculation of the Historical Plan RSP recovery rate to reflect a $10 million contribution from the Government; and
  - Adjustment of the Industrial Customer kWh sales used in 2004 Test Year.

RSP Activity During 2007

- Adjustment of rates for Aur Resources to exclude Historical Plan impacts.
- Rural Rate Alteration adjusted to include a monthly amount of $92,560.
- Industrial Customer's recovery of the Historical Plan balance expired with a $1,382,494 transferred to the Current Plan.

RSP Activity During 2008

- Rural Rate Alteration adjusted to include a monthly amount of $32,433.
- Interim rates put in place for Industrial Customers based on 2007 rates.
- NP's recovery of the Historical Plan balance expired with a credit balance of $2,238,025 transferred to the Current Plan.

RSP Activity During 2009

- Rural Rate Alteration adjusted to $5,766/month.
- Industrial Customer rates continued to be based on interim rates.
- On June 30, 2009, Hydro filed an application with the Board concerning the RSP components of the rates to be charged to Industrial Customers.