



File No. \_\_\_\_\_

**NEWFOUNDLAND AND LABRADOR HYDRO**

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October 9, 2006

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

**Attention: G. Cheryl Blundon – Director of Corporate Services  
and Board Secretary**

Dear Ms. Blundon:

**Re: Application for Approval of Recovery of  
Costs of No. 6 Fuel not Exceeding 1% Sulphur**

This is further to correspondence of October 5, 2006 filed with the Board by Mr. Johnson, the Consumer Advocate, and by Mr. Hutchings, on behalf of the Industrial Customers, both which were filed as comments on Hydro's application of September 18, 2006 in the above-noted matter.

We would note that at this point, no party is stating, as a matter of principle, that Hydro should not be permitted to recover its costs of 1% sulphur fuel; the only outstanding issue pertains to the mechanics of that recovery.

The principal contentious issue raised in both submissions pertain to whether permitting the recovery in rates of costs incurred for 1% sulphur fuel constitutes retroactive ratemaking due to the fact that the fuel was acquired by Hydro prior to the Order of the Board that will arise from the application. This position appears to be based upon incorrect assumptions as to the way that that fuel expenses are recovered by Hydro.

Hydro recovers its Holyrood No. 6 fuel costs through the operation of the Rate Stabilization Plan (RSP). Under the RSP, fuel costs are recognized as being expensed by Hydro at the time that the fuel is burned to generate power and energy, not at the time that it is acquired in the marketplace. The fuel expense used is the average cost of fuel oil inventory in Hydro's storage for that period. Therefore, if Hydro is granted permission by this Board to recover the cost of 1% sulphur fuel through the RSP, that Order would pertain to the cost of fuel

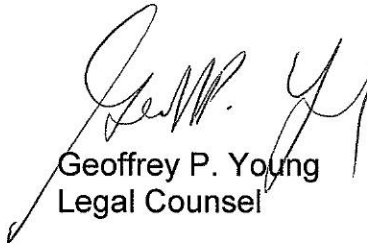
consumed following the date of that Order, regardless of when that inventory was actually purchased.

Up to the point of an Order issuing from the Board in this matter, Hydro will continue to use the 2% sulphur fuel cost as the fuel expense in the RSP, even though 1% sulphur fuel was actually consumed. This expense difference has been absorbed by Hydro to date. Going forward, after an Order of the Board is issued permitting Hydro's recovery of 1% sulphur fuel costs, Hydro will then use its costs of burning 1% sulphur fuel as its fuel expense. This means that, contrary to the proposal by the Consumer Advocate, there will have been no 1% sulphur fuel costs recognized as being collectible by Hydro prior to the Order, and therefore there is no amount that can be refunded to the RSP.

Unlike the requirement to have capital acquisitions approved, Hydro does not apply for pre-approval of its operating expenses. The issue is whether an expense incurred is properly recoverable as having been prudent and providing least cost reliable power for its consumers, consistent with Hydro's obligations to act within the law. This fuel expense should be recognized as being incurred by Hydro in accordance with its normal regulatory treatment of those expenses. Under the RSP methodology, this occurs at the time the fuel is consumed for power and energy generation, not when it is acquired.

Yours truly,

**NEWFOUNDLAND AND  
LABRADOR HYDRO**



Geoffrey P. Young  
Legal Counsel

c.c. Mr. Peter Alteen - Newfoundland Power  
Mr. Thomas Johnson - Consumer Advocate  
Mr. Joseph S. Hutchings, Q.C., Poole Althouse &  
Mr. Paul Coxworthy, Stewart McKelvey, counsel for Industrial Customers