

Northwest Territories Power Corporation

**2006-2007 and 2007-2008 Phase 2 GRA and
Code of Conduct Review**

ARGUMENT SUBMITTED ON BEHALF OF THE

THERMAL GENERATION COMMUNITIES [TGC]

COMPRISED OF

TOWN OF INUVIK

VILLAGE OF FORT SIMPSON

HAMLET OF FORT LIARD

October 14, 2008

1. INTRODUCTION

The TGC Argument will deal with issues related to the following:

- a) NTPC's response to Directive 50 in Decision 13-2007
- b) NTPC's response to Directive 49 in Decision 13-2007
- c) NTPC's 2006-07 and 2007-08 Phase 2 GRA

2. DIRECTIVE 50, DECISION 13-2007

In Decision 13-2007, the Board directed NTPC as follows:

50. The Board directs NTPC, by the end of November 2007, to file with the Board a detailed policy that explains how the interests of the regulated ratepayers will be protected in relation to decisions by the Board and Senior Management regarding the operations of NTPC and NTHC. In particular, the Board expects a detailed explanation as to how it will be decided which of the two companies will pursue new generation and sales opportunities and how the interests of the regulated ratepayers will be protected in that decision-making process. [Decision 13-2007, Page 176]

By letter date November 30, 2008, NTPC filed its policy in response to the above noted direction. This policy was approved by the Corporation's Board of Directors on January 22, 2008. To the extent this policy is "incorporated into the NTPC Code of Conduct"¹, matters pertaining to compliance with Direction 50 are included in the next section, dealing with compliance with Direction 49 of Decision 17-2007.

3. DIRECTIVE 49, DECISION 13-2007

In Decision 13-2007, the Board directed NTPC as follows:

¹ Letter dated January 31, 2008 from NTPC

49. The Board directs NTPC, by the end of January 2008, to file with the Board a formalized inter-affiliate code of conduct which would establish principles related to pricing and other matters governing all transactions with the Corporation's parent, other affiliates and non-regulated operations. [Decision 13-2007, Page 176-177]

By letter dated January 31, 2008, NTPC filed its "Code of Conduct for Affiliate Transactions" in response to the above noted Directive 49; it states:

The Corporation determined that simply adopting a code of conduct, albeit with modifications, developed and approved for another utility operating and regulated in another jurisdiction would simply not meet the above fundamental goal. Rather, a "made in the NWT" approach was required. Therefore, NTPC Code of Conduct must be appropriate for the Corporation and the transactions it engages in with its affiliates. The NTPC Code of Conduct must also comply with the legislatively established structure of the electric utility industry in the Northwest Territories.

The NTPC Code of Conduct attempts to minimize costs ultimately paid by customers through rates *by focusing on inter-affiliate cost tracking and information retention requirements*. Such information will be provided to the Board and Interested Parties so that they may periodically assess the relatively small number of inter-affiliate transactions engaged in by the Corporation, including joint-use facilities, and satisfy themselves that ratepayers are indeed not harmed by such transactions.

The NTPC Code of Conduct is a flexible document that can easily be modified in the future to address other types of inter-affiliate transactions or requirements that do not presently arise. The Corporation expects that should the type, degree or volume of its inter-affiliate transactions become more complex, it will amend the NTPC Code of Conduct as required. {Emphasis added}

The proposed inter-affiliate NTPC Code of Conduct attempts to formalize its current policies on inter-affiliate cost tracking and information retention requirements, with additional steps to ensure "more affiliate employee education, documentation and regular incorporation into budget processes".² The proposed Code of Conduct also includes several considerations to determine whether a particular business activity should be

² Response TGC.NTPC-CCR-1 [(a) and (b)]

allocated to NTPC or an affiliate. However, as discussed hereinafter, a number of these considerations are subjective and appear to lack transparency in how the decision was made to allocate a particular business activity to a non-regulated entity, for example. As such, the TGC submit it may be difficult to demonstrate if the best interests of the regulated customers have been maintained.

The Board, in Decision 13-2007 was clear:

“...merely codifying the Corporation’s current cost-tracking measures will not provide the level of transparency and assurance of market-based transactions that is required to protect the regulated ratepayers.”³

In our view, the proposed Code of Conduct contains a number of platitudes, but lacks substantive content which would satisfy the Board’s expectation NTPC should file “a comprehensive code of conduct”⁴ to ensure inter-affiliate transactions “do not negatively impact upon the regulated ratepayers.”⁵

Application of Code of Conduct to NTPC’s Affiliates

NTPC indicates Policy A-3, which was incorporated in the Code of Conduct document, is an NTPC policy i.e. it has not been formally or otherwise been adopted or approved by the parent, NTHC, or any of the other affiliates. This is an issue as NTPC must follow the Code of Conduct, but there appears no compulsion on parent company or any of the affiliates to follow suit. **If, as NTPC suggests NTHC and will also follow NTPC’s Code of Conduct and Policy A-3⁶, this arrangement must be made specifically part of the NTPC Code of Conduct to avoid unintended consequences.**

³ Decision 13-2007, Page 157

⁴ Ibid

⁵ Ibid

⁶ Response TGC.NTPC-CCR-5 (e)

Competition from NTPC's Affiliates

NTPC also asserts there is no competition from its affiliates:

The question asks about “competition from” NTPC’s subsidiaries, affiliates and parent. NTPC does not currently face, and does not foresee any future where it would face, competition from any of these related parties. That is not the purpose of establishing the NT Hydro group of companies.⁷

However, the Board has clearly determined Bill 4 (now NT Hydro Act) places NTPC in direct competition with its parent for new power customers:

Not only is there the possibility of additional affiliates being created under Section 5(3), it is the Board’s view that Bill 4 places NTPC into direct competition with its own parent company for new power customers. The effect is that there will be a conflict of interest created for the Board of Directors and Senior Management of the two Corporations from the perspective of protecting the interests of the regulated ratepayers. For example, if an opportunity for acquiring a significant new power customer was to arise, would NTPC or NTHC be allowed to pursue the opportunity? How would this decision be made? Where would the interests of the regulated customers be considered and protected in this process?⁸

In our view, there is nothing in the proposed affiliate Code of Conduct which would avoid the potential scenario which places NTPC in direct competition with one or more of its affiliates.⁹ The fact is both the President and Director of Finance and CFO of NTPC hold similar positions for each of NTPC’s affiliates.¹⁰ The proposed Code of Conduct does not address how these officers are able, in fact, to avoid the potential conflict of interest that will invariably arise if a particular business activity is capable of being undertaken by either NTPC or one of the affiliates.

⁷ Response TGC.NTPC-CCR-6 (d)

⁸ Decision 13-2007, page 159

⁹ The potential for direct form of competition arises because “The *NTPC Act* and the *NT Hydro Act* establish the objects of NTPC and NT Hydro, respectively, to generate, transform, transmit, distribute, deliver, sell and supply electricity on a safe, economic, efficient and reliable basis.” [Affiliate Code of Conduct, Page 2]

¹⁰ Response TGC.NTPC-CCR-11

In our view, unless the Code of Conduct provides for complete transparency as to why the Board of Directors of NTHC or an affiliate were able to divert a business activity needed to serve a new or existing load away from NTPC (for example), the proposed Code of Conduct provides little or no comfort in ensuring the interests of the regulated ratepayers are protected, nor does it provide any comfort in addressing some of the questions as noted in the above noted text from Decision 13-2007 [Page 159].

Separation of regulated vs. non regulated costs

The Board also expressed concern in Decision 13-2007 NTPC's operating environment has now changed with the creation of NTHC:

As part of its rationale against requiring a code of conduct, NTPC asserted that NTPC's operating environment does not include non-regulated generation and retail functions. The Board disagrees. With the creation of the NTHC, the NTPC operating environment clearly now does include non-regulated generation and retail functions with all the complexity that that entails.¹¹

Not only do we have the creation of non-regulated operations, an additional complexity arises in that new business activity or projects are assigned to an affiliate based on a ranking of risks:

Every business venture or activity contains an element of risk. Risk must be proactively identified and managed. Each corporate entity may have different risk tolerance. Generally, if a project/activity risk is high and the potential for downside to regulated rate payers significant, then the project/activity should be undertaken in a manner and by an entity that will not expose the regulated customers to a liability or cost should the project/activity be unsuccessful.¹²

The foregoing could result in an affiliate undertaking a project simply on grounds (whether perceived or real) that the project is too risky for NTPC. If such a project

¹¹ Decision 13-2007, Page 160

¹² Code of Conduct, Page 2

happens to be in Inuvik, for example, this will create a situation where two (or more) affiliates are serving the same NTPC customer base in Inuvik. If the project made economic sense to the affiliate, the question is why it did not make economic sense for NTPC as the incumbent supplier. NTPC has hitherto been able to manage risks associated with new business activities; no evidence is provided as to why NTPC cannot adequately manage such risk any more. The prospect of multiple service providers will create confusion with customers, and potentially create need for increased regulatory oversight.

With the growth in non-regulated operations within NTHC group,¹³ it is imperative the Code of Conduct provide adequate checks and balances to ensure NTPC's regulated customers are not harmed in any way as a result of NTHC or any of its affiliates (NTEC 03, in this case). It is not clear how the proposed Code of Conduct addresses this concern.

4. DIRECTIVE 51, DECISION 13-2007

The Board also directed the Corporation as follows:

51. The Board directs NTPC to provide the Board with biannual reports that discuss the following:

1. The efforts and progress of NTPC and its affiliates in pursuing alternative energy, demand side management and energy efficiency projects;
2. Justification for any projects being pursued by NTPC's affiliates rather than NTPC;
3. Funding programs that are, or will be, available and any efforts and progress by NTPC and its affiliates in obtaining funding.¹⁴

NTPC has not provided any reports pursuant to the above noted direction, rather, it proposes the biannual reports will be filed with the Board "after receiving a decision on

¹³ See discussion re: Taltson expansion in BR.NTPC-7

¹⁴ Decision 13-2007, page 177

Phase II.”¹⁵ The TGC submit there is no nexus between the Board’s decision on Phase 2 matters and the compliance with the above noted Board Directive. In fact, the Board agreed with the concerns of the intervenors in respect of the high cost of power in the diesel communities and made the following additional comments in support of the need to file the biannual reports noted in Directive 51:

The Board is also concerned by the NTPC’s apparent willingness to forego some projects in favor of allowing its non-regulated affiliated companies to take the lead with little to no justification being provided to the Board. The Board recognizes there are risks related to the economic and technical viability of certain alternative energy projects and notes NTPC’s view that such projects are better pursued by private business and Government rather than a Crown Corporation, such as NTPC. However, the Board notes that NTPC was able to manage such risks in the past through appropriate business arrangements with third parties such as the DPC with respect to the development of hydro on the Snare River. Assuming risk considerations can be addressed through appropriate business arrangements as in the past, the ***Board expects NTPC to take the lead in aggressively pursuing, from a least cost planning perspective, alternative energy, demand side management and energy efficiency project opportunities while ensuring that project decisions are made in the best interests of NTPC’s regulated ratepayers rather than NTPC’s affiliates.***

The Board finds that requiring NTPC to provide regular reporting on its efforts in the areas of alternative energy, demand side management and energy efficiency projects should not create an undue hardship for NTPC, particularly given that the Board expects the production and evaluation of such reports should be part of NTPC’s own internal processes.¹⁶ {Emphasis added}

The TGC is concerned that in light of the activities being pursued by its affiliates, NTPC simply may not have any incentive to do anything substantive to address alternatives to the high cost of power in the thermal/diesel communities. The Board also expressed concern about the lack of progress in this area by NTPC:

While the Board notes that there have been some large successes by NTPC in lowering its diesel usage, such as the natural gas engines in Inuvik and the

¹⁵ Response TGC.NTPC-CCR-2

¹⁶ Decision 13-2007, page 165

purchase of Bluefish, the Board is concerned with the lack of progress in the majority of the small, isolated diesel communities.¹⁷

Based on the foregoing, the TGC recommend the Board direct NTPC to immediately comply with the Directive 51 and commence providing biannual reports for the year 2008. Where projects have been assigned to one or more of the affiliates, NTPC should provide a detailed assessment as to why it was not able to undertake such a project.

¹⁷ Decision 13-2007, page 164

5. COMMENTS ON NTPC'S 2006-07 AND 2007-08 PHASE 2 GRA FILING

a) Simplified Approach to Phase 2

NTPC proposed a “simplified approach” to the Phase 2 Filing:

The Corporation has developed its Phase II Application using a simplified approach. The Corporation has prioritized collecting outstanding balances related to the 2006/07 and 2007/08 GRA Shortfalls and the Stabilization Funds. The Corporation is proposing this simplified approach to Phase II in consideration of the 15% cap on base rate and shortfall rider increases; to reduce regulatory and administrative costs in light of the limited ability to rebalance rates between communities and rate classes and for reasons of intergenerational equity related to collecting shortfall and stabilization fund balances relating to costs already incurred to provide service to customers. Following the implementation of these rider adjustments, there would be very little ability for the Corporation to adjust base rates for most communities and rate classes. Therefore the Corporation is proposing only a very limited scope of base rate rebalancing.¹⁸

As noted in the TGC letter of August 19, 2008, the TGC agreed with the “simplified approach” to dealing with Phase 2 issues in light of the limited scope to adjust base rates following a 15% cap on base rates and shortfall rider increases. More specifically, the TGC note the 2006-2008 Phase 2 Application does not propose any changes in cost of service methods, nor is there an application for a broader rebalancing of base rates between customer classes and communities. As we understand, these matters are proposed to be dealt with in NTPC's next Phase 2 GTA; since the next Phase 1 is expected to be filed sometime in 2010 for the Test Years 2010-11 and 2011-12¹⁹, and assuming the Phase 2 is a separate rate filing, it does not appear NTPC will file its Phase 2 until some time in 2011.

The TGC note, however, the “GNWT is currently conducting a review of rate regulation and subsidies that may impact future rate rebalancing directions between customer

¹⁸ NPTC 2006-08 Phase GRA, Page ES-v

¹⁹ Response TGC.NTPC-GRA-1 (b)

classes and communities.”²⁰ According to the February 20, 2008 NWT Hansard²¹, this review is fairly broad and all encompassing. For example, it will include consideration of levelized power rates, among other issues. This is obviously an issue that is very important to the TGC members, and as well to the other thermal communities, and intervenor evidence has been adduced in prior proceedings suggesting some form of a common or postage rate²². The TGC note a public discussion paper will be ready for Cabinet’s review in September 2008, followed by public discussion, which will lead to a detailed report for Cabinet’s consideration in 2009.

To the extent this review is completed prior to NTPC’s next Phase 2 GTA, expected to be filed sometime in 2011, and considering the stress the high power rates are creating in the thermal communities²³, the TGC submit NTPC be directed to file revised rates reflecting the results of this review so as to give immediate effect to the recommendations in the review report.

b) Application of the 15% Rate Rider

The TGC notes the application of the 15% rider is only to the base rates; this results in the end customer rates being higher in many instances when the deficiency in the fuel stabilization funds are taken into account.²⁴

²⁰ NPTC 2006-08 Phase GRA, Page 1-7, L7-9

²¹ Response TGC.NTPC-GRA-2a, Attachment 1

²² See for example, evidence of Fort Providence dated Oct 31, 2005, filed in the NUL (NWT)’s 2005-06 GRA

²³ Ibid, Feb 20, 2008 Hansard, Pages 459-461

²⁴ NPTC 2006-08 Phase GRA, Schedule 1.1; Response TGC.NTPC-GRA-1 (d) Attachment shows, for example, the Residential rate increase in Fort Simpson is 12.76% before the stabilization rider and 29.07% without.

The foregoing treatment is entirely inconsistent with a recent ruling by the Board that, in the interest of rate stability, the maximum rate increase of 15% should reflect both the increase in base rates as well as any increases occasioned by fuel rate riders:

It is the Board's view that the increases in Rider A for the communities of Dory Point/Kakisa, Fort Providence and Trout Lake must take into account the refiling ordered by the Board in Decision 10-2008. Therefore, having regard to rate stability considerations, the Board has decided to direct Northland to refile its application for increases to Rider A *with any increases in Rider A limited by a 15% cap on Apr. 1st rate increases taking into account the combined impact of Riders A, E and K.*²⁵ {Emphasis added}

The TGC note NTPC has addressed in detail how it can adhere to the above noted Board determination and keep the total rate increase limited to 15% i.e. by way of a “comprehensive alternative approach to the application”.²⁶

The TGC recommend NTPC be directed to re-file in compliance with Decision 11-2008 such that the total rate increase is limited to 15%, using the “comprehensive alternative approach to the application.” As part of this exercise, the TGC recommend the Board direct the Corporation to use the most recent fuel price forecasts to compute the “keep up” amounts; the current fuel prices are significantly lower²⁷ than the US \$103/bbl cited by NTPC.

c) Proposal to increase interest rates on Shortfall balances

NTPC states:

For the period starting April 1, 2008 until full collection of the 2007/08 shortfall the Corporation is permitted to apply short-term interest to the actual outstanding receivable monthly at a level equal to 50% of the Bank of Canada Prime

²⁵ PUB Decision 11-2008, Page 4

²⁶ Response BR.NTPC-1 [(a) and (c)]; BR-NTPC-2 (b)

²⁷ For example, the close of oil price on Oct 14, 2008 is \$78.63.

Business interest rate.... Accordingly, the Corporation is applying for approval to charge an interest rate of prime less 50 basis points on any shortfall balances outstanding beyond October 1, 2009. This is the same interest rate presently applied to the stabilization funds. In the event that the interest rate change after 12 months is not approved, the Corporation will seek to collect the outstanding shortfall amounts over a 12 month period instead of an 18 month period.²⁸

NTPC now seeks to undo the clear direction of the Board was to allow NTPC recovery of only 50% of the applicable interest rate:

It is the Board's decision that the NTPC will be allowed to charge interest at a rate of 3.00% on the 07/08 shortfall on a mid-year basis for 2007/08. For the period starting April 1, 2008 until full collection of the 07/08 shortfall, the NTPC will be allowed to apply short-term interest to the actual outstanding receivable monthly, at a level equal to 50% of the Bank of Canada Prime Business interest rate.²⁹

A review of Decision 16-2008 indicates a number of reasons why the Board considered it appropriate to allow a reduced rate of interest; for example, in respect of the 2006-07 deficiency, the Board states:

As has been indicated above, there was, in the Board's view, no significant regulatory lag. It appears to the Board that the timing of the application has in large part contributed to the size of the shortfall. As such, the Board's refusal to accept a negotiated settlement process would not have had an impact upon the size of the 06/07 shortfall.³⁰

And with respect to the 2008-2009 revenue deficiency, the Board states:

Interest on 07/08 Shortfall

It is the Board's view that the NTPC bears as much responsibility for the existence and size of the 07/08 shortfall as it does for the 06/07 shortfall. Even with a fully litigated Phase 1 GRA, which took approximately 13 months, if the NTPC had filed its GRA in a timely manner before, or early in, the 06/07 test year, it is very likely that the full recovery interim rates would have been in place

²⁸ 2006-2008 Phase 2 GRA, Page B-1

²⁹ Decision 16-2008, Page 17

³⁰ Ibid, Pages 13-14

for the start of the 07/08 test year instead of January 1, 2008. If not eliminated completely, the 07/08 shortfall would at least have been significantly reduced from what it is now.³¹

The TGC submit NTPC's complaint that the allowed interest rate "reflects a very low short-term interest rate"³² should be dismissed.

The basis upon which the Board determined the interest rate on the shortfall balances has not changed. No evidence has been brought forward to suggest the Board erred in its determination that "NTPC bears as much responsibility for the existence and size of the 07/08 shortfall as it does for the 06/07 shortfall." The proposal to charge Prime less 50 basis points effective October 1, 2009 should therefore be rejected.

d) Revenue Cost [RC] Ratios

A review of Appendix E, Illustrative Cost of Service, indicates several communities are outside of the Board-approved 95-105% RC ratio range. In response to a question from the Board if the RC should be transitioned to the 95-105% in each of the years in the next GTA Test Period, NTPC responded:

In the Corporation's view, such a direction could be issued by the Board as a future rate design criteria NTPC could seek to meet in its next GRA. At that time, NTPC's proposals could be assessed by the Board based on the extent to which the proposed rates meet this rate design criteria, in light of other relevant criteria. Similar to the present application, it is not likely that this new criteria could be met simultaneously with all other priority rate design criteria (such as the 15% cap) but that balancing exercise between the various criteria would be a suitable matter to be assessed at a future GRA.³³

³¹ Ibid, Page 15

³² 2006-2008 Phase 2 GRA, Page B-2, L1

³³ Response BR.NTPC-5 (a)

The TGC also note the results presented in Appendix E are not based on a current cost of service study and therefore, such results could vary materially if a proper cost of service reflecting cost causation is filed and tested. As well, there is currently a review by the GNWT of rate regulation and subsidies that may impact future rate rebalancing directions between customer classes and communities. Such review may have some significant impact on rate design and the ensuing RC ratios. **For these reasons, the TGC respectfully submit it may be premature to provide any direction to NTPC to transition communities to a 95-105% RC range in each of the years in the next Test Period.**

e) Proposal to Adjust FSF Account every 6 months

NTPC proposes to adjust FSF accounts every 6 months:

Further, the Corporation notes that fuel prices have been extremely volatile recently and that fuel price changes can contribute to balances or credits in the stabilization funds to a significant degree. Therefore, the Corporation proposes to file Stabilization Fund Adjustment Applications on a regular schedule. The Corporation respectfully requests approval to file Applications for these adjustments by February 15 and August 15 each year for rider adjustments to be implemented effective April 1 and October 1 each year respectively.³⁴

NTPC provided the following elaboration on its proposal:

For the diesel communities, Inuvik and Norman Wells stabilization funds:

Each 6 months (April 1 and October 1) implement new stabilization fund riders that comprise 2 components: 1) for the “keep up” (or fuel price variance) component, ensure the base riders in place (1.000 index) recovers the difference between the weighted average price for fuel (as at the date of application) and the most recent GRA price (and based on forecast 12 month generation and weighted average GRA plant efficiencies); and, 2) for the “catch up” (or balance retirement) component, take the full fund balance and divide by the forecast 12

³⁴ 2006-2008 Phase 2 GRA, Page C-7

months sales to determine the base rider (1,000 index). These values would be updated on a rolling basis at each 6 month update.³⁵

The TGC agree the price of fuel has been very volatile in the past. In the interest of collecting the balances in the FSF accounts from customers who gave rise to these costs in a timely basis, the TGC is not opposed to the frequency of filings proposed by NTPC, or to the need to include both a “keep up” and “catch up” components. However, since NTPC will be able to collect the deficiencies in these stabilization funds on a more frequent basis, there should be no need for it to impute interest on the outstanding balances. **As such, we recommend the Board direct NTPC cease adding interest to the balances outstanding in the Stabilization Fund Adjustment applications filed every 6 months.**

f) Actual vs. Approved Forecast Plant Efficiency

NTPC uses PUB-approved plant efficiencies for purposes of determining fuel volumes used in the determination of the fuel stabilization account:

The fuel stabilization funds are calculated using actual generation and the PUB approved fuel efficiencies from the most recent GRA. NTPC bears the risks related to actual fuel efficiency variances from PUB approved values. This is consistent with the Board’s findings in Decision 13-2007 that this approach is consistent with forward test year regulation. Therefore, the volume of fuel charged to the stabilization fund may vary from actual fuel volumes, as a result of using the PUB approved fuel efficiency (instead of the actual plant efficiency). In this manner, customers are protected from fuel expense changes due to changes in fuel efficiency.³⁶

As noted in the above response, the method used by NTPC results in a disconnect between the actual fuel used and the volumes used for purposes of determining balances collected or refunded through the FSF account mechanism. Since the fuel efficiencies

³⁵ Response HC.NTPC-2 (a)

³⁶ Response TGC.NTPC-GRA-6 (a)

generally tend to improve as older engines are replaced by newer ones which are more fuel efficient, one should expect the plant heat rates should be improving on an actual basis. If so, NTPC benefits by charging customers using outdated plant heat rates forecast, in this rate case, some two to three years ago; no wonder then it is willing to bear “the risks related to actual fuel efficiency variances from PUB approved values” as noted in the above quote.

The fuel deferral account concept should provide NTPC full recovery of its actual fuel costs, no more and no less. As well, with the proposed 6-month renewal of rider, any argument in respect of consistency with forward test year regulation does not apply. **The TGC therefore recommend the Board direct NTPC to use actual plant heat rates in order to compute the fuel volumes for purposes of the fuel stabilization fund accounts.**