

Q~

**RO. Box 908, St. John's, NF, Canada A1 C 5M2 (709) 576-8600**

**Web Site: [www.city.st-johns.nf.ca](http://www.city.st-johns.nf.ca)**

October 24, 2001

Public Utilities Board  
Suite E2 10, Prince Charles Building  
120 Torbay Road  
St. John's, NF A1A 5B2

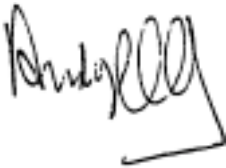
Dear Sirs:

I recently received a letter from Mr. Dennis Browne, Consumer Advocate, regarding the public hearing of Newfoundland Hydro's rate application currently before the Board.

As you may recall, I was a member of the P.U.B. in 1985 when the Rate Stabilization Plan was proposed by Hydro and approved by the Board. I therefore have considerable knowledge regarding the setting of fuel prices and the need for a Plan to take care of variations in costs over time.

Attached is a review of the history of this issue and the reasons why I believe the Rate Stabilization Plan should be maintained.

Yours truly,

A handwritten signature in black ink, appearing to read "Andy Wells", with a horizontal line underneath.

Andy Wells,  
Mayor.

c.c. Mr. Dennis Browne, **Q.C.** Consumer Advocate  
Mr. William Wells, President &  
C.E.O., Newfoundland Hydro

***WORKING TOGETHER FOR A BETTER CITY***

## **NEWFOUNDLAND HYDRO RATE APPLICATION AND THE RATE STABILIZATION PLAN**

Until the late 1970's, Newfoundland Hydro was not regulated by the P.U.B. and electricity rates were set by Cabinet. Therefore the question of how to account for the cost of fuel (Bunker C) at Holyrod was not a matter of public debate.

When Government decided to have the P.U.B. regulate Hydro as well as Newfoundland Light and Power, Hydro proposed to have a two tier pricing system and this was accepted by the Board. This rate structure saw all of Hydro's costs, except the cost of fuel at Holyrod, included in the regular rate. The cost of Bunker C used at Holyrod was recovered in full as it was incurred through a monthly "fuel adjustment charge".

By the early 1980's this monthly surcharge became extremely unpopular and led to mass demonstrations against both Hydro and Newfoundland Light and Power (who actually sent out the bills to most consumers). One such group was from Flatrock and was led by a Ms. Roma Peddle who staged a number of effective demonstrations with candles and the like.

The reasons for the great unpopularity of the fuel surcharge were numerous:

- Since the Holyrod facility was primarily used only in the winter months, residents were getting huge electricity bills in the December/March period because not only was their usage of electricity much higher because of the winter conditions but the price per unit was double or triple the price per unit for the rest of the year. Indeed for those with electric heat the "Fuel Adjustment" was often much greater than the "regular" charge.

This surcharge was hitting families at their most vulnerable time during the year. Unemployment was highest in the winter months and Christmas expenses took whatever credit was available. In short the surcharge was being imposed just when families were most in need of a break.

- The price of fuel varied with every shipment and the need to utilize the capacity at Holyrod varied with the weather. Therefore the surcharge varied greatly from month to month and no one had any idea what the next month's bill was likely to be.
- The use of a surcharge for power generated at Holyrod also implied that somehow the electricity generated at Holyrod was somehow "different" than that generated at hydroelectric facilities. In reality, Newfoundland Hydro needs both thermal and hydroelectric generation to meet the annual demand and so it is the overall cost of operation and the average cost of production which is critical. No one cost is more or less important than another.

***WORKING TOGETHER FOR A BETTER CITY***

Because of all of the above, in 1985 Newfoundland Hydro proposed to the P.U.B. a new pricing policy which treated all legitimate costs equally and eliminated the “Fuel Adjustment Charge”. Basically what this entailed was Newfoundland Hydro including in its “base” rate the annual cost of operating the Holyrod Plant, including the estimated cost of Bunker C, and providing a “Rate Stabilization Plan” to take care of the difference (positive or negative) between the estimated annual cost and the actual cost on an annual basis. The difference (plus or minus) was put in an account and each summer the rate to consumers was adjusted slightly up or down to amortize the balance in the account over a three year period.

This provided price stability to consumers and eliminated the need to increase the unit price of electricity just when consumers could least afford it. In short the Plan has been a great success and it is doubtful if many consumers even note the mid summer adjustment.

the annual cost of fuel at Holyrod depends on three factors –the price per barrel, the annual rainfall and the severity of the winter.

Clearly if the price of fuel decreases, there is above normal rainfall and/or the winter is mild, the cost of operating Holyrod goes down and there will be a positive balance to refund to consumers and vice versa.

The P.U.B. approved Hydro’s proposal in 1985 and set the base cost of fuel at \$18 per barrel and the limits of the Plan at plus or minus \$50 million before Hydro would have to reappear before the Board.

In practice the plan has worked extremely well. In some years there has been a surplus and in others a deficit with the annual adjustments being relatively modest in both directions.

In 1992, the P.U.B. lowered the price per barrell from \$18 to \$12.50 and it has stayed at this rate ever since.

Therein lies the current problem.

Hydro is currently paying in excess of \$20/barrel and hence the deficit in the Rate Stabilization Plan is increasing rapidly. Indeed for 2002, Hydro is predicting a price of \$28/barrel and for 2003 a price of \$26/barrel and so without a significant increase in the \$12.50/barrel currently allowed, the deficit in the Plan will skyrocket and so will the annual adjustments.

However, for whatever reason, Hydro is only proposing to increase the base price in the Plan from \$12.50/barrel to \$20/barrel and to take care of the resulting deficit is proposing to have the ceiling in the Plan increased from \$50 million to \$100 million.

***WORKING TOGETHER FOR A BETTER CITY***

It would seem to be much more realistic to face the fact that fuel prices have increased significantly and put the full estimated 2002 cost/barrel (i.e. \$28) in the base rate and have much lower adjustments to take care of each year. This could negate the need to increase the limits to plus or minus \$100 million or at least make the increase in the limits more limited.

It is important to note that consumers are going to pay the full legitimate costs of producing electricity in any event. What is being argued is whether it is better to have a greater increase in the base price now and lower automatic adjustments in the next several years or vice versa.

The Consumer Advocate means to believe that the Rate Stabilization Plan itself should be discarded. This does not at all seem reasonable because the Plan has worked extremely well in the past and will continue to do so in the future provided the cost/barrel of fuel included in the base price is based on the best information available at the time rates are established.

If the Rate Stabilization Plan is discarded then Hydro will have no choice but to revert to a two tier pricing system or a variation thereof and we are all going to be back in the same stew we were in prior to *1985*. In short we should not throw out the baby with the bath water!

It would seem much more sensible to keep the Rate Stabilization Plan in operation but ensure that the price of fuel used at Holyrod is as accurate as possible. Since it is Hydro's best estimate that this will be \$28 in 2002, then that is the number that should be included in the base price of electricity. To use a lower figure is merely masking the true cost of producing electricity.