Q. Hydro's response to PUB-68 includes a May 11, 2001 letter from Mr. Hayes of Newfoundland Power to Mr. Young of Hydro addressing Newfoundland Power's position regarding an appropriate demand-energy rate structure for Hydro's wholesale tariff. In its response to IC-205, Hydro indicates its agreement with Newfoundland Power's position stated in the letter. With regard to this letter, provide the following:

(i) Explain how a demand-energy rate would create volatility in the earnings of both Hydro and Newfoundland from year to year.

(ii) Provide an estimate of how much consumer rates would increase owing to Hydro's increased business risk resulting from a demand-energy wholesale rate.

(iii) What are the benefits arising from a demand-energy rate? Provide an estimate of the value of benefits arising from a demand-energy rate and compare it to the costs arising from the increased volatility.

(iv) Provide all documentation related to public pressure to provide stable rates and that leads Hydro to believe that public reaction to an increase in the variability of electricity rates would be overwhelmingly negative.

(v) Provide an estimate of Hydro's overall cost to provide stable rates by component, and compare it to the consumer benefits related to reduced rates owing to Hydro's reduced business risk.

A. (i) Newfoundland Power has a very high proportion of weather sensitive load. Therefore their peak for any year would be determined to a great extent by the actual weather conditions for that year. An abnormally cold day could result in significantly higher demand and therefore increased purchased power cost for Newfoundland Power and revenue for Hydro. Conversely the absence of a typical cold day could result in significantly lower peak with the respective impacts on the purchased power expense for Newfoundland Power and revenues for Hydro. Variations in energy related revenue due to abnormal weather are offset somewhat by the load variation component of the RSP.

(ii) The increase in rates due to the increased business risk will be dependent on the increase in ROE allowed by the Board to offset the increase in business risk.

(iii) In theory, pricing each component of a rate close to its embedded cost provides a better matching of revenue to embedded cost. The volatility of revenue from each rate component net of the related change in cost could thereby be reduced if the average embedded cost change is similar to the incremental cost change. It is also desirable to price the run-out energy rate in line with incremental cost to promote efficient use of resources. At times these two objectives are contrary to each other. For example the average energy cost for Newfoundland Power as per JAB-1, Schedule 1.3 is 2.586 ¢/kWh. The incremental cost of energy produced at Holyrood based on $28 /bbl is 4.59 ¢/kWh. The proposed flat energy charge of 4.8 ¢/kWh is more consistent with the pricing objective to promote efficient use of resources. Therefore, the benefits, if any, of a demand-energy rate structure depend on the relative priority one places on the various rate design objectives.

(iv) Please see response to NP-27 regarding Hydro's 2000 Customer Survey whereby "electricity at a reasonable cost" was ranked number 3 by customers. Attached are various 1985 newspaper clippings, as well as extracts from the transcripts of Hydro's 1985 General Rate Application both of which outline customers' concerns at the time, concerning major fluctuations in electricity rates due to the application of a fuel adjustment charge formula. This formula was subsequently eliminated and replaced on January 1, 1986 with the Rate Stabilization Plan.

(v) As identified in part (ii) above, the impact of a change in business risk cannot be quantified hence the requested comparison cannot be made.