

**Q. Re: p. 9 – RSP Cap**

- (a) Please elaborate on how a cap of \$50 million provides Hydro an incentive to operate efficiently and a \$100 million cap does not.**
  - (b) Please explain why a fully regulated utility would decide to absorb the additional RSP cost when it is a true cost incurred to supply customers.**
  - (c) Given the projected year end balances in the RSP for 2001 and 2002 are above \$50 million, how are you proposing the amount over \$50 million be dealt with if all other aspects of Hydro's cost of service do not change?**
  - (d) If Hydro is able to keep all of its controllable costs under control so that financially it does not require a rate change and its largest uncontrollable cost, world fuel prices, have risen causing higher thermal production costs, should it have a public hearing to review all its costs? Similarly, if Newfoundland Power keeps all of its controlled costs under control so that a rate change is not required, should it have a public hearing to review all its costs at a pass-through hearing resulting from the current Hydro application? Please explain the difference.**
  - (e) If Hydro is more efficient and reduces its costs, should it absorb the additional production costs due to rising world fuel prices? If Newfoundland Power is more efficient and reduces its costs, should it absorb some of the costs passed on to it through the RSP to avoid a rate increase? Please explain the difference.**
- A.**
- (a) If the cap remains at \$50 million, instead of being raised to \$100 million, Hydro would have to request a hearing to recover the additional amounts beyond the \$50 million. Presumably, Hydro would not want to have such a hearing, and would thus try to avoid it. This should tend to place greater pressure on Hydro to be more efficient with regard to spending.
  - (b) A fully regulated utility might very well decide that the impact on customers of a rate increase, or the pain of a hearing might justify not earning what otherwise might be a fair return granted at a hearing. Such trade-offs are common in the decisions of whether to file for a rate case, for example.
  - (c) The amounts over \$50 million in the RSP, if any, would require that Hydro file with the Board for recovery of those amounts. If the Board felt the prima-facie evidence behind the increase justified it, the Board could have a hearing where the fuel costs, load changes, and hydraulic production would be reviewed.

It is important to note that the retail portion of the RSP is *forecast* to exceed \$50 million in 2001 but the actual balance at the end of June, 2001 is \$39 million and Hydro's storage levels are above normal. It is not a foregone conclusion that the Retail Plan will exceed \$50 million in 2001. Hydro is also projecting the balance to drop back to \$37 million by 2004 (NP-50).

- (d) Only the costs causing the RSP to rise above \$50 million would be reviewed by the Board in the circumstances indicated. Similarly for a Newfoundland Power pass-through hearing, only the change in purchased power expense should be reviewed.

In the case of Hydro's proposed increase in the RSP cap to \$100 million, certain other circumstances not mentioned in the question come into play. For example, Hydro's last proposed test year was 1992. Such potentially long periods between rate cases indicate flow-through of amounts as high as \$100 million should be subject to a significant degree of regulatory scrutiny.

Similarly, if Newfoundland Power had not had a rate case for 10 years and proposed to increase consumers' rates automatically to customers by 3 or 4%; a full hearing might be warranted

- (e) Mr. Brockman is not proposing that Hydro necessarily absorb prudently incurred fuel costs. He is simply proposing that Hydro be given a choice between a more formal hearing to recover costs above \$50 million (for the Retail Plan) in the RSP and controlling its other costs, or even deciding to recover less return on stockholder equity if the balance rises above \$50 million. The same answer and theory of incentive regulation holds for Newfoundland Power.