

**IN THE MATTER OF** the *Electrical Power Control Act, 1994* (the “EPCA”) and the *Public Utilities Act, R.S.N. 1990, Chapter P-47* (the “Act”) and their subordinate regulations; and

**IN THE MATTER OF** an Application by Newfoundland and Labrador Hydro (“Hydro”) for approvals of: (1) Under Section 70 of the Act, changes in the rates to be charged for the Supply of power and energy to its Retail Customer, Newfoundland Power, its Rural Customers and its Industrial Customers; (2) Under Section 71 of the Act, its Rules and Regulations applicable to the supply of electricity to its Rural Customers; (3) Under Section 71 of the Act, the contracts setting out the terms and conditions applicable to the supply of electricity to its Industrial Customers; and (4) Under Section 41 of the Act, its 2002 Capital Budget.

**RESPONSE TO NLH-99**

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**NLH-99 (Re: p.36, regarding the RSP)**

Q: Would Mr. Osler support elimination of the RSP for industrial customers and to have it replaced by a fuel adjustment charge?

A: Mr. Osler does not support simply eliminating the RSP for industrial customers in order to have it replaced for these customers by a fuel adjustment charge. There is need for consistency in treatment of industrial customers and NP. Further, as reviewed below, Mr. Osler has recommended changes to the RSP which retain the hydraulic variance as well as the fuel adjustment charge components.

Mr. Osler supports the concept of a fuel adjustment charge for all customers, assuming this is defined to be a fund that operates basically the same as the fuel price variance component of the existing RSP. Further, Mr. Osler supports the concept of a hydraulic variance fund for all customers which could be based on the existing hydraulic variance portion of the RSP. Each of these mechanisms are normal regulatory accounts similar to those maintained by other utilities, and each represents an area where it is reasonable to manage risks which are not under the control of the utility. It is not a prime concern at this time whether these are two different funds or are part of the same fund; however, there appears to be merit in combining the two parts into one fund.

In contrast, Mr. Osler does not support the continuation of the load variance component of the RSP for any customers. Reasons for this conclusion include:

- 1) **Load variance risks normally reside with the utility:** Hydro's RSP load variance mechanism is not a typical regulatory account encountered elsewhere. The load variance component serves to protect Hydro from (and transfer to customers) risks of load variation and errors in Hydro's forecasts - regardless of the source of these variations - which is a risk that is normally borne by the utility. This concept is further supported by the evidence of Kathleen C. McShane filed as Appendix 5 of the Northwest Territories Power Corporation 1995/98 General Rate Application (an excerpt is attached) which reviews the proposed NTPC rate stabilization fund (roughly comparable to Hydro's RSP without the load variation component) - Ms. McShane notes that "regulators have traditionally proceeded on the premise that utilities should be at risk for recovery of costs over which they have some degree of control" (page 4) and as an example she cites "risk from the load forecast" (page 5, bullet i) and "risk for the efficient operation of its plants" (page 5, bullet iv). As a result, Ms. McShane did not recommend a load variance component of the NWT rate stabilization fund.
- 2) **Adds unnecessary complication:** The load variance component of the RSP is the only component that requires the complex mechanism for adjusting for NP versus IC balances and charging differential RSP adjustment rates. In the absence of this component (i.e. if the RSP only addressed fuel price and water variations), the RSP adjustment could be a simple flat rider per kW.h (annually adjusted) and the rider could be equal for NP, IC and Rural customers. [The steps to deal with rural deficit adjustments assigned to Hydro and to NP could then be addressed as a transparent and specific adjustment.]

- 3) **Protects Hydro from GRA Requirements:** The load variation component of the RSP has been a significant factor in Hydro being able to avoid regulatory review for almost 10 years.

In effect, ignoring the adjustment charges to NP and the Industrial customers, each portion of the RSP acts to adjust Hydro's income statement for each year from what would be recorded without the RSP. The load variation portion acts to ensure that Hydro's income statement for each year reflects the GRA forecast load rather than the actual load – and any variance is then assigned to the RSP. Without the RSP, Hydro's income from NP (and from IC in most past years) would fall (compared to what occurs with the RSP) when actual load is less than forecast; however, the RSP protects Hydro from such income reductions, and a shortfall in actual load becomes a charge that builds up the RSP. Subsequent RSP adjustment charges to NP and IC are then used to assign the increased RSP amount to these customers over three years – but these adjustment recoveries are cash payments to the RSP that do not affect Hydro's annual income statements.

The table below summarizes the data from the December RSP reports filed in IC-73, indicating the annual incremental impacts on the RSP (ignoring RSP adjustment charges to NP and the Industrial customers) arising from each of the main portions of the RSP. The load variation portion is compared with the overall impact arising from the main non-load portions, i.e., fuel price portion, hydraulic portion, and the rural rate adjustment portion. This table shows that without the load variation portion of the RSP, Hydro's income would have been reduced by almost \$19 million over 8 years – and the RSP in effect compensated Hydro, due to the load variation component of the RSP, this same amount with the annual contributions to Hydro's income being well over \$1 million in most years, and as high as \$5.3 million in 1999. The relevance of such amounts can be demonstrated by considering that Hydro's proposed total return on Equity (at a 1.08 interest coverage margin) in 2002 is \$5.66 million (JAB-1, Schedule 1.1, line 21).

In short, there were clearly many years where the income to Hydro from the load variation component of the RSP was material in maintaining Hydro's margin and allowing the Corporation to recover these amounts through an automatic rider (via the RSP) rather than through regulatory review of the increase in the amounts that customers pay (via a GRA).

Year (\$000)	Total Load variation portion of RSP	Total non-load portion of RSP (column A+B+C)	Fuel Price portion of RSP (column A)	Hydraulic portion of RSP (column B)	Rural Rate portion of RSP (column C)
1992	1,482	3,236	3,435	-199	0
1993	1,804	3,004	7,897	-4,867	-26
1994	2,315	-14,545	3,657	-18,078	-124
1995	1,848	16,167	20,135	-3,824	-144
1996	2,505	14,944	22,811	-7,724	-143
1997	-651	16,286	25,727	-8,942	-499
1998	3,576	12,005	12,800	-908	113
1999	5,344	-7,881	9,316	-16,804	-393
2000	593	12,172	30,411	-17,321	-918
<b>Total</b>	<b>18,816</b>	<b>55,388</b>	<b>136,189</b>	<b>-78,667</b>	<b>-2,134</b>

24 Regulators have traditionally proceeded on the premise that utilities should be  
25 at risk for recovery of costs over which they have some degree of control. The  
26 proposed rate stabilization fund is consistent with that premise.

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1 i. The Corporation is at risk for its load forecast. The rate  
2 stabilization accounts will not be charged or credited with  
3 amounts which relate to costs incurred (avoided) due to  
4 deviations from load forecasts.

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6 ii. The operation of the funding mechanism (the rider) and the  
7 annual charges/credits to the fund for deviations between normal  
8 and actual water assigns the "risk" of deviations from normal  
9 water to the ratepayer beyond the target range.

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11 iii. Ratepayers will absorb the risk associated with differences  
12 between forecast and actual costs per litre of fuel as applied to  
13 volumes required to efficiently generate the load forecast  
14 assuming normal hydro conditions. NWTPC will not, however,  
15 recover any higher than forecast fuel price related to diesel  
16 generation required as a result of lower than normal water.

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18 The mitigation of this risk to the shareholder recognizes that the  
19 utility has no control over the price of fuel, nor, in NWTPC's  
20 case, does it have the flexibility afforded other utilities to vary  
21 the mix of generation to minimize generation costs.

22  
23 iv. The Corporation is at risk for the efficient operation of its  
24 plants; the charges/credits to the rate stabilization accounts will  
25 be made using the approved efficiency factor. If the utility  
26 utilizes "excess" fuel to generate the forecast load, it will not be  
27 allowed to recover the difference between forecast and actual  
28 fuel price for those volumes of fuel.