

1 Q. If the Board accepts Mr. Bowman's recommendation to "eliminate the Rate
2 Stabilization Plan" (page 5), Hydro will have significant production cost volatility
3 on an annual basis. How does Mr. Bowman propose to deal with the resulting
4 production cost volatility in setting rates?

5

6 ANSWER:

7 Mr. Bowman points out that Hydro will have production cost volatility on an
8 annual basis regardless of the status of the rate stabilization plan. The RSP has
9 improved rate stability on an annual basis, but has not improved rate stability over
10 time – it has simply deferred costs to the future. Hydro is now proposing to collect
11 a portion of these deferred costs, and as a result, is proposing significant rate
12 increases to consumers effective January 1, 2002. For example, Industrial
13 Customers would see a proposed rate increase exceeding 18% (Pre-filed
14 Testimony of C.F. Osler, page 19, line 17), with the promise of additional
15 increases in the next two years.

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17 Mr. Bowman believes that if the RSP is eliminated, rates will be more stable over
18 time as Hydro will be forced to do a better job of forecasting and managing fuel
19 supply risk, therefore, mitigating rate volatility. All utilities are forced to deal
20 with production cost volatility, and in many respects, Hydro's production cost
21 volatility is more easily managed owing to the high percentage of hydro-electric
22 production in its supply mix. Under the current RSP, Hydro has little incentive to
23 manage production cost volatility, and to operate efficiently, as pointed out by
24 Newfoundland Power's expert witness, Mr. Brockman (Brockman Direct
25 Testimony, page 9, lines 6 to7). If Hydro were required to submit a rate
26 application for increased rates when fuel costs are greater than forecast rather than
27 automatically passing the costs through to consumers as they do today under the
28 RSP, Hydro would have greater incentive to better manage production costs.
29 Hydro's alternative would be to have its shareholder absorb the cost, also leading
30 to increased stability of consumer rates.

1 Another method for improving rate stability would be for the Board to incorporate
2 an incentive regulatory mechanism that would reward Hydro for managing fuel
3 supply risk. Any reward related to rate stability should be consistent with
4 consumer value.