Q. The IC Cost of Service witnesses recommend the load variation component of the RSP should be terminated (page 4 of pre-filed testimony of C. F. Osler and P. Bowman). Please provide background information on the reason for the existence of the load variation component in the RSP.

A. In the 1985 hearing, Hydro sought approval for a Rate Stabilization Plan that had three elements as outlined at pages 39 to 42 of the 1985 report which are attached. The Board added the load variation component of the Rate Stabilization Plan as noted on the attached pages 88 and 90 of the 1985 report.

Rate Stabilization Plan

Hydro's submission on the Rate Stabilization Plan

Mr. Abery testified that Hydro is proposing that a Rate Stabilization Plan be established to replace the present Water Equalization Provision. This Plan will help ensure that rates remain stable and certain over the next two to three years. In addition, it will ensure that consumers will benefit should favourable events result in significant improvement in Hydro's financial position.

The Plan will have three elements; one relating to variations in water conditions, one relating to variations in oil costs and one relating to a coverage cap as follows:

(i) Water Variation Provision: The balance in the present Water Equalization Provision will be credited to customers over the next three years and this has been incorporated in the overall rate Hydro is proposing. A new provision will be established and funds will accrue to or be charged to the provision depending upon whether hydro production is above or below average.

The provision will be adjusted by using $30 per barrel for fuel as used in the 1986 cost of service study multiplied by the number of barrels required to produce equivalent energy from thermal.

Interest, at Hydro's average borrowing rate, will be credited to or charged against the account again depending upon hydro production. The balance in the provision, positive or negative, will be written off over a three year period commencing with the next rate hearing.

(ii) Fuel Cost Variation Provision: This will be a new component which will be used to account for variatons in the price of Bunker 'C' fuel oil from the $30 per barrel level used in the 1986 cost of service study. It will operate on the same basis as the Water Variation Provision. It will be positive if prices fall and negative if prices rise. Adjustments to the provision will be calculated by multiplying the number of barrels of oil used for thermal production in a period by the fuel cost variation.

The Balances in the Water Variation Provision and the Fuel Cost Variation Provision will attract interest which will be calculated by using Hydro's average cost of borrowing. Any balance in the provision positive or negative at its next rate hearing will be included in the rates and amortized over the following three year period; and,

(iii) Coverage Cap: Nothwithstanding the best efforts to forecast future events, it is possible that factors could change in such a manner that Hydro's revenues were greater than anticipated or its costs less, thus leading to a significant increase in its retail coverage level. It is proposed that, should this occur in any year before the next rate hearing, Hydro's coverage on its retail customers be capped at 1.20, the mid-point of the approved coverage range. Any revenue in excess of this would be refunded to customers the following year when the financial statement has been finalized. The Water and Fuel Cost Variation Provisions eliminate the effect on Hydro's margin and interest coverage for changes in hydro production and fuel costs and the Coverage Cap prevents Hydro from over earning which may occur when there is a decrease in load.

Mr. Abery stated that overall, Hydro believes that the adoption of the proposed Rate Stabilization Plan will stabilize rates to customers and provide the certainty that has been missing over the past few years.

During the hearing Hydro proposed that it be required to initiate an appearance before the Board if the net balance of provisions created by the Rate Stabilization Plan, to the extent that they are applicable to retailers, reaches $50 million (either positive or negative). At that appearance Hydro would either propose alternative rates or present facts relevant to examining the need for an alteration of rates in light of the circumstances at that time.

Mr. Kierans pointed out that it is important for the Board to acknowledge that under the proposed Rate Stabilization Plan, Hydro will be assuming the risks of the volatility of oil prices as well as the increased usage of oil due to lower than average water years. These risks are currently borne by Hydro's customers through the existing fuel cost adjustment mechanism.

(ii) Hydro will inform the Board of the amounts being accrued in each month, the balance accrued to date and the status of the amount being amortized.

(iii) NLP will calculate a rate adjustment per kwh by dividing the sum of the annual amortization to be billed by Hydro plus any balance in the NLP rate stabilization account referred to in (iv), by the total kwh sold in the previous 12 months and report to the Board the calculation of the charge to be included in customers' bills in the following 12 months.

(iv) Under or over collections by NLP will be carried forward in an interest bearing rate stabilization account.

(v) NLP will report to the Board monthly the amount collected to date and the balance remaining.

(vi) Any earnings variation because of a difference between the estimated load and the actual load be included in the Rate Stabilization Plans of Hydro and NLP.

The Board recommends that any earnings variation because of a difference between the estimated load and the actual load be included in the Rate Stabilization Plan so that Hydro's earnings will not vary.

The Board does not accept Mr. Hutchings' submission that Hydro breached the EPCA and NLP breached Section 67 of the Public Utilities Act in deferring payment of part of the FAC in the winter of 1985. There was no change in the overall rates and no interest was charged by Hydro to the retailers on the deferred amounts.

The Board does not believe it is necessary to reopen the hearing to hear further evidence and discussion on the various alternative plans.

It may well be that adjustments or refinements to the plan will be required in the future but these will be made on the basis of actual experience rather than on computer simulation.