IN THE MATTER OF the Public Utilities Act, R.S.N., c. P-42 (the *"Act")*

AND

IN THE MATTER OF a General Rate Application (the "Application") by Newfoundland and Labrador Hydro ("Hydro") for approvals of, under Section 70 of the *Act,* changes in the rates to be charged for the supply of power and energy to Newfoundland Power Inc. ("NP"), Rural Customers and Industrial Customers; and under Section 71 of the *Act,* changes in the Rules and Regulations applicable to the supply of electricity to Rural Customers.

Parties' Agreement on Cost of Service, Rate Design And Rate Stabilization Plan

Terms of Agreement

1. As a result of this Agreement, reached through a negotiation process, the Parties consent to the admission in the record of this Application of all pre-filed testimony and exhibits pertaining to: (1) cost of service; (2) rate design; (3) rate stabilization plan matters and (4) tariff rules and regulations without the calling of witnesses for the purpose of cross-examination insofar as such testimony and exhibits relate to the issues agreed to. The Parties recommend that the Board make its determinations on the agreed upon issues in accordance with the proposed resolution of these issues as stated in this Agreement. This Agreement represents a reasoned consensus on the stated issues and the individual agreements of the Parties are not intended to be severable. Issues not agreed upon should be determined by the Board based on the full record of the hearing.

Matters Agreed Upon

2. Except as otherwise stated in this Agreement, the undersigned Parties have reached agreement on cost of service, rate design, and rate stabilization plan matters. The rate design principles as provided in Attachment A were accepted and used by the Parties in coming to agreement. Matters not agreed upon by the Parties are as follows:
    a. The treatment of customer-owned generation in the cost of service study,
    b. Hydro's Rate Stabilization Plan (RSP) proposals relating to the treatment of the CFB Goose Bay credit and limitations on the effects of variations in Rural diesel fuel and power purchase costs on Hydro's net income,
    c. the disposition of the forecast hydraulic production variation balance, and
    d. the calculation and application of specifically assigned charges to customers.

Hydro COS Study

3. All Parties consider that Hydro's cost of service (COS) study filed in this proceeding is in compliance with Board Orders regarding the use of embedded cost of service studies as a guide in determining the revenue requirement to be applied to each customer class.

4. All parties agree on the cost of service methodologies in Exhibit RDG-1 ("2007 Forecast Cost of Service") with respect to Functionalization, Classification and Allocation, with the exception of:
    a. the treatment of customer owned generation and matters relating thereto, or issues arising as a result of any changes made to the current treatment of customer-owned generation, and
    b. the calculation and application of specifically assigned charges to customers.

Wholesale Rate

5. With respect to rates for Newfoundland Power, the Parties agree as follows:

    a. Except as otherwise stated in this Agreement, rate designs and other tariff provisions for Newfoundland Power as outlined in the Application should continue to apply.

    b. Hydro's energy rate to Newfoundland Power should continue to be a two-block structure as follows:

        i. the first-block energy charge should be applied to the first 250 GWh of energy purchases per month,

        ii. the energy charge for the first block would be calculated in accordance with the Board's Decision and Order, and

        iii. the energy charge for the end or 'run out' block rate would be set at a level that reflects the production cost at the Holyrood thermal plant, which production cost shall be as determined by the Board in its Decision and Order.

    c. It is appropriate to reduce Hydro's demand rate to Newfoundland Power to $4.00 per kW per month to better reflect the marginal capacity costs currently indicated on the Island Interconnected System (see July 2006 report entitled Implications of *Marginal Cost Results for Class Revenue Allocation and Rate Design*).

    d. Unless altered as a result of the Board's decision with respect to the treatment of customer-owned generation, Hydro's demand rate to Newfoundland Power will continue to apply to the single highest weather adjusted native load for the winter season.

    e. Following the current GRA, Hydro and Newfoundland Power will enter into discussions toward development of a demand billing approach to reflect the marginal cost of capacity during the winter months. A report documenting the agreement and

justifications (or if agreement is not reached, the reasons why agreement was not reached) will be prepared by Hydro and submitted to the Board on or before June 30, 2007.

IC Rate Design

6. With respect to rates for the Industrial Customers, the Parties agree that except as otherwise stated in this Agreement, rate designs and other tariff provisions for the Industrial Customers as outlined in the Application should continue to apply.

RSP Design

7. With respect to the Rate Stabilization Plan, the Parties agree as follows:
    a. The current provisions of the Rate Stabilization Plan should continue as approved for all hydraulic, fuel and load related components and all recovery-related calculations with the exception of the three issues identified in paragraph (c.) below.
    b. When new test year base rates are implemented, if the fuel rider forecast is more current, a fuel rider which incorporates the new forecast should be implemented at the same time as the change in base rates.
    c. The following issues have not been agreed upon:
        i. Whether there should be any limitations on the potential effects of variations in Rural diesel fuel costs and Rural power purchase costs on Hydro's net income;
        ii. Whether there should be any limitations on the potential effects of the full or partial closure of the CFB Goose Bay facility on Hydro's net income; and
        iii. The disposition of the forecast hydraulic production variation balance in the RSP.

Review Processes

8. Three review processes applying the principles set out in Attachment A shall be initiated by Hydro in 2007 to examine:

    i. The wholesale power rate design for Newfoundland Power as described in paragraph 5 (e);

    ii. The rate design for ICs; and

    iii. Re-design of the RSP to better meet design objectives.

9. The "Framework for Industrial Customers' Rate Design Review" (Attachment B) will apply to the review process on the rate design for the ICs.

10. By February 1, 2007, the Parties shall establish such further terms as needed for each of the three review processes, including the proposal for discussions, detailed schedule, confidentiality terms, role and involvement of the Parties, and payment of costs for participants and the Parties.

11. Matters dealt with in the review processes but which are not resolved through negotiations may be submitted to the Board for resolution.

12. The Parties agree to use their best efforts to achieve an implementation date of January 1, 2008 for rate design and the design of the RSP.

Wholesale Rate Review Report

13. Hydro shall file a report pertaining to the review of the wholesale power rate design for Newfoundland

Power as described in paragraph 5(e) by June 30, 2007. The report will document the review results relating to the Newfoundland Power rate design and all matters arising, and provide recommendations to the Board relating to implementation.

RSP Review Objectives

14. The RSP will be reviewed with the intent to better reflect design objectives. This review will include, but not be limited to:

    i. Definition of the design objectives against which the current RSP and all proposed modifications will be evaluated.

    ii. A review of the necessity of a load variation component of the RSP, given potential changes to IC rates to reflect marginal fuel costs.

    iii. Modification of the RSP to enhance the price signal for marginal consumption by ICs and NP.

    iv. Simplification of the RSP by separately tracking provisions not related to the hydraulic and fuel price components of the Plan through an accounting mechanism discrete from the RSP.

RSP and IC Rate Design Report

15. As soon as practicable following the conduct of the review of the IC rate design and re-design of the RSP, and in no event later than October 31, 2007, Hydro shall host a Technical Conference, to be attended by the Parties and others as determined by the Parties, to further discuss the IC rate design and re-design of the RSP.

Agreed to this 20th day of October, 2006

For Newfoundland Power: _____

For Industrial Customers: _____

For the Consumer Advocate: _____

For Newfoundland & Labrador Hydro: _____

For Board Appointed Facilitator: _____

Attachment A

Parties' Agreement on Rate Design Principles

1.0 The Use of Embedded Cost Studies

The use of embedded cost of service studies to attribute cost responsibility follows logically from the generally accepted principles of good rate design. These principles are codified in James Bonbright's *Principles of Public Utility Rates*. The principles that relate most to cost of service studies are effectiveness in yielding total revenue requirements and fairness in the apportionment of total cost of service among the different ratepayers. The goal of achieving fairness in the apportionment of total cost of service among the different ratepayers and preventing undue discrimination is the stated purpose of most cost of service studies. This Board has accepted the use of embedded cost of service studies as the method to be used in determining reasonable cost recovery among customer classes.

2.0 Reflecting Marginal Costs in Rate Design

Reflecting marginal costs in rate designs is also consistent with the generally accepted principles. Rates for marginal demand and energy use that reflect marginal costs send more efficient price signals to consumers and are consistent with energy efficiency/demand management programs and Government environmental initiatives such as greenhouse gas emissions reduction.

3.0 Rate Design Principles

Giving consideration to the generally accepted principles and past regulatory practice in this jurisdiction, the Industrial customers and Newfoundland Power rate designs will be developed and implemented based on the following principles:

A. Rates will be designed to recover the class revenue requirement derived in the embedded cost of service study.

B. Rate design will give consideration to the fairness of embedded cost recovery from individual customers within classes.

C. Capacity and energy rate components will reflect current forecasts of time varying marginal costs of system capacity and energy when the benefits resulting from more complex rate designs are judged to exceed the costs of implementation.

D. The rate designs will take into account trends in marginal costs. For example, if system marginal capacity costs are expected to increase over time, they may be averaged over a number of years in the future in order to capture a portion of the expected increase. Trends and the relevance of future capacity additions may be given more or less weighting depending on the objectives at the time.

E. Rate designs will incorporate an element of revenue / price stability, certainty, predictability and understandability. This will include consideration of marginal costs over a number of years into the future.

4.0 Other Considerations

The parties will consider the implications for Newfoundland Power and Industrial Customers to:

- implement demand management or energy conservation activities;
- operate and expand generation capabilities; and,
- maximize the economic benefits from use of electricity.

Rate design principles can often conflict with one another, requiring that a balance be struck when designing rates. This balancing must guard against unintended consequences such as the inefficient dispatch of customer-owned generation, etc.

Attachment B

Framework for Industrial Customers' Rate Design Review

1.0 Current Rate Design Methodology

The current Industrial Customer (IC) firm rate design entails a single demand charge applied to all Power on Order each month and a single energy charge applied to all firm kWh consumed. Non-firm kWh are priced largely at the cost of fuel at Holyrood.

2.0 Rate Design Review

In light of the principles identified in Attachment A, Hydro and the ICs will enter into discussions following the 2006 GRA directed toward development of a suitable revised Island industrial rate design focused on the following points:

1) New rate designs will continue to be based on recovering the full IC revenue requirement measured by the embedded Cost-of-Service study, but with a marginal price signal on the discretionary or marginal components of the load.

2) The discussions will focus on development of a suitable and practical industrial rate design for future implementation subject to review by stakeholders and the Board.

3) A variety of issues related to practical implementation and fairness require careful consideration. Guidance on these matters will be sought through discussions at times with each of the Industrial Customers regarding the unique characteristics of their operations and specific facility plans, and through review of similar rate structures in other jurisdictions. Practical issues include, but are not limited to:

a. **Energy Blocks:** Determination of a reasonable approach for sizing first block energy versus run-out (marginal) blocks, including:

- The means to set an initial annual division between the first block for each customer versus the run-out or second block.
- The basis and timing under which the size of the first block might be adjusted for each customer (both short-term and long-term).
- Approaches used to set the first block energy allocation to new industrial customers coming on the system.
- Means to apply the annual first block energy concept to monthly billing.

b. Demand Charges: Interaction between demand changes, actual metered peak loads, Power on Order and delimitation between firm and non-firm supplies.

c. Customer Generation: Interaction with customer generation including impacts on dispatch and expansion of generation capability.

d. Other Contract Provisions: Interactions with other provisions in the existing industrial customer contracts such as Force Majeure events, and interaction with non-firm rate provisions.

e. Impacts on Loads and Customer Decisions: Impacts on the economics of customer choices with respect to expansions of operations, or reductions. This matter should include an understanding of any likely impact of the rate design on the future growth and development of the level of industrial activity of Newfoundland.

f. DSM and Conservation: Implications for IC to implement DSM or conservation activities to reduce net loads on Hydro's system and capture long-term system savings.