

1 Q. Given NERA's conclusion that "NP may well be over-investing in demand-
2 reducing measures" in respect of loads used for the Hydro Cost of Service
3 and Two-part rate design, what measures does NERA view as available to
4 Hydro to address any "over-investment" that occurred to date. Would NERA
5 recommend any adjustments be made to the Cost of Service methodology
6 for allocating demand-related costs to NP to ensure they do not capture
7 "savings" from these peak reductions that in NERA's opinion do not reflect
8 any underlying reductions in Hydro's costs? If not, why not?
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11 A. NERA has provided the following response to this Request For Information:
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13 The "over-investment in demand-reducing measures" mentioned in our report
14 refers to response by NP to the high (relative to marginal cost) demand
15 charges in the current, Board-approved, rates. This "over-investment" is in
16 comparison to the efficient level of such investment that would have occurred
17 if NP had faced demand charges equal to marginal cost. We do not mean to
18 suggest that NP made *imprudent* investment in such measures, and we
19 would not suggest that Hydro take any measures to address any such past
20 over-investment. NP will have incentives to use past investments efficiently
21 and make and use new load management investments if the company faces
22 prices at the margin that are as close as possible to Hydro's marginal costs.
23

24 On the issue of adjustments to the method for allocating embedded demand
25 related costs so that NP does not continue to capture savings due demand
26 reductions greater than Hydro's avoided costs: embedded cost studies
27 allocate demand-related costs to classes on the basis of some measure of
28 test-year demand (including the effects of any demand response programs).

1 We do not recommend that NP's demand allocators be calculated any
2 differently from other classes' loads for this purpose.¹

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4 However, the NLH embedded study assigns roughly one-third of the NP and
5 Industrial Customer revenue requirements to demand. To the degree that the
6 embedded study results continue to be used to set demand charges, NP will
7 not only continue to "capture savings" in excess of avoided costs from past
8 investments to reduce peak demands, which is just a transfer, but will also
9 continue to face an inefficiently high incentive to invest in additional demand
10 reducing programs. Fixing this would call for change in classification
11 methods used in the embedded cost study to shift costs from demand to
12 energy (more in line with the marginal cost relationship).

¹ NP's demand allocation factor should, of course, continue to reflect the effects of NP's own generation capacity.