

1 Q. Stone and Webster stated that "notwithstanding NERA's findings, there are a  
2 number of important and justifiable reasons to retain the existing rate  
3 structures for both NP and the Industrial Customers".  
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5 Does NERA agree with Stone and Webster's approach to assessing the rate  
6 designs for Newfoundland Power and Industrial Customers? If not, provide  
7 reasons why Hydro's approach to rate design for Newfoundland Power and  
8 Industrial Customers requires modification. (Cost of Service Evidence, page  
9 14, lines 7 to 9)  
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12 A. NERA has provided the following response to this Request For Information:  
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14 Hydro engaged NERA to prepare a marginal cost study and a report  
15 summarizing the implications of the marginal costs for rate design. NERA  
16 was not given the assignment to develop a rate proposal for this case. We  
17 recognize that rate setting requires balancing many objectives, one of which  
18 is economic efficiency, but we have not studied all of the objectives and  
19 issues related to Hydro's rates. We have also not studied the impacts that a  
20 marginal cost-based rate structure (with small, winter-only demand charges)  
21 might have on load. Nor have we studied the probability of significant  
22 increases or decreases in fuel prices, and therefore the probability that the  
23 marginal capacity costs we estimated are too low or too high. Finally, we  
24 have not analyzed the likelihood that the Labrador Interconnect will be built  
25 and the timing of its completion date; this development would significantly  
26 change the level and structure of Hydro's marginal costs, as our study  
27 shows.

1           That said, we disagree with some of Stone & Webster's points:

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3           • We believe that marginal-cost-based demand charges are important  
4           price signals, even on isolated systems. Demand-charges higher than  
5           (accurately estimated) marginal costs encourage customer investment  
6           in peak-shaving that costs more than the benefits produced to the  
7           system.  
8
- 9           • The fuel rider adjusts the Industrial energy charge as fuel prices  
10          change, but the total charge per kWh remains well below marginal  
11          cost with the current and proposed rate structure. Actions by industrial  
12          customers that would efficiently reduce their energy consumption may  
13          not be taken because the pay-off is too low when energy charges are  
14          low.  
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- 16          • S&W is concerned that low or zero demand charges fail to provide  
17          "meaningful price signals as to conservation of capacity." We are not  
18          certain what is meant by the term "meaningful price signals," but  
19          demand charges that reflect low marginal capacity costs do provide  
20          efficient price signals about the cost effects of use of (cheap) capacity.  
21
- 22          • S&W suggests that Hydro should continue to use an embedded cost-  
23          of-service study because such studies are the industry standard for  
24          setting equitable and non-discriminatory revenue requirement and  
25          rates for each class of customer. While it is true that the Board has  
26          traditionally used the results of an embedded cost-of-service study,  
27          the Board specifically ordered Hydro to provide a marginal cost study,  
28          mentioning its usefulness in addressing issues such as seasonal and

- 1 time-of-use rates, demand-side management program evaluation, the
- 2 value of the Interruptible B load, NP's Curtailable service option, and
- 3 the level of the demand rate for NP's wholesale demand-energy rate.