

1 **Q. Please indicate when NP’s major deferral accounts for weather and power costs**
2 **were introduced and whether this change in its underlying risk was taken into**
3 **account in terms of its capital structure.**
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5 A. Newfoundland Power’s primary regulatory mechanisms for weather and supply costs
6 were introduced to address specific new developments on the Island Interconnected
7 system, which occurred since 1968. Their introduction did not affect the “underlying
8 risk” to which the Company was exposed prior to the emergence of the new
9 developments. Accordingly, there would be no cause to take the introduction of the
10 mechanisms “...into account in terms of [Newfoundland Power’s] capital structure”.

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12 Newfoundland Power’s Weather Normalization Reserve was introduced in 1968.¹ The
13 reserve addressed a new development on the Island Interconnected system, particularly
14 the development of Newfoundland and Labrador Hydro’s (“Hydro”) Bay d’Espoir
15 hydroelectric development. Following this development, Hydro had surplus generating
16 capability which was directed at the domestic heating market. As electric heat became
17 more prominent, Newfoundland Power’s sales became more subject to weather.
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19 In 2007, the Board approved Newfoundland Power’s recovery through the Rate
20 Stabilization Account (“RSA”) of the difference between the marginal energy supply cost
21 from Hydro and the average energy supply cost reflected in customer rates (the “energy
22 supply cost variance”).² The establishment of a means of recovery of the energy supply
23 cost variance addressed a new development on the Island Interconnected system,
24 particularly Hydro’s increased marginal cost of energy production. Hydro’s high
25 marginal energy price to Newfoundland Power ensured that Newfoundland Power would
26 lose money for every kWh of increased customer energy served following a test year.
27 Unless a reasonable means of recovery of the higher Hydro marginal cost of production
28 was permitted between test years, Newfoundland Power would be practically required to
29 file a general rate application for every year.³

¹ See Order No. P.U. 32 (1968). Order No. P.U. 1 (1974) established a degree day normalization substantially similar to that used by natural gas distribution companies to adjust for the effect of weather on Newfoundland Power’s sales.

² See Order No. P.U. 32 (2007). Newfoundland Power’s RSA was originally introduced in 1985 primarily as a means of ensuring that *Hydro’s production costs* were recovered in, or credited to, Newfoundland Power’s customer rates in a timely fashion.

³ This practical requirement likely explains the fact that the Board’s approval of recovery of the energy cost variance via the RSA was recommended in a settlement agreement.

1 In 2007, the Board approved Newfoundland Power’s demand management incentive
2 (“DMI”) account.⁴ The establishment of the DMI account addressed a new development
3 on the Island Interconnected system, particularly the adoption of a specific demand cost
4 in Hydro’s wholesale utility rate.⁵ The DMI account was established to provide a
5 meaningful incentive for Newfoundland Power to undertake reasonable initiatives to
6 minimize peak demand. The DMI account effectively limits Newfoundland Power’s risk
7 of recovery of demand costs paid to Hydro to approximately \pm \$640,000 or about 25% of
8 the range of return on rate base typically approved by the Board.⁶

⁴ See Order No. P.U. 32 (2007).

⁵ See Order No. P.U. 44 (2004) which approved a purchased power unit cost variance reserve. This reserve was discontinued at the time of the Board’s approval of the DMI account in Order No. P.U. 32 (2007).

⁶ See *Company Evidence, Section 4: Finance*, page 4-35.