Q. Given anticipated changes in the near future, including a marginal cost review, a cost of service review and interconnection, please provide an opinion in relation to the benefits and disadvantages of implementing a net metering program at this time which is in accordance with the Net Metering Policy Framework and to allow full consideration of the alternative approaches in relation to compensation for net excess generation following the completion of the reviews.

A. **1. Introduction**

A marginal cost review, cost of service review, and interconnection of Muskrat Falls are expected to occur within the next few years. In developing the Net Metering Service Option proposed in the Application, Newfoundland Power considered this regulatory outlook. It is Newfoundland Power's opinion that sufficient information is currently available to enable design of a net metering service offering for customers which has due regard for the cost outlook on the Island Interconnected system.

Current public utility practice indicates three alternatives for compensating net excess energy upon annual settlement. They include (i) retail rates, (ii) marginal energy costs, and (iii) $0 value. It is Newfoundland Power's view that the Net Metering Service Option proposed for implementation in the Application provides the best of the alternative approaches in relation to compensation for net excess energy in the context of the current outlook for the Island Interconnected system. The details of the reasoning supporting this view are provided in the response to Request for Information PUB-NP-009.

The remainder of this response deals specifically with the alternative proposed in this Request for Information.

2. Island Interconnected System Cost Outlook

Notwithstanding the regulatory reviews which are scheduled, certain cost attributes of the Island Interconnected system following the interconnection of Muskrat Falls are reasonably clear today.

Following the interconnection of Muskrat Falls, retail customer rates are expected to materially increase. While the magnitude of this increase is uncertain, the size of the investment involved clearly indicates material increases in retail customer rates will occur. Similarly, it seems clear that the marginal cost of supply following the interconnection of Muskrat Falls will be substantially lower than retail customer rates. This largely results from the substitution of Muskrat Falls hydroelectric production for Holyrood thermal production as the primary marginal energy source for the Island Interconnected system.

These forecast cost dynamics are substantially different from existing cost dynamics where retail customer energy rates roughly approximate marginal energy costs. The

regulatory processes referred to in this Request for Information are not likely to alter these general cost dynamics. Given this, in Newfoundland Power's view, these forecast cost dynamics should be given due regard in the design of any net metering service offering.

3. Benefits and Disadvantages

In developing the Net Metering Service Option proposed in the Application, Newfoundland Power gave due consideration to the alternative proposed in this Request for Information. A proposal that retail rates be used to compensate net excess energy on annual settlement would, in light of the general cost dynamics described in the previous paragraph, risk sending an inappropriate price signal to customers. This price signal may have added significance given the decades long expected useful life of customer-owned generating facilities.

Compensation based upon retail rates is appropriate where retail customer energy rates roughly approximate marginal energy costs. Customers installing generation resources which are expected to be net metered might reasonably expect that, in future, on annual settlement excess energy would be compensated based on retail rates. However, it appears reasonably clear today that compensation based on retail rates will *not* be consistent with either (i) the least cost delivery of service or (ii) non-discriminatory rate making following the interconnection of Muskrat Falls. This will likely require changes to the design of the Net Metering Service Option following the interconnection.

By comparison, the Net Metering Service Option proposed in the Application provides for annual settlement of excess energy to compensate customers based upon avoided or marginal system energy costs. Currently, marginal system energy costs approximate retail rates. Following the interconnection of Muskrat Falls, marginal system energy costs will be lower than retail rates. In both the current and post-interconnection scenarios, the annual settlement of excess energy is, or will be, consistent with the least cost delivery of service and non-discriminatory rate making. The annual settlement of excess energy based upon marginal system costs therefore provides greater predictability in rate design than the alternative provided in this Request for Information.

Newfoundland Power believes that predictability and freedom from future controversy are, to the extent possible, advantageous features in rate design. The Company observes that rate *predictability* does not equate to rate *stability*.

Based upon the current cost outlook for the Island Interconnected system, Newfoundland Power does not expect future rates to be stable. This was not, in Newfoundland Power's view, sufficient reason to ignore rate predictability in its design of the Net Metering Service Option. Bonbright's *Principles of Public Utility Rates* ("Bonbright") has referred to the inter-relationship of rate predictability and rate stability as follows:

> In ratemaking, the attribute of *predictability,* is more important than *stability* per

> se. Time-of-use rates, for example, are not stable (in a strict sense), but are predictable and, most would agree, desirable. One could certainly argue that ratepayers should be given the information they need to *predict* rates accurately. However, this does not imply a necessary need to keep rates stable at the expense of otherwise efficient pricing.[1]

Newfoundland Power believes the improved rate predictability associated with annual settlement based upon marginal costs is a decided advantage over the use of retail rates as proposed in this Request for Information.

[1] See *Principles of Public Utility Rates (2nd ed.)*, Bonbright, Danielsen and Kamerschen, Public Utilities Reports Inc., March 1988, page 382, et. seq.