Q. Under Section 3 of the *EPCA*, *"It is declared to be the policy of the province that*
(a) the rates to be charged, either generally or under specific contracts, for the supply of power within the province
(i) should be reasonable and not unjustly discriminatory,
(ii) should be established, wherever practicable, based on forecast costs for that supply of power for 1 or more years…
(b) all sources and facilities for the production, transmission and distribution of power in the province should be managed and operated in a manner…
(iii) that would result in power being delivered to consumers in the province at the lowest possible cost consistent with reliable service."

According to the Application Hydro was aware in December 2007 that the normal operation of the Rate Stabilization Plan, as it had been approved by the Board, *"…could cause significant rate volatility for the Island Industrial Customers."* As the interim rates requested at that time were not based on either test year costs or on a methodology that has been approved by the Board, and as Hydro has now applied to finalize these rates, please give the rationale as to why these interim rates can be considered reasonable, as required under the *EPCA*.

A. Section 4 of the EPCA reads as follows:

Implementing Policy

4. In carrying out its duties and exercising its powers under this Act or under the Public Utilities Act , the public utilities board shall implement the power policy declared in section 3, and in doing so shall apply tests which are consistent with generally accepted sound public utility practice.

Applying generally accepted sound public utility practice requires an adherence to the principles of rate design. It is well recognized that good rate design takes into consideration its sometime competing objectives – for instance, an overly strict adherence to the cost causality principle may give an outcome that is considered harsh, heavy handed, or unfair. Thus, rate design outcomes such as lifeline rates are sometimes implemented to ensure that a basic amount of electricity can be available to everyone at an affordable price, even though lifeline rates are known to under recover the costs incurred in providing that level of service.

The following is an excerpt from direct testimony given before this Board in the 1992 Referral by Newfoundland and Labrador Hydro for the Proposed Cost of Service Methodology, per Dr. Robert Sarikas, being examined by Geoffrey Young (transcript, September 14, 1992, tape # 004, page 2):

> *Q. Will you please discuss the relationship between rate design objectives or goals and ratemaking methodologies?*
>
> *A. Possible goals or objectives of rate design include at least the following: meeting the annual revenue requirement, equity or fairness, economic efficiency, simplicity and understanding of the rate form, conservation of resources, stability, social goals, administrative ease, employment, and the protection of the environment. While the rate designer may not give weight to all of these objectives, indeed many of them are conflicting, they have been espoused as goals of rate design in rate proceedings and published articles. Methodologies include cost analysis both embedded and marginal, along with various methods of allocation useful in fully distributed cost studies, and market studies useful in assessing value of service. Rate forms*

> *useful in rate design include flat rates, declining block rates, inverted rates, Hopkinson and Wright demand rates, and combinations thereof. These methodologies and rate forms are tools of rate design that are useful in working toward one or more of the above objectives or goals. As an example, any effort to achieve economic efficiency through rate design would call for the use of marginal cost analysis or the use of allocation methodologies in embedded cost of service studies that give weight to cost behaviour. Emphasis on the goal of fairness, particularly if fairness is defined as giving weight to allocated costs, may suggest one of the numerous methods of capacity cost allocation. Thus, methods themselves are not right or wrong per se. They are only proper or improper, measured in terms of how they aid in attaining the desired objectives.*

In the Board's February 1993 Report arising from the Referral by Newfoundland and Labrador Hydro for the Proposed Cost of Service Methodology, the Board referred to a response to an Information Request (GCB-14(a)) provided by Dr. Sarikas where he said:

> *Rate design objectives were said to include: meeting the revenue requirement, fairness, economic efficiency, simplicity and ease of understanding, conservation of resources, stability and gradualism, social goals, administrative ease, employment, and protection of the environment.*

Among the generally accepted rate making objectives, as referenced by Bonbright and others, is stability or the avoidance of rate volatility. Fuel adjustment formulas are regulatory devices designed to assist customers and utilities to account for the impacts of sudden changes in commodity prices, weather, hydrology, etc. The RSP

was designed to smooth the rate volatility that would be occasioned by the direct reflection in rates of changes in fuel prices and other energy cost factors. Unfortunately, due to the unanticipated sharp decreases in Industrial Customer consumption in recent years due to the closure of the Abitibi paper mills and the reduction in production at the Corner Brook mill, the effect of the RSP has been to cause, not mitigate, rate volatility. Ensuring that the RSP achieved its intended effect has required a number of RSP rule changes over the years and, on one occasion, has required the infusion of $10 million from the Government.

Retaining rates at present levels during these times of extreme volatility in the Industrial Customer class load has the advantage of achieving rate stability. This is preferable to changing rates in accordance with the RSP rules that would otherwise apply which would result in unprecedented instability in rates. (Refer to the charts shown in Hydro's covering letter to its Application.) Additionally, freezing rates has also allowed a period of time where further changes in the pulp and paper sector load have become known. This additional time has allowed an opportunity to further analyze and review the fairness of the allocation of the windfall savings reflected in the Industrial Customers RSP load variation. Please also refer to NP-NLH-9.