Q. **Reference: Volume II, Exhibit 9: Cost of Service Study / Utility and Industrial Rate Design Report**

Page 10 of Exhibit 9: *Cost of Service Study/Utility and Industrial Rate Design Report* states…

"Rate designs will incorporate an element of revenue/price stability, certainty, predictability and understandability. This will include consideration of marginal costs over a number of years into the future."

Given that Hydro is proposing a 4.8% *decrease* in wholesale charges to Newfoundland Power, please explain in detail how an *increase* in the demand charge from $4 per kW to $9.12 per kW (128%) and an *increase* in the marginal energy rate (i.e., the excess rate) from 8.805¢ to 10.400¢ per kWh (18%) is consistent with each of the principles of revenue/price stability, certainty, predictability and understandability and considers marginal costs over a number of years into the future (i.e., gives consideration of marginal costs of a Labrador Interconnection). (Volume II, Exhibit 9, Page 10)

A. Insofar as the increase in the demand charge from $4.00/kW to $9.12/kW is concerned, the lower than cost demand charge of $4.00/kW was arrived at principally through negotiation in Hydro's 2006 GRA and was reflected as a lower rate in recognition of the NERA marginal cost study. The balance of the demand-related costs was collected in the energy component of NP's rate. The proposed demand charge of $9.12/kW is based on the cost to serve in Hydro's Cost of Service study, and is consistent with the demand rate proposed for the IC . This is not inconsistent with marginal cost principles, as when the Labrador Interconnection is completed and given the future elimination of Holyrood fuel costs with the replacement energy coming from Muskrat Falls (a hydroelectric source), energy

costs may decrease and demand costs may increase. The rationale for the increase in the energy rate to $0.10400 is fully explained in Section 2.2.4 of Exhibit 9.

Subsequent to the approval of the present rates to NP in Hydro's 2006 GRA, significant changes have occurred, e.g., fuel prices have escalated and the Labrador interconnection has been initiated. Incorporating these changes in NP's rate structure more properly positions the rate to a forward-looking perspective in terms of the rate principles indicated.