Q. Given the magnitude of the forecast capital budgets for 2012-2016 and the potential rate impacts on customers are there alternatives available to smooth the projected rate impacts? Please explain in detail.

A. The capital budgets are one aspect of Hydro's medium-term outlook. The potential Labrador Interconnection will also have an impact on medium- and long-term electrical supply, and once a decision is reached, it will change Hydro's medium-term capital spending, and likely operational spending (Holyrood fuel vs. Labrador Interconnection costs). Hydro believes that these matters should be considered together in determining the potential rate impacts, and expects to have dialog with the Board and its customers as the future becomes clearer.

Hydro acknowledges the importance of rate stability and the need to avoid intergenerational equity issues, while continuing to provide customers with reliable and cost-effective electrical supply. In this regard, Hydro recognizes that balancing rate design objectives with reliability and operational requirements over the next few years can present a challenge and intends to fully examine options in concert with other parties.

In terms of potential options, Hydro notes that depreciation associated with the 2012-2016 capital projects already provides a smoothing of the costs. Hydro also attempts to avoid unnecessary rate impacts by proposing capital projects at the required time, rather than advancing the capital expenditures. Timing is not seen as having a very significant impact on rates since they are recovered over the long-term through depreciation expense. By advancing costs, ratepayers incur costs before necessary, gaining rate stability, but a higher cost compared to least cost timing. Delaying costs may smooth rate impacts, but do so at the cost of violating constraints or jeopardizing reliability.

Options for rate smoothing other than timing that Hydro has considered include:

- Decoupling of rates from costs

  As an example, Hydro notes that Nova Scotia Power's press release of May 13, 2011 concerning its General Rate Application, filed on that day included the following statement:

  "NS Power has publicly proposed a three-year plan that would hold price increases to 4 percent per year for 2012 to 2014. If discussions with customer representatives produce an agreement-in-principle for such a plan, NS Power will add it to the filing and request approval from the UARB."

  Based upon the proposed settlement announced on September 19, 2011 by Nova Scotia Power, it appears this three-year plan was not settled upon with customer representatives, but Hydro considers such a methodology may be prudent. It should be noted that such an approach would not reduce costs; rather it would lessen the magnitude on annual rate changes.

- Funding of costs outside of rate base

  Hydro has no information to indicate that an external party would wish to underwrite or subsidize revenue requirement or rates arising from capital expenditures. Hydro notes that it considers all of the costs associated with its capital as reasonable, prudent and properly allowable under the Public Utilities Act.

In summary, Hydro does not yet have adequate data to consider potential medium-term rate impacts, but intends to consider, in consultation with the appropriate parties, rate impacts and potential smoothing mechanisms.