

NOVA SCOTIA UTILITY AND REVIEW BOARD

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NOVA SCOTIA UTILITY
AND REVIEW BOARD

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IN THE MATTER OF: The *Public Utilities Act*, R.S.N.S.,
1989, c.380, as amended,

- and -

IN THE MATTER OF: An Application by Nova Scotia
Power Incorporated for approval of a
Load Retention Rate.

CLOSING SUBMISSION OF SEMPRA ATLANTIC GAS

1. INTRODUCTION

The issue is not whether Nova Scotia Power Incorporated ("NSPI") should be given more flexibility to compete with natural gas; the issue is how best to ensure that the flexibility granted to NSPI enhances rather than distorts, or worse inhibits real competition in the energy marketplace.

It is the position of Sempra Atlantic Gas Inc. ("Sempra Atlantic") that:

- a. NSPI should be allowed to have rate offerings that enable it to respond to competitive situations;
- b. The Load Retention Rate ("LR Rate") proposed by NSPI does not have adequate rate payer safeguards; and
- c. The terms and conditions of the offering of an LR Rate should ensure that it be pro-competitive not anti-competitive.

Sempra Atlantic does not oppose, in principle, the offering of an LR Rate by NSPI, but in its present form, the LR Rate proposed by NSPI neither offers adequate ratepayer safeguards nor promotes real competition. Without amendments, the proposed LR Rate is not in the public interest.

2. THE PUBLIC INTEREST

NSPI's application is brought pursuant to section 64 of the *Public Utilities Act*:

- 64(1) No public utility shall charge, demand, collect or receive any compensation for any service performed by it until such public utility has first submitted for the approval of the Board a schedule of rates, tolls and charges and has obtained the approval of the Board thereof;
- (2) The schedule of rates, tolls and charges so approved shall be filed with the Board and shall be the only lawful rates, tolls and charges of such public utility until altered, reduced or modified as provided in this Act.

Even with the advent of natural gas, NSPI will remain a monopoly for most of its customers. As a result, requests such as the present one for an LR Rate should receive great scrutiny. NSPI's purported efforts to be "competitive" should be as transparent as possible given its monopolistic power.

With a competitive desire, NSPI says it has proposed rates that the evidence shows will result in lower electricity rates for a very small number of large industrial customers (perhaps as few as three or four). It is very clear, however, that the cost of these discounts may be placed upon the remaining residential, commercial and industrial customers of NSPI. These customers, if NSPI has its way, and if NSPI cannot mitigate this loss through other measures, will eventually face higher power rates.

NSPI, during the course of its evidence, talked of "customer choice". It said its LR Rate proposal was to give customers a choice. Given that the proposed special rate is available only to those companies which have both the technical and economic ability to engage in co-generation, the vast majority of NSPI's customers do not, and will not in the monopolized electrical utility market, have an alternative choice for most of their electric power needs. The implementation of an LR Rate will not grant any additional choice to any of those consumers.

It is this monopolistic control that NSPI exercises over the majority of its customers that makes the Board's role in this Hearing so crucial in ensuring the public interest is met by protecting rate payers and promoting healthy competition.

Principles such as those first enunciated in *Board of Commissioners of Public Utilities v. Nova Scotia Power Corp* (1976) 75 D.L.R. (3d) 72 at p. 77 (N.S.S.C.A.D.), and oft times repeated, are very relevant to the public interest concerns raised by this Application under the *Public Utilities Act*:

The scheme of regulation established by the Act envisages and indeed compels control by the Board of all aspects of a utility's operation in providing a controlled service. Two great objects are enshrined – that all rates charged must be just, reasonable and sufficient and not discriminatory or preferential, and that the service must be adequately, efficiently and reasonably supplied to the public. Almost all provisions of the Act are directed toward securing these two objects – that a public utility give adequate service and charge only reasonable and just rates.

Applying these principles, the LR Rate as it is presently drafted by NSPI is not a just and reasonable rate and not in the public interest.

3. **NSPI SHOULD BE ALLOWED TO HAVE RATE OFFERINGS THAT ENABLE IT TO RESPOND TO COMPETITIVE SITUATIONS**

Open and fair competition in the energy market will benefit Nova Scotia.

During the Natural Gas Distribution Hearings, the Board heard a lot of evidence from a variety of interests that the introduction of natural gas to the energy market as a new competitive energy source would benefit Nova Scotia residents, businesses and institutions.

The LR Rate proposal is an indication that NSPI is reacting, as expected, to the threat of that competition. The UARB should do what it can to allow and foster that competition. Provided that NSPI's reaction to competition is a proper one through a fair, reasonable and efficient LR Rate, then the public interest will benefit from the competition that ensures.

Sempra Atlantic is not opposed in principle to an LR Rate as part of NSPI's response to competition. It is very reasonable for NSPI to want to propose rate offerings that will seem to make it more competitive. However, the public interest requires that in doing something reasonable (i.e. responding to competition), NSPI does not put forward an unreasonable proposal.

4. **THE LR RATE PRESENTLY PROPOSED BY NSPI DOES NOT HAVE ADEQUATE RATEPAYER SAFEGUARDS**

NSPI's rate offering creates distorted incentives and imposes the burden on the UARB to sort out the results. The proposed LR Rate imposes no requirements on LR Rate customers. This could potentially encourage some customers to create dubious "analyses", showing they have competitive alternatives in order to secure lower rates.

The LR Rate, as proposed by NSPI, completely insulates NSPI's shareholders, thus not deterring NSPI from providing unnecessarily deep, discount rates to LR Rate customers. The UARB is expected to act as backstop to protect the remaining ratepayers, but without the benefit of input of other parties from whom these "secret rates for secret customers" are to be kept confidential.

The Board must reject this approach. An LR Rate will only be beneficial if the key parties' incentives are properly aligned with the public interest. The Board's expert, Mr. Kumar, summarized concerns shared by Sempra Atlantic, when he stated in his Pre-filed Evidence at p. 20:

NSPI's proposed LR Rate provision is a proper response to a competitive market. However, NSPI's proposal lacks certain customer protection provisions...

Sempra Atlantic agrees with and supports the UARB's adoption of the eight recommendations made by Mr. Kumar at pp. 20-21 of his Pre-filed Evidence. In approving an LR Rate offering by NSPI, Sempra Atlantic urges the UARB to incorporate Mr. Kumar's recommendations within the approved tariff.

The Board's expert, Mr. Kumar, represented no vested interest. He approached the issues raised by an LR Rate offering in an arm's length, objective and informed way that should be viewed as quite helpful in determining what is in the public interest.

It is particularly noteworthy that both NSPI's Supplementary Evidence and the answers given by the NSPI Panel in cross-examination that purported to respond to Mr. Kumar's recommendations were as vague as they were weak. By way of example, the NSPI Supplementary Evidence purports to respond to Mr. Kumar's eight specific recommendations. At p. 3 Mr. Whalen says:

NSPI has concerns with a number of these conditions **including, but not limited to**, conditions 2, 3, 6 and 8. [Emphasis added]

The evidence goes on to briefly discuss conditions 2, 3, 6 and 8 but is silent as to the other four conditions.

From a public interest perspective it is unhelpful to simply dismiss the well-reasoned recommendations of an independent expert by indicating only that one has concerns "with a number of" those recommendations, talking about some of those but leaving the rest hanging.

NSPI's evidence is even unclear regarding the recommendations that its witnesses do specifically identify as being objectionable. For example, with regard to Recommendation 2, the NSPI Supplementary Evidence at p. 3 lines 3-7 states:

Condition 2 would make the rate available “at the time the customer can possibly install its own generator”. NSPI agrees that the in-service date of the customer’s generation must be a factor in the determination of the Load Retention Rate. However, there may circumstances where it is appropriate to permit some of the benefits of the Load Retention Rate to be realized prior to that in-service date.

The NSPI witnesses were pressed on cross-examination for an indication as to what possible “circumstances” would justify lowering the rate at the expense of other captive customers before the Load Retention customer has an alternate fuel possibly available. No clear answer was forthcoming.

In cross-examination all the NSPI witnesses could indicate was that NSPI wanted some flexibility to determine the date (see Transcript pp. 66-67 Q/141-143).

141.Q. But I just want to be clear, though, to return to your two points of a moment ago where you indicated that you wanted the flexibility ---

A. (Huskilson) Yes.

142.Q. --- and keeping in mind Mr. Kumar’s recommendation. If you’re given the flexibility because of difficulties in determining dates ---

A. (Huskilson) Yes.

143.Q. --- do you nevertheless agree that you will not drop the price prior to the customer possibly being able to install his own generator?

A. (Huskilson) Given that we have flexibility to determine that date, I think that’s a fair situation.

It was only during the cross-examination of Dr. Rosenberg, testifying for Stora Enso, that it was further proposed that this recommendation should not prevent the imposition of an LR Rate prior to the alternate energy actually becoming available, provided the rate was calculated on a net present value basis.

The lack of clear evidence from NSPI as to exactly what it is seeking in an LR Rate makes plain the importance of the Board carefully redrafting the LR Rate offering to ensure that the rather broad and sometimes vague language presently

used by NSPI in the proposed tariff is not left to run contrary to the interests of the captive customers of NSPI.

NSPI has not been able, in its Pre-filed Evidence, cross-examination or in Information Responses, to provide any useful guidance on how rates will be determined except through the generalities of the conditions in the proposed tariff. Would a customer take firm or interruptible service under the LR Rate? Would local distribution constraints affect the negotiated rate? Would short-run or long-run marginal costs apply? Will contract terms be short or long? Would rates be fixed, formula driven or indexed? The list goes on, but NSPI's answer always seems to be the same; it will depend on the circumstances. With no disrespect intended, NSPI's filing is opaque and amorphous. The public cannot see what is inside it and does not know what shape it actually will take.

NSPI certainly needs flexibility to adapt to customer circumstances. However, there are other parties involved in these events, and NSPI's proposal is far too one-sided. Ratepayers have a right to know that they really do benefit from these LR Rate contracts and NSPI's assurances alone will not satisfy those concerns. Similarly, other market participants have a right to know at least some aspects of the regulatory framework they are dealing with. Why should, for example, manufacturers of co-gen equipment spend time in Nova Scotia trying to sell, if NSPI will simply wait them out and then match their offer? A monopoly like NSPI wields tremendous market power. There needs to be clear guidelines that reassure ratepayers and present a rational and coherent regulatory framework for market participants.

As Mr. Kumar rightly points out in his Pre-filed Evidence, NSPI has the responsibility of proving that it needs this rate offering in this specific form and yet its Application did not:

- State potential revenue losses
- Accurately analyze rate information from other jurisdictions
- Address the competitive electric market, or
- Provide any specific basis for its LR Rate proposal.

Mr. Kumar, in his evidence, also went on to cite very specific shortcomings in the terms proposed by NSPI for its LR Rate. Semptra Atlantic agrees with the thrust of his evidence, which is that the shortcomings must be addressed before any LR Rate is approved. Several of these will now be referred to in more detail.

A. The need for a clearly stated price floor.

As an expert, Mr. Kumar read the wording of the NSPI proposal as not specifying any minimum rate level. NSPI suggests there will be a price floor but that the "floor" will differ from customer to customer. In spite of that, NSPI in its Pre-

filed Evidence cited the 1996 NSPI rate case testimony of former Board expert, Dr. Chamberlin:

The utility must follow regulatory guidelines concerning eligibility, **price floors** and in some cases contract terms. [See: NSPI, Pre-filed Testimony of Mr. Huskison, p. 5. Emphasis added]

At that time Dr. Chamberlin in his Prepared Testimony also said (See Sempra IR-4, Chamberlin Prepared Testimony, p. 17):

I indicted that for utility rates to be considered efficient they must reflect marginal cost. Marginal cost can be measured either over the short-run or long-run. For rate design purposes, the choice depends on the length of the contract or “compact” a utility has with its customers. For example, if the utility sells power on the spot market, short-run marginal costs are appropriate because there is no obligation to serve and no need to make resource investments on a customer’s behalf. If the utility expects to continue supplying the customer far into the future, then long-run marginal costs are appropriate.

In his cross-examination (also found as part of Sempra IR-4; see pp. 2760 and 2764), Dr. Chamberlin indicated:

... My concern is not with allocation, it is with getting the price signals right. And I think that’s important because **if the prices don’t reflect marginal costs, they’re inefficient and the whole system produces less value than it can.** I think that’s the issue that I’m concerned with.

... I think you could say that a number of customers who are aggressively seeking discounts these days are taking advantage of the fact that wholesale markets and spot markets and all those kinds of markets are very competitive and very soft today. I think the issue is what do you do about that. I think there are two choices. One is you can be responsive to it and try to find ways to retain those customers, or you can say, “Well, go take advantage of somebody else’s spot market.” And the question to address is, “Are you better off letting the customer go or is everybody better off finding ways to keep him?” I would think, **as long as they’re paying, you know, over the marginal cost and that the appropriate time commitment is addressed, that everybody is better off by keeping him.** [Emphasis added]

NSPI asserts that the wording of its proposed LR Rate clearly defines a price floor. All of the experts involved in this case apparently missed this clarity. With respect to NSPI, it is not clear that costs are recovered by its rate offering though all of the experts seem to agree that marginal costs must be recovered. To do otherwise, would be to allow NSPI to provide service below cost which is clearly not in the interests of ratepayers or the public.

Dr. Rosenberg, for example, in his Pre-filed Evidence (p. 9) indicates with respect “competitive alternative rates” (“CAR”):

- Q. Are there any features that are common to all CARs?
- A. Yes, there is one feature, that to the best of my knowledge, is universal. Regulators require that other customers be better off as a consequence of the CAR than they would have been absent the special rate. Sometimes this is stated explicitly. Other times it is expressed as a condition that the rate be greater than the incremental cost of providing the service. Occasionally the regulators will stipulate a minimum amount by which the rate must exceed that incremental (or marginal) cost. Sometimes the rate requires that the customer make a positive contribution to the utility’s fixed cost. These are all different ways of saying the same thing. Also, more often than not, the rate gives the utility the ability to negotiate an individual rate, including broadly flexible price and terms arrived at on a case-by-case basis, rather than impose a one-size-fits-all formula.

Furthermore at pp. 12-13 of his Pre-filed Testimony, Dr. Rosenberg states:

- Q. Is it common to impose this “indifferent condition” in a competitive alternative rate?
- A. It is not unheard of, but it is my definite impression that most CARs just allow the parties to negotiate a rate based on the specific circumstances of the situation, subject only to the conditions that I previously indicated were ordinary for a rate of this sort. I believe the usual approach is typified by the Central Illinois Public Service Company Tariff (Rider 16, included in the Response to the Board’s IR-19). The section of that tariff to which I refer was obliterated on the copy that NSPI included in its Responses. The obliterated portion of that tariff reads, in part (see Pre-filed Testimony at p. 9):

Revenues from service to the Customer under such contract shall be greater than the applicable incremental customer, facility, energy and capacity cost to serve such Customer, ensuring a positive contribution to fixed costs.

I would commend this language to be used in lieu of the third bullet in (1) of the AVAILABILITY section of NSPI's Load Retention Rate.

The rate survey information filed by NSPI in response to UARB IR-19 contains numerous examples of price floors. See for example:

- Alliant Energy – See first page of tariff, para. (4)
- El Paso Electric – See first page under Monthly Rate – note this tariff also limits the length of the contract and the maximum amount that can be taken under the contract.
- PPL - See Second Revised Page No. 19E General Conditions para. 5.
- SoCal Edison – This tariff, although included in NSPI's survey, is not really relevant to the point NSPI is trying to make as the tariff in that case is for customers that are about to leave the electrical system for other than competitive reasons (and in this regard see the opening sentences of Sheet 1 of 4). Nevertheless the tariff establishes a price floor at marginal cost (see Sheet 4 of 4, Special Conditions 10-11).

Thus, there are numerous specific examples of regulators who to protect other customers have stipulated a specific price floor. It appears to be a standard provision in numerous jurisdictions that rates on discounted contracts should exceed marginal cost.

Since NSPI has requested confidentiality of the terms and conditions of the specific LR Rate contracts, guidelines such as very clear price floors will serve to demonstrate to the public that its interests are being served.

Mr. Kumar's Pre-filed Evidence (pp. 15-16) recommended that not only should there be a minimum price floor but that companies that choose an LR Rate as opposed to co-generation should pay a premium for not having to tie up significant sums of capital that could be used for other purposes. Such customers who forego building and operating co-gen facilities also get other benefits such as avoiding construction problems and other uncertainties, and not having to engage

in work that is not within the customer's core competency. This makes good business sense and so Semptra Atlantic agrees that the LR Rate should include the price floor recommended by Mr. Kumar of at least 10% above the higher of NSPI's short or long-term marginal costs.

B. There should be guidelines for the minimum and maximum length of LR Rate contracts.

The terms of the LR Rate offering should require that each individual contract be subject to a minimum and maximum term. With regard to maximums the terms should not be beyond the reasonable planning horizon of both NSPI and the customer in question. If contracts are allowed to go beyond the reasonable planning horizon of NSPI, then the Board will not have any reliable forecast of marginal cost.

A number of parties discussed the role unbundling of electric services may play in the future. Mr. Kumar suggested that all LR Rate contracts should end when competition is introduced into the electric market. The clear trend, as identified by all relevant testimony in this case, is toward unbundling. This will create more choices for customers and opportunities for savings in the procurement of electricity. Further, these savings and choices are created without demands from an incumbent monopoly for other customers to provide additional revenues to "make up" for the losses. In other words, a competitive electric market achieves the same ends as NSPI's LR Rate but without requiring rate payer subsidies or detailed Board review of complex negotiated contracts.

Mr. Kumar made a very simple yet powerful point. By signing long-term contracts with a small number of large customers, a significant portion of the electric load could be removed from the market. This will discourage suppliers, limit liquidity and hamper development of a competitive electric market in Nova Scotia. The Board must ensure that NSPI is not exploiting its current monopoly to position itself more favorably for this unbundled market. Contracts should not be allowed to run longer than the Board believes it will take to introduce unbundling into the electric market in Nova Scotia. Since this seems inevitable, but is not currently scheduled into the regulatory calendar, a length of four or five years seems to be a reasonable maximum contract length.

LR contracts should also be subject to a minimum term so that LR customers demonstrate their seriousness and are not just taking advantage of NSPI and the then current market conditions.

C. The LR Rate contract should include a minimum and maximum take provision.

LR customers who qualify for this discount rate on the assumption of a certain load should have to commit to a minimum energy consumption based upon the

customer's historical consumption patterns. Other captive customers of NSPI are expected, if NSPI gets its way and there are no other mitigating circumstances, to foot the bill so the least the LR customers can do is to also assume some of the risk through a minimum take provision.

It is not in the public interest to give large industrials a free ride by playing off the power company with idle threats to leave the system. A maximum load should also be imposed in the contracts. Customers should not be able to use this rate offering to get artificially low incremental rates.

D. The LR Rate should be unbundled.

Other services, such as ancillary or backup services should not be bundled into this rate. This will help ensure that NSPI does not unfairly take advantage of its situation as a fully bundled utility to provide special discounts on other aspects of service that are more difficult for regulators to value and potential competitors to meet.

For instance, if a customer receives interruptible service in a LR Rate, then the customer should not get any special treatment when service is curtailed. The contract should also reflect the current quality of service the customer receives. A customer currently taking interruptible service should not receive a price decrease along with firm service.

One of the goals should be to ensure, to the greatest extent possible, that competition is transparent. Preventing NSPI from bundling in other services with this discounted rate will help serve the goal of transparent competition.

E. The confidentiality provision needs to be weighed more towards the public interest.

During cross-examination by Sempra Atlantic counsel (See Q. 222, pp. 97-99), NSPI agreed that it would provide the detailed information Mr. Kumar says NSPI ought to provide (Pre-filed Testimony p. 19):

However, I should emphasize that a customer requesting LR Rates should be required to provide all the relevant data and information to NSPI which is needed for the LR Rate. Further, all the data, information and analysis needed and used by NSPI's acceptance of a customer's request for LR Rate should be made available to the UARB.

While Sempra Atlantic does not oppose the non-disclosure of individual LR Rate contracts, the discussion during cross-examination showed there is no evidentiary basis or public policy argument for opposing public disclosure of summary reports showing:

- The names of all LR customers
- The number of LR customers
- Volumes of energy under LR contracts
- Average rates including level of discounted service

NSPI is not just another competitor. Its desire for contract confidentiality needs to be weighed against the need for ensuring transparency in pricing and providing service in a way that benefits competition overall without unduly disadvantaging NSPI. Such summary reports, as has been suggested, provide important information without harming NSPI or its potential LR customers confidential needs.

A developing and evolving competitive market needs this type of information, and a protected, regulated monopoly like NSPI should have to provide at least this level of information. Otherwise, there is no way for other market participants and ratepayers to evaluate whether NSPI's conduct is truly benefiting all of its customers.

During cross-examination NSPI could not give any reason for its "fears" that there would be difficulties if customers are themselves named. Perhaps the greatest evidence against the assertion that LR customers would be harmed if identified is the fact that the largest potential LR customer, Store Enso, voluntarily came forward to be joined as a party in this proceeding.

Board Counsel's cross-examination of the NSPI Panel highlighted valid concerns about both the extraordinary nature of NSPI's request ("secret rates for secret customers") and the lack of evidence to justify NSPI's position (See Transcript, 13 Jan 00, pp. 395-399).

In light of the concerns and the lack of evidence supporting NSPI's request for total secrecy, the Board should, in approving any LR Rate offering, require at least the periodic public filing of summary reports as suggested above.

G. Summary of Required Safeguards

To adequately, fairly and reasonably protect captive customers and to promote real competition and efficient rates, an LR Rate offering should not be adopted until its wording incorporates:

1. The clearly stated price floor recommended by Mr. Kumar.
2. Guidelines for minimum and maximum contract length.
3. Minimum and maximum take provisions based on the customer's historical consumption.

4. A restriction on bundling in other services with the LR Rate offering.
5. A confidentiality provision that allows public summary reports.
6. The other recommendations of Mr. Kumar.

5. THE LR RATE SHOULD BE PRO-COMPETITIVE AND NOT ANTI-COMPETITIVE

The Board's expert, Mr. Kumar, in his Pre-filed Evidence at p. 14, states:

It may not be unreasonable to an entity to lower its rates to avoid a loss of customers to its competitors, however, it is not reasonable for such an entity to engage in competition at the cost of its captive customers in a monopolized market. In a monopolized utility market, regulators generally make sure that a utility does not use rates solely to strengthen its monopoly power and inhibit competition, especially at the cost of its capital customers. Further, the UARB should make sure that the LR Rate is made available to all customers on non-discriminatory basis and is not used by NSPI's affiliates in which NSPI has significant financial interest.

Sempra Atlantic echoes these sentiments.

While the proposed rate offering itself is silent on who will bear the cost of discounted rates, NSPI's intentions are clear. In Sempra Atlantic IR-13 (4), NSPI was asked:

Does NSPI think it appropriate for shareholders to bear the risk incurred when offering discounts by way of a Load Retention Rate.

NSPI's response was "No".

In response to Sempra Atlantic IR-13 (5), NSPI tried to justify why customers should bear the risk rather than shareholders:

NSPI's business decision to seek the proposed rate is meant to allow it to reduce the real risk to its customers. It is not taking a risk for potential shareholder benefit.

The theme of business decisions and the assumption of risk were explored in cross-examination by Board Counsel beginning at p. 345 of the Transcript and running approximately ten pages. The issue raised was whether it is appropriate to look at the proposed LR Rate in isolation, rather than taking into account the history and circumstances that have lead us to a position where certain NSPI customers are able to provide themselves with an alternative electrical supply more cheaply than they can obtain from NSPI based on its current rates.

The position adopted by NSPI's witnesses seems to be that this situation should be blamed upon what they have described as relatively new combined cycle gas technology. In the end, however, they agreed that responding to such changes in technology was NSPI's responsibility:

- Q. Sure. But you'll agree with me when it comes to adapting to changing technologies and the ability to deal with changes in technology which have come about, that's something that rests in Nova Scotia Power's hands, it doesn't rest in the customers' hands?
- A. (Huskilson) I think facing technologies as they come forward is a response that a business has to make.
- Q. And as far as I am aware, this Board has never rejected or interfered with Nova Scotia Power's configuration of its system. Is that correct, as far as you know?
- A. (Huskilson) That seems like a reasonable statement, yes.
[p. 351]

Board Counsel went on to note, that inherent in the proposal put forward by NSPI were risks that rates would be set at a price that was lower than necessary because of faulty projections or assessments:

- Q. All right. So far we've been talking about the risk, that there will be a revenue loss associated --- the known revenue loss associated with the rate, but there is also another risk that the rate creates, and that is that you will wind up setting a price that is lower than necessary because of faulty projections with respect to either customer cost of self-generation or, on the other hand, projections of your own future costs which you're measuring their costs against. That's a risk as well, isn't it?
- A. (Whalen) It is a risk. [pp. 351-352]

NSPI's witnesses suggested that any such risks would be managed in the negotiation process between itself and the customers who would be receiving the LR Rates. Prompted by questions from Board Counsel, however, the witnesses conceded that the negotiation process would not eliminate risks, it would simply shift them from one party or another:

- Q. And that negotiation process will be all about shifting risks, or attempts to shift risks from one party to another, and you're going to wind up bearing some of those risks at the end of the negotiation. Whether the future projections are correct or not, some of those risks, unless you're very successful in negotiations, will wind up being borne by NSPI, will they not, either in terms of future fuel costs or whether or not the customers' initial projections were sound?
- A. (Huskilson) I think, in the end, the price that ends up being negotiated will relate to those risks. I believe that that's true. (pp. 353-354)

The bottom line is that NSPI's proposed LR Rate carries with it the risk of loss. In suggesting that NSPI shareholders should not bear this risk of loss, NSPI claims that circumstances have forced it to a point where this risk must be assumed, as a lesser evil than if NSPI were to do nothing and run the risk of loss of load on the system. In truth, however, this choice betwixt Scylla and Charybdis is the culmination of business decisions and assumed risks of NSPI to this point in time which cannot be overlooked.

From this historical perspective, it is very reasonable to suggest that NSPI shareholders should assume the risks of the LR Rate. Customers have had no control over the past decisions NSPI has made regarding technology. Prospectively those same captive customers will have no influence on the LR Rate negotiation process NSPI proposes or on ensuring the cost projections upon which those negotiations will be based are accurate. This also suggests the risk should lie with shareholders and not captive customers. Moreover, and still looking ahead, the NSPI shareholders also stand to benefit from competition and for that reason as well those shareholders ought to assume the risk of the LR Rate.

Dr. Rosenberg emphasized the importance of the Board's role when dealing with a monopoly utility (see Pre-filed Evidence p. 5):

The *raison d'être* for regulations is to protect customers from monopolistic practice. Good regulation is pro-competitive, not anti-competitive. Regulation itself is intended as a surrogate for competition. It stands to reason that when regulators can

encourage authentic competition, that – almost by definition – is regulation carried to its ideal.

The cross-examination of the NSPI Panel made it clear that the benefit of such a Load Retention Rate works as much to the benefit of shareholders as other customers. In the long-term it is to the benefit of NSPI's shareholders that the company retain as many of its customers and as much load as possible. The LR Rate proposal would seem to be consistent with NSPI's strategic corporate objectives. Since NSPI shareholders are thus the beneficiaries of the LR Rate, they should pay the costs.

It is not in issue that NSPI must have incentives that promote competition and competitive behavior. NSPI no doubt will indicate that the issue of who bears the cost of these discounted rates is a matter that can be addressed at the next general rate case. While that is true, NSPI has made plain its views both in cross-examination and in the IR Responses that it believes (all else being equal) its captive customers and not its shareholders should bear those risks.

The Board's expert, Mr. Kumar, has specifically recommended in this regard (Pre-filed Evidence p. 21):

NSPI should not be assured that it will be able to recover all losses caused by its LR Rate.

The notion that other ratepayers should finance the cost of these LR contracts is inconsistent with a truly competitive marketplace. Real competition requires that businesses be at risk. Allowing one player the ability to discount competitively but not suffer any consequences to its shareholders creates an unfair playing field. The incentive for NSPI would be to discount more than is necessary because its captive ratepayers will have to provide additional revenues leaving the shareholders of NSPI indifferent. A company acting in a truly competitive market place would have to take a reduction in its earning (all else being equal) to the discount. If NSPI wants to compete (as it says it does), then the consequences of competition must follow.

It is noteworthy that, during cross-examination of NSPI, it became apparent that while the NSPI witnesses understand that other companies now offering other forms of energy come to the market with the shareholders of those companies accepting the risks of price discounts, NSPI chose not to structure its LR Rate proposal so that its shareholders could both accept the risk but also take the benefit of any upside. Such a proposal would have been far more consistent with the desire to operate in truly competitive market place than the proposed scheme that captive customers bear the risk.

The idea that shareholders and not captive customers should be at risk is not new. Indeed NSPI relied upon the evidence of the Board's 1996 expert, Dr.

Chamberlin, to the effect that Dr. Chamberlin's views on flexible rates were consistent with NSPI's LR Rate proposal. As was pointed out in cross-examination the paragraph in Dr. Chamberlin's 1996 Pre-filed Testimony that immediately follows the testimony which was cited in NSPI's Pre-filed Evidence is informative in this regard. That testimony begins at p. 26 of Dr. Chamberlin's Pre-filed Evidence (attached to Sempra Atlantic IR-4 (1)):

Flexible pricing eliminates case-by-case review, but does not eliminate regulatory oversight. Utilities must document that a customer has a bona fide energy alternative and some commissions require that utilities provide detailed transaction data, such as breakdowns of demand and energy charges, data on the utility's short-term and long-term marginal costs, and calculations showing that revenues under the contract will exceed the utilities variable costs. **Several commissions also require that stockholders share a percentage of any lost revenues.** [Emphasis added]

Another example supportive of the view that shareholders ought to bear the risk of this competitive behaviour is found in a case cited by NSPI in its Pre-Hearing Brief and reproduced in its Book of Authorities, namely *Re Northern Indiana Public Service Company* 89 PUR 4th 385, a decision of the Indiana Utility Regulatory Commission. At p. 393 it is noted with respect to the Generation Alternative Rider ("Rider GA") being considered that:

Rider GA is somewhat remedial in nature as it is designed to defer on-site industrial generation at a time when NIPSCO's system has excess capacity. It is clear that in the absence of Rider GA, on-site generation would be constructed resulting in unnecessarily duplicative expenditure resources for a period of time. As designed, the risk of loss produced by Rider GA is placed on NIPSCO's shareholders from the date of the approval of the Rider to NIPSCO's next general rate proceeding.

(See also pp. 394-395. As a further aside, it is also interesting to note at p. 386 that the tariff in that case required that Rider GA contracts be limited to a five year term.)

Another example of a Regulator indicating the importance of ratepayers being protected from under-recoveries of power supply costs and other charges and indicating that the shareholders of a utility may be called upon to absorb these costs is the decision of the Michigan Public Service Commission in the matter of *Consumers Power Company, Application to Approve a Special Contract with the Upjohn Company*, Case No. U-11001, which is found as part of the attachments to UARB IR-19 (see Decision, pp. 4-5).

Mr. Kumar's Pre-filed Testimony at pp. 8-9 cites further authorities from Pennsylvania, New Hampshire and Virginia all supporting the assertion that recovery of revenue loss from other captive ratepayers should not be guaranteed.

Mitigative measures to limit the cost of the discounts that will be incurred through the implementation of an LR Rate are entirely within the control of NSPI and its shareholders. The captive ratepayers of NSPI have no ability to influence the business decisions that NSPI may take with regard to measures such as those outlined by Mr. Kumar and others during this Hearing. Given that lack of ability by captive ratepayers to influence NSPI's actions, and given that NSPI wishes to now act in a competitive marketplace, NSPI should not be able to use its monopolistic power to gain an unfair competitive advantage.

NSPI should be required to play on a level playing field by the same rules as other competitors. To do otherwise will not be reasonable or just.

By serving notice upon NSPI now that its shareholders and not captive ratepayers will bear the risk of this competitive action, the LR Rate will then serve as a pro-competitive and not anti-competitive force in the energy marketplace.

6. CONCLUSION

Sempra Atlantic, while agreeing that NSPI should be allowed to have rate offerings that enable it to respond to competitive situations, submits that the Board should not approve the proposed LR Rate without first amending it to include provisions to safeguard captive ratepayers and to ensure that the LR Rate operates pro-competitively and not anti-competitively. Leaving the NSPI proposed LR Rate unaltered would be contrary to the public interest, as the rate would not be just or reasonable.

All of which is respectfully submitted this 28th day of January, 2000.



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