

P-871.9  
(F2-4)

**LOAD RETENTION RATE  
POST-HEARING BRIEF**

**A. Introduction**

This is the submission of Stora Enso Port Hawkesbury Limited ("Stora Enso") to the Nova Scotia Utility and Review Board (the "Board") in respect of an application of Nova Scotia Power Incorporated ("NSPI") for approval of a Load Retention Rate ("LRR").

All parties to this Hearing would appear to be in favour of some form of LRR. All evidence is in favour of such a rate, and certainly there is no evidence to the contrary.

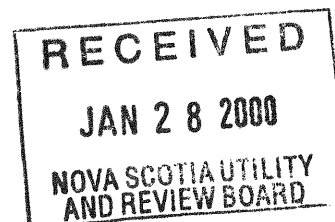
The central point is that a customer with the capability to self generate has the option of leaving the NSPI system, and if that customer chose to leave the system it would be to the detriment of all other customers. The objective of the LRR, therefore, must be to maximize the likelihood that an agreement can be made between the customer and NSPI -- subject of course to the underlying condition that the negotiated rate covers variable costs and a contribution to fixed costs.

Conditions which would inhibit free negotiation, and thus inhibit ultimate agreement on a LRR, were suggested to the Board by in direct and cross-examination evidence of Jatinder Kumar (expert witness on behalf of the Board). NSPI also proposed some conditions in its application.

In light of the fact that no party has filed or given evidence opposing the LRR, the only real issue before the Board is whether negotiations between NSPI and a customer should be conducted by the parties with maximum flexibility, or whether the Board should circumscribe those negotiations by preemptively establishing conditions or guidelines that must guide the parties in the course of their negotiations.

In the argument which follows, we will consider and make submissions regarding the following issues:

- the approval of the LRR;
- discrimination;



- timing for the implementation of a LRR;
- the availability of the LRR after the installation of long-term capacity;
- eligibility for open access and retail choice to LRR customers;
- minimum LRR;
- confidentiality.

## **B. Approval of LRR Rate**

The purpose of the LRR from the Utility's perspective was succinctly stated as follows:

The load retention rate is primarily initiated to protect customers of Nova Scotia from the possible loss of other customers and to be able to be competitive with other prices that the customers may be able to attain in other means, in alternate supplies.

**Testimony of C. Huskison, p.21, question 10**

From the LRR customer's perspective, the purpose of the LRR is to make the customer decidedly favour remaining with the Utility.

**Prefiled Evidence of Dr. Rosenberg, p. 11**

No evidence was provided which refuted the proposition that the LRR was to the benefit of the customers of NSPI. In fact, Mr. Kumar readily agreed that the LRR in general be approved.

**Testimony of J. Kumar, p.486, question 27**

Therefore, it is submitted that the Board endorse the implementation of such a rate.

## **C. Discrimination**

Although the customer on a LRR has a negotiated rate which is different from a rate on any posted rate schedule, that LRR is not unduly discriminatory. In fact, it is trite to say that any approved rate should not be unduly discriminatory.

A LRR would not be discriminatory just because different customers who find themselves in different circumstances pay different amounts under the rate.

**Testimony of J. Kumar, p.488, question 33**

As a result, it is submitted that there is no issue for the Board to consider as to whether the LRR, as proposed by NSPI, is discriminatory.

**D. Timing for the Implementation of a LRR**

Various parties explored the proposition as to whether the LRR should only be made available at the time a customer is in a position to install its own generation. A decision by a customer to leave the system and utilize its own generation is both a financial and an engineering based decision. Although it may take, for example, two years to put in place generating capacity, financial arrangements could be put in place to account for the delay in implementation, and over the term of the LRR leave the customer in the same financial position as if they had waited until the in-service date. The advantages of the latter circumstance are that the customer is able to enjoy sooner the benefits it would have otherwise had if it had self generated; NSPI retains a customer; and some portion of fixed cost is recovered leaving the other NSPI customers in a better position than if self generation had occurred.

Because the economic benefit associated with a LRR or self generation extends over time, the assessment of those alternatives must be based upon net present value. All witnesses were in agreement that it is possible to structure a LRR whereby the LRR would have present worth discounted over the life of the contract which would provide the same benefits to the customer as if the customer had waited until the possible in-service date to receive a LRR.

**Testimony of F. Hussey, p. 287, question from Board  
Member Harris**

**Testimony of F. Hussey, p. 306-308, questions 143-145**

**Testimony of Dr. A. Rosenberg, p. 483-485, question 113**

**Testimony of M. Whalen, p. 72, question 139**

**Testimony of J. Kumar, p. 488-489, question 34**

We take it from this evidence that all parties (including Mr. Kumar) would now agree that there should be no condition or guideline, such as Mr. Kumar's Condition No. 2 (p. 20 of his direct evidence), that "The LR rate should be made available at the time a customer can possibly install its own generator."

As for a condition requiring a "net present value" calculation based on the projected in-service date of the self-generation, it is respectfully submitted that this would be redundant. The principle of providing a net benefit to the utility is already explicitly stated in the rate as applied for, and the effect of timing differences is an inherent part of calculating any such benefit.

**Testimony of J. Kumar, questions 44-67**

**E. Availability of the LRR after the Installation of Long Term Capacity**

Mr. Kumar's Condition No. 3 (page 20 of his pre-filed evidence) states: "the LR Rate may not be made available after NSPI installs or acquires new long-term capacity."

However, during the Hearing, it seems clear that what Mr. Kumar meant by this condition was not that a customer must automatically be dropped when new plant comes into service, but simply that marginal capacity costs have to be taken into account in calculating the net benefit to the system of offering a LRR.

**Testimony of J. Kumar, p. 493-500, question 44-67**

With this proposition, all parties (or at least Stora Enso) can agree. For the same reasons as expressed under paragraph D immediately above, however, this proposition does not have to be explicitly stated, since all such system characteristics have to be taken into account in calculating net benefits.

Condition No. 3, therefore, should simply be deleted.

**F. Eligibility for Open Access and Retail Choice**

Stora Enso agrees with the proposition that NSPI should allow open access and retail choice to all of its LRR customers who could become eligible under any market restructuring which would provide for an open market in electricity. Any impact that this eligibility may have on the rate negotiated should, however, be left to the negotiation between the parties, and should not form part of the Board's consideration at this stage of approving the proposed rate, or even at the time the negotiated rate is approved by the Board provided, in the latter case, that the agreed rate is otherwise acceptable.

There was considerable discussion about this issue, particularly by Dr. Kumar (Transcript, page 551-564). Mr. Kumar seems to suggest that a long term contract entered into now, before the electricity market is opened up, could inhibit the opening up of that market, or tie it up even after it is opened. With respect, it is difficult to see how parties negotiating a LRR, who in so doing are acting in a completely competitive manner, are somehow engaging in "anti-competitive" activity. It is equally difficult to see how, after the market opens up, a voluntary agreement to sign up electricity capacity for some period in the future somehow "ties up" the competitive market. This argument entails a contradiction: it is to say that if, in a free market situation, I buy a certain portion of the stream of commerce, then to that extent my behaviour is anti-competitive. This cannot be; to so argue is to say that all purchases are anti-competitive. And the situation is not different for large purchases compared to small ones. Can it really be argued that someone who purchases 20% of the offshore gas supplies from Nova Scotia in the free gas market that now exists has "tied up" the competitive market? What is the difference between that situation and the electricity market?

**Testimony of J. Kumar, questions 217, 218**

Mr. Kumar also expresses concern about the inadequate manager of the purchasing company, who might not take into account the long-term possibility that markets might be freed up in future. He also says that it could be unfair to the utility, if the benefit of open markets to the utility in later years is somehow usurped because of some long term contract. With respect, sophisticated purchasers and vendors of electricity, such as are likely to take advantage of the LRR, should be allowed to make their own decisions in this regard. Placing conditions of this kind in the way of flexible negotiations merely amounts to the kind of "over-regulation" (that Mr. Kumar elsewhere

disparages), in favour of the view that regulation should mimic competitive markets as far as reasonably possible.

**Testimony of J. Kumar, question from Board member Harris**

**Testimony of J. Kumar, question 120-121**

## **G. Minimum LRR**

As stated above, the purpose of a LRR is, from a utility's perspective, to protect other customers by offering a competitive alternative to those customers who could self-generate; and, from the perspective of the potential LRR customer, to make that customer decidedly favour remaining with the utility. In negotiating the rate, the utility's objective is to push the LRR upward, and the customer's objective is to push the LRR downward. These competing objectives can only be resolved by negotiation which is unhindered as to the point of price equilibrium.

Three alternatives as to floor pricing were suggested to the Board:

1. Mr. Kumar's Condition No. 6, that the LRR should be at least equal to 10% above the higher of NSPI's short term or long term marginal cost.
2. NSPI's condition that the LRR should not be less than necessary to make the customer indifferent with respect to the options available.
3. Dr. Rosenberg's proposal that the LRR be freely negotiated to establish a rate that causes the customer to stay on the system and ensures a positive contribution to fixed cost.

We will consider the first two of these alternatives to show why the Rosenberg proposal is preferable.

### **(a) Mr. Kumar's Condition**

Under cross-examination Mr. Kumar could not provide any substantive reason for selecting the floor price of 10% above NSPI's marginal cost. Indeed, one can only conclude that the 10%

floor is arbitrary.

**Testimony of J. Kumar, p. 500, question 71**

Mr. Kumar was not aware of any other rate that imposes a 10% rule. With respect, the 10% rule is based on Mr. Kumar's own discretion, and not upon any substantive analysis. In fact, when pressed under cross-examination on what a utility should do if faced with a customer leaving the system if a LRR is not below 10%, Mr. Kumar responded that "something is better than nothing". Under cross-examination, Mr. Kumar abandons the 10% rule and advocates instead that the LRR should at least be a "significant positive contribution" which should be assessed by the Board at the time a contract is approved.

**Evidence of J. Kumar, p. 502-504, questions 74-78**

One of Mr. Kumar's concerns was to ensure that the utility negotiates effectively to obtain the highest possible LRR. There are, however, two acutely pressing incentives for NSPI to do just that. In the first place, NSPI cannot pass on its revenue loss to its other customers, unless and until a new rate structure is approved at a general rate hearing. In other words, NSPI's shareholders are stuck with any revenue shortfall for at least some period of time, which could indeed be lengthy. Naturally, NSPI would be anxious to reduce these losses to a minimum.

Secondly, in any general rate hearing, NSPI would be subject to close scrutiny by the Board to ensure that it has done its best in its LRR negotiations. (This issue could possibly come up at the stage in the LRR process where the Board approves the negotiated rate; but in Stora Enso's respectful opinion, that issue should really not occupy the Board at that time. Rather, the Board's concern at that stage should simply be to ensure that the utility and its other customers will receive a net benefit as a result of the negotiated rate.) If the utility has not shown due diligence, the Board certainly has the power to reflect any imprudence in setting the cost base. NSPI is thus under a second strong incentive to negotiate hard for the best possible rate.

**(b) NSPI's Position**

The rate proposed by NSPI includes the condition that:

“The price being offered to retain this customer is not less than necessary to make the customer indifferent with respect to the options available.”

In Stora Enso’s submission creates a term which is burdensome to administer, unnecessary within a competitive negotiation process, and is subjective, being inherently within the interest of the LRR customer. What about the situation where the LRR offered by the utility is equal to the customer’s cogen rate, but the customer still insists on some lower rate, failing which it will leave the system? The “indifference rate” is then that lower rate; and who is NSPI (or anyone else) to say when any customer has reached its “indifference rate”?

This is a subjective issue to the customer. The Board’s only concern is the public interest mandate, which is satisfied so long as there is a contribution to fixed costs. We grant that, when a customer threatens to leave the system unless it gets a rate below the cogen rate, NSPI might be sceptical about its real intentions. But, assuming the customer can establish to NSPI’s (and the Board’s) satisfaction that it really will leave the system, how is the public interest served by having in place an artificial preemptive condition that prevents agreement on an LRR at that lower level?

This rate condition is burdensome to administer because there are so many variables involved in calculating the cost to a customer of a co-generation project. It is doubtful that NSPI could calculate the exact price of the customer’s alternative, and therefore the point of indifference of the customer. In addition, there are a number of qualitative factors which would be considered within the assessment of the point of indifference.

**Prefiled Evidence of Dr. Rosenberg, p. 11**

Within a competitive negotiation process, the parties will likely negotiate and arrive at a price that is somewhere between the utility’s incremental cost and the customer’s cogen option. It is reasonable to argue that each party will have its own negotiating strengths and weaknesses which will not permit either party to drive the price to its absolute minimum or propel the price to its absolute maximum.

**Prefiled Evidence of Dr. Rosenberg,, p. 11**

Only the LRR customer can truly determine its own level of indifference. In any case, that customer will not be determining its point of price indifference, but rather the point where, taking a number of factors related to its business into account, not just the cost of self generation, the customer decides in favour of remaining with the Utility. This is a choice that can only be assessed by the customer and, with respect, not by NSPI or the Board. The Board is mandated to protect the public interest, which is already covered under the NSPI proposed rate condition that:

“retaining the customer’s load through a load retention rate is better for other NSPI customers than losing the customer in question.”

This condition means that retaining the customer’s load must make a contribution to fixed cost, and would thus be better for other NSPI customers than losing the customer in question. Implementation of this condition would fulfil the public interest mandate of the Board.

Looking at the evidence in respect of this issue as a whole, the only true guideline or condition to establish a minimum Load Retention Rate is that there be a contribution to fixed cost. Whether this condition has been met can be assessed by the Board at the time the rate is approved.

Therefore, it is submitted that the Board ought not to accept the condition proposed by NSPI.

## **Confidentiality**

The primary motivating factor for self generation is the current reality of cost reduction facing industry competing in a world market. If industry cannot compete effectively, it will not survive.

In assessing the viability of self generation, a business has to consider not only capital costs but all the other factors going into its strategy to meet the competition. If a business knows that these costs and other business information can become public, this will certainly be a disincentive to negotiate.

Moreover, given that an LRR negotiation is in the nature of a free market negotiation, and in such negotiations all information (including the name of the customer and the amount of the rate)

would certainly remain proprietary and confidential, the mind set of the customer is directed to the notion that this information should likewise remain confidential, notwithstanding that the utility is in this case regulated. Here again, knowing that this information could become public would be an inhibiting factor to negotiation.

Given that the objective of the LRR is to encourage customers to stay with the utility, rather than self-generate, it would seem counter-productive to require disclosure. It is presumably for this reason that the common practice in other jurisdictions, in particular the United States, is for the Board to keep confidential not only the negotiating details, the name of the customer and the amount of the rates. All such information is considered proprietary.

**Testimony of Dr. Rosenberg p. 466, question 60-62**

**Summary**

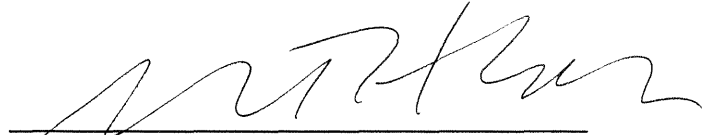
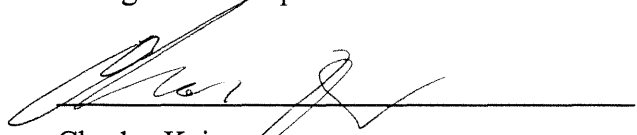
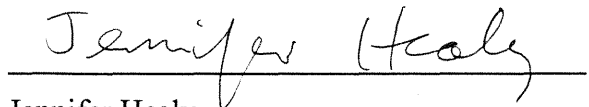
Based upon the foregoing, it is respectfully submitted that:

1. The Load Retention Rate as proposed by NSPI be approved by the Board subject to the deletion of the following condition: "The Price offered by this rate is not less than that necessary to make the customer in question indifferent with respect to alternative supply versus continuing to purchase the electric power and energy from NSPI."
2. The implementation of the LRR should not be delayed until the time the customer is in a position to install its own generation.
3. The LRR rate should not be subject to a condition that it should cease to be in effect after the installation of any long term capacity by NSPI.
4. There is no need for the Board to order that NSPI should allow open access and retail choice to all of its LRR customers who could become eligible under any market restructuring which would provide for an open market in electricity.
5. The Board should reject the condition proposed by Mr. Kumar that the LRR should be at

least equal to 10% above the higher of NSPI's short term or long term marginal cost.

6. The Board should exempt the requirement for confidentiality as proposed in the NSPI rate.

All of which is respectfully submitted.

  
\_\_\_\_\_  
George T.H. Cooper  
\_\_\_\_\_  
Charles Keizer  
\_\_\_\_\_  
Jennifer Healy

Counsel for Stora Enso Port Hawkesbury Limited

January 28, 2000