Q. **Reference: Exhibit 9 page 10.**

Why has Lummus considered that NP's demand rate should be raised to be "cost-based" on average costs, when Hydro's previous rate consultant (NERA) concluded in their report (as part of the 2006 GRA – July 2006) that under Hydro's then demand cost structure (which had lower demand rates) it was likely that "NP may well be over-investing in demand-reducing measures" leading to reduced billings to NP with no corresponding reduction in Hydro's system costs.

A. The findings of the marginal cost study, which was completed by NERA Economic Consulting, include: (1) marginal capacity costs are reduced to virtually zero, based on current fuel price forecasts; and (2) marginal energy costs are based on the cost of fuel at Holyrood. Retaining an embedded cost methodology for determining rates maintains some stability in the level of the demand charge for both Newfoundland Power and Industrial Customers and eliminates wide fluctuations based solely on marginal costs which are leveraged to fuel price forecasts. In Hydro's 2006 GRA, as the demand rate to Newfoundland Power was reduced to $4.00/kW/month as a result of settlement negotiations. The level of the demand rate gave some recognition of the marginal capacity costs that was then indicated on the Island Interconnected System. The cost-based demand charge to NP can be viewed as placing less emphasis on Holyrood fuel and correspondingly greater emphasis on capacity cost.