

**NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES**

AN ORDER OF THE BOARD

NO. P. U. 15 (2009)

1 **IN THE MATTER OF** the *Electrical Power*
2 *Control Act*, RSNL 1994, Chapter E-5.1 (the
3 “*EPCA*”) and the *Public Utilities Act*, RSNL 1990,
4 Chapter P-47 (the “*Act*”), as amended;

AND

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8 **IN THE MATTER OF** a deferral account
9 to true-up Newfoundland Power Inc.
10 (“Newfoundland Power”) corporate income
11 taxes for years subsequent to the
12 2008 test year to reflect federal corporate
13 tax reductions.

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16 **Background**

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18 On October 30, 2007 as the hearing of evidence in Newfoundland Power’s 2008 general rate
19 application was coming to a close, the Federal Government announced corporate tax reductions
20 beginning in 2008. The evidence filed by Newfoundland Power in its general rate application as to
21 the 2008 test year corporate tax calculations did not reflect the announced 2008 corporate tax
22 reductions. After this announcement a joint proposal was filed by Newfoundland Power and the
23 Consumer Advocate suggesting the creation of a deferral account to true-up the 2008 income tax
24 expense to allow for the appropriate disposition of any tax savings resulting from the announcement.
25 The announced changes were enacted by the Federal Government on December 14, 2007. On
26 December 19, 2007 the Board issued Order No. P.U. 32(2007) approving, among other things, the
27 joint proposal and ordering Newfoundland Power to establish a deferral account to true up the
28 income tax expense for the 2008 test year and subsequent years to reflect the 2008 corporate tax
29 reductions with the disposition of the account balance, if any, to be subject to a further Order of the
30 Board.

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32 On February 29, 2008 Newfoundland Power filed an application with the Board for approval
33 of the definition of 2008 Tax Deferral Account, the amount of the 2008 income tax true-up and the
34 disposition of the 2008 income tax true-up. The Board’s financial consultants, Grant Thornton,
35 reviewed the Application and filed a report on April 9, 2008 noting that Newfoundland Power’s
36 application did not address whether it planned to also reflect the corporate tax reductions for the
37 period 2009 to 2012. On May 21, 2008 the Consumer Advocate filed submissions requesting that
38 the Board ensure that the benefits of the corporate tax reductions for years after 2008 be passed on to

1 consumers. Newfoundland Power on May 22, 2008 submitted that no evidentiary basis existed on
2 the record of the application for due consideration of the issue of tax reductions subsequent to 2008.
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4 On May 29, 2008 in Order No. P.U. 10(2008) the Board approved Newfoundland Power's
5 proposals for the disposition of the 2008 Income Tax True-up and accepted Newfoundland Power's
6 submission that there was not sufficient evidentiary record in the application to allow for a full
7 consideration of the issue of future corporate tax reductions beyond 2008 and how or whether any
8 savings should be passed on to consumers. The Board determined that this issue would be
9 considered in a subsequent process.

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11 On June 13, 2008, the Board wrote the parties requesting that they hold discussions to
12 determine if a consensus may be reached as to a suitable approach to address any potential corporate
13 tax savings for 2009 and 2010. On November 25, 2008 the parties wrote to advise that a consensus
14 as to a suitable approach could not be reached. In separate correspondence also dated November 25,
15 2008 the Consumer Advocate asked the Board to "...direct Newfoundland Power Inc. to initiate a
16 process to deal with tax rate reductions in 2009, 2010 (and subsequent years unless there is a GRA)
17 to ensure that the benefits of the tax reductions being implemented are passed on to consumers."
18 The Consumer Advocate argued that there was "...no impediment to having issues beyond the scope
19 of the 2008 NP GRA and issues which may or may not have been addressed in the resulting Order in
20 a separate proceeding before the Board." The Consumer Advocate cited several occasions where
21 Newfoundland Power utilized non-GRA applications to "protect itself from cost increases."
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23 The Board wrote the parties on December 12, 2008 requiring that evidence be filed on
24 January 9, 2009 and submissions be filed on January 16, 2009. Newfoundland and Labrador Hydro
25 was copied with documents throughout the process but did not participate.
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27 **Evidence and Submissions**

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30 On January 9, 2009 the Consumer Advocate filed evidence setting out, among other things,
31 the Department of Finance (Canada) Economic Statement, dated October 30, 2007. Newfoundland
32 Power also filed evidence on January 9, 2009, including a report, "*Corporate Income Tax*
33 *Reductions Subsequent to 2008*", outlining forecast tax changes and impacts for 2009 and 2010
34 based on the financial outlook as at November 2008.
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36 On January 16, 2009 the Consumer Advocate filed a submission requesting that the Board
37 direct Newfoundland Power to establish a deferral account to capture the actual impact of the
38 substantial tax savings in 2009 and 2010 for subsequent disposition to customers. The Consumer
39 Advocate notes that Newfoundland Power has in the past made several applications for deferral of
40 increased expenses and suggests that it would be contrary to basic regulatory principles to treat
41 increases and decreases in utility expenses differently in relation to deferral accounts. He argues that
42 the source of authority and justification for ordering a deferral account in relation to an unanticipated
43 expense increase is the same for a decreased expense. The Consumer Advocate says that requiring
44 Newfoundland Power to establish a deferral account for the tax reductions is justified on the basis

1 that the tax reductions are out of the control of the utility and there is no incentive benefit to
2 allowing the savings to be passed on to the shareholder and, secondly, on the basis of the estimated
3 revenue impacts. He suggests that the same threshold should be applied in the case of cost decreases
4 as in the case of cost increases.
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6 Newfoundland Power filed a submission on January 16, 2009 stating that the corporate tax
7 reductions in 2009 and 2010 were anticipated and reflected in the evidence filed in the 2008 General
8 Rate Application. Newfoundland Power states that the evidence showed that corporate taxes were
9 forecast to decline by 0.5% in 2009 and 1.0% in 2010 as demonstrated in the five-year forecast filed
10 in response to CA-NP-111 and CA-NP-111(1st Revision). Newfoundland Power argues that the
11 Board's ability to create a reserve or deferral account absent a rate case is limited by the impact on
12 the utility's ability to achieve its return as determined by the Board. Newfoundland Power cites
13 prior decisions of the Board confirming that required payments into reserve accounts cannot deprive
14 Newfoundland Power of any amount which is within the allowed return on rate base as fixed and
15 determined pursuant to s. 80(1) of the *Act*. Newfoundland Power says that ordering the deferral of
16 the 2009 and 2010 corporate tax savings would reduce Newfoundland Power's 2009 and 2010
17 returns and is not supported on the basic facts. Newfoundland Power argues that because ordering a
18 reserve "*would have the effect of depriving the Company of amounts necessary to achieve a just and*
19 *reasonable return...in the circumstances of this application, the Board lacks the jurisdiction to order*
20 *a reserve or deferral account as requested by the Consumer Advocate.*"
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22 In response the Consumer Advocate says that Newfoundland Power's claim that the return
23 on equity or rate base would be inadequate cannot be supported without a general rate application as
24 there is no evidence that has been properly tested upon which to make this determination. The
25 Consumer Advocate states that he "*...does not consider the actual return an appropriate basis for*
26 *determining the disposition of deferred costs in a non-GRA year*". The Consumer Advocate argues
27 that the disposition should be made based on a determination as to who should bear the costs. He
28 says that, given that the costs are not actually incurred by the company, the savings should be flowed
29 through to customers.
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32 **Decision**

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34 The Board has in the past approved the use of deferral accounts outside of a general rate
35 application to allow the deferral of certain significant expenses but has consistently held that this is
36 an extraordinary measure that is to be used in extraordinary circumstances. The Board continues to
37 believe that this is an appropriate approach. Rate regulation is, in accordance with the *Act*, a
38 prospective exercise based on the best available evidence of revenues and costs in relation to one or
39 more years which is tested in a comprehensive and detailed way through a general rate application.
40 To thereafter make changes to a single expense item outside of a general rate application with no
41 comprehensive testing of other changes or the overall results may not always be consistent with the
42 principles underlying prospective regulation and may generate results which do not reflect the actual
43 circumstances. Newfoundland Power suggests that ordering a deferral in the circumstances may
44 cause negative impacts on the utility's ability to earn a fair return and therefore this deferral is

1 outside of the jurisdiction of the Board. While the Board does not accept that this is a jurisdictional
2 issue it is cognizant that it is appropriate only in extraordinary circumstances to address one expense
3 or revenue item without comprehensively reviewing and testing all the circumstances.
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5 Recent examples of the approval of deferral accounts by the Board outside of a general rate
6 application have been mainly in relation to unanticipated major extraordinary repairs which were
7 outside of the control of the utility and where the amount was material such that taking it into
8 income in one year would have resulted in a shock to the utility's earnings. The Board also has
9 approved the use of deferral accounts to capture major expenses in relation to certain unique
10 programs, the costs of which the Board determines are appropriate to defer in the circumstances.
11 For example, the Board has ordered the deferral of costs associated with conservation initiatives and
12 retirement programs. These are major programs involving significant expenditures which were
13 considered and supported in a general rate application but at the time could not practically be
14 quantified and addressed, most often because of outstanding information.
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16 The Consumer Advocate suggests that a deferral account for the income tax reductions for
17 2009 and 2010 should be established to be consistent with Newfoundland Power's proposal in a
18 separate application to defer the 2009 costs associated with energy conservation initiatives.
19 However, the Board notes significant factual differences in these two matters. Newfoundland
20 Power's application to defer the costs associated with the conservation initiative was approved in
21 Order No. P.U. 13(2009) as having been anticipated in the latest general rate applications of both
22 Newfoundland Power and Newfoundland and Labrador Hydro, where the Board determined it was
23 prudent to await further information before making a determination on the specific initiatives to be
24 implemented. In contrast, evidence of the corporate tax reductions of 0.5% in 2009 and 1.0% in
25 2010 was presented in Newfoundland Power's general rate application but was not challenged or
26 otherwise raised as an issue or concern. The anticipated reductions were reflected in CA-NP-111
27 filed as part of Newfoundland Power's general rate application. The Department of Finance
28 (Canada) Economic Statement, dated October 30, 2007, filed by the Consumer Advocate in the
29 within application confirms that these anticipated reductions were not changed with the
30 announcement. The Board agrees with Newfoundland Power that this matter is analogous to the
31 depreciation expense associated with increased plant investment which the Board refused to allow
32 Newfoundland Power to recover in Order No. P.U. 40(2005), noting that the appropriate time to
33 address the increased expense was during the general rate application.
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35 It would be extraordinary for the Board over a year after the conclusion of the general rate
36 application to require Newfoundland Power to set up a deferral account to reflect a drop in expenses
37 which was anticipated and reflected in the evidence filed in the general rate application. While it is
38 conceivable that there may be circumstances where this extraordinary measure might be appropriate,
39 no such circumstances have been demonstrated in this case. The amount of the corporate tax
40 reductions on an annual basis is not compelling, Newfoundland Power estimates the 2009 savings to
41 be \$334,000 and the savings in 2010 are estimated by Newfoundland Power to be \$999,000.
42 Newfoundland Power presented evidence that the anticipated rate of return after the corporate tax
43 reductions would be in the range which was determined to be appropriate in the general rate
44 application. While the Board notes that detailed evidence as to the actual forecast returns based on

1 the most up to date information was not presented for testing, the available evidence as to the
2 forecast return does not justify the suggested intervention.

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4 The Board is satisfied that the anticipated tax savings for 2009 and 2010 are the result of
5 corporate tax reductions which were anticipated by Newfoundland Power and reflected in the
6 evidence filed during its last general rate application. The additional tax changes announced for
7 2008 before the close of the general rate application were addressed by the joint submission of the
8 parties at the time and as a result of the subsequent Order of the Board Newfoundland Power must
9 set up a deferral account to collect the savings flowing from these reductions for each year until the
10 next general rate application. The Board finds that there is no reasonable basis upon which to now
11 order a deferral account in relation to the corporate tax reductions of 0.5% in 2009 and 1.0% in
12 2010.

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14 **IT IS THEREFORE ORDERED THAT:**

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16 1. The Board will make no Order as to the corporate tax reductions of 0.5% in 2009 and 1.0%
17 in 2010.
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19 2. Newfoundland Power shall pay all the expenses of the Board incurred in this application.

DATED at St. John's, Newfoundland and Labrador, this 25th day of March 2009.

Andrew Wells
Chair and Chief Executive Officer

Darlene Whalen, P.Eng.
Vice-Chair

Dwanda Newman, LL.B
Commissioner

G. Cheryl Blundon
Board Secretary