NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

AN ORDER OF THE BOARD

NO. P.U. 39(2014)

IN THE MATTER OF the *Electrical Power Control Act, 1994,* SNL 1994, Chapter E-5.1 (the *"EPCA")* and the *Public Utilities Act,* RSNL 1990, Chapter P-47 (the *"Act"),* as amended, and regulations thereunder; and

IN THE MATTER OF a general rate application by Newfoundland and Labrador Hydro to establish customer electricity rates; and

IN THE MATTER OF an application by Newfoundland and Labrador Hydro, dated May 12, 2014, for approval of, on an interim basis: i) the transfer of $29.4 million to be recognized as revenue; and, ii) changes to Island Industrial customer rates and rules.

The Application

On May 12, 2014 Newfoundland and Labrador Hydro ("Hydro") filed an application with the Board seeking interim relief in advance of the conclusion of its general rate application (the "Application"). The Application requests:

> *...that the Board make an interim Order pursuant to Section 75 of the Act, approving on an interim basis:*
>
> *i)* *a transfer of $29.4 million from the $68.6 million credit balance in the Hydraulic Production Variation component of the Rate Stabilization Plan (as of March 31st, 2014) to be recognized as revenue by Hydro in 2014 to provide an opportunity to earn a reasonable return on rate base in 2014;*
>
> *ii)* *approval of an Industrial Customer fuel rider of 1.490¢ per kWh effective January 1, 2014 in accordance with existing RSP rules;*
>
> *iii)* *approval of a recovery adjustment rider of 0.168¢ per kWh effective July 1, 2014 for disposition of the Industrial Customer Current Plan RSP balance at December 31st, 2013;*
>
> *iv)* *revised RSP rules effective January 1, 2014 to permit the use of the Industrial Customer RSP Surplus to permit the phase-in of Island Industrial Customer rates. Schedule 1 provides the proposed RSP rules; and*
>
> v) *the phase-in of Island Industrial Customer rates as provided in the Schedules 2, 3 and 4 to this Application. Schedule 2 provides the Industrial Customer rates*

> *to become effective January 1, 2014. Schedule 3 provides the Industrial Customer rates to become effective July 1, 2014. Schedule 3* [sic] *provides the Industrial Customer rates to become effective September 1, 2014.* (Application, pages 3-4)

A copy of the Application was provided to the parties in the general rate application proceeding: Newfoundland Power; the Consumer Advocate, Mr. Thomas Johnson; Corner Brook Pulp and Paper Limited, North Atlantic Refining Limited and Teck Resources Limited (the "Industrial Customer Group"); Vale Newfoundland and Labrador Limited ("Vale"); the Innu Nation; the Towns of Labrador City, Wabush, Happy Valley-Goose Bay, and North West River (the "Towns"); and Yvonne Jones, MP.

Requests for information in relation to the Application were issued on June 2, 2014 which were answered by June 27, 2014. Further requests for information were issued by June 27, 2014 and were answered on July 4, 2014.

On July 11, 2014 Newfoundland Power, the Consumer Advocate, the Industrial Customer Group and Vale filed submissions in relation to the Application. On July 16, 2014 Hydro filed a submission. The Innu Nation, the Towns and Yvonne Jones, MP did not file requests for information or submissions.

Background

On July 30, 2013 Hydro filed two applications - a general rate application and an application for changes in relation to the Island Industrial customer rates and Hydro's Rate Stabilization Plan ("RSP"). Both of these applications were filed in accordance with a direction from Government issued on April 4, 2013, pursuant to section 5.1 of the EPCA. In OC2013-089 Government directed the Board that:

> *1) Effective July 1, 2013, Island industrial customer rates will no longer be frozen. Effective on this date rate increases for island industrial customers will be phased in over a three year period, with funding for this phase-in to be drawn from the January 1, 2007 to June 30, 2013 accumulated Load Variation (the Rate Stabilization Plan Surplus) component of the Rate Stabilization Plan and credited to the Island industrial customer Rate Stabilization Plan effective June 30, 2013;*
> *2) On June 30, 2013 the Island industrial customers' Rate Stabilization Plan will be credited with $56.5 million, the estimated Rate Stabilization Plan amount required to phase-in industrial customer rates, based on Newfoundland and Labrador Hydro's General Rate Application. The remaining balance in the Rate Stabilization Plan Surplus on June 30, 2013, will be transferred to the credit of Newfoundland Power's Rate Stabilization Plan. No future adjustments will be made to these amounts credited. Effective July 1, 2013 all Island industrial customers, with the exception of Teck Resources, will be subject to the same standard industrial rate, equivalent to the existing base rate but excluding the Rate Stabilization Plan adjustment currently in place;*

> *3) Teck Resources rate increase will be phased in, to a reasonable degree, in three equal annual percentage increases, and at the end of the phase-in period Teck Resources will be subject to the standard industrial rate;*
> *4) Over the three year Island industrial rate phase in period, the shortfall in Newfoundland and Labrador Hydro's revenues when compared to revenue at the Board of Commissioners of Public Utilities-approved Island industrial customer rates, shall be funded from the Island industrial customer Rate Stabilization Plan;*
> *5) Notwithstanding Items 1) through 4) above, effective January 1, 2014, the Island industrial customers will be subject to Rate Stabilization Plan rate changes in accordance with the Board of Commissioners of Public Utilities-approved methodology;*
> *6) Newfoundland and Labrador Hydro's General Rate Application process shall include a Rate Stabilization Plan surplus refund plan to ratepayers. The refund plan shall comprise direct payments or rebates to ratepayers and shall not be in the form of an electricity rate adjustment. This refund plan will exclude Island industrial customers who will receive Rate Stabilization Plan surplus funds through the three year phase-in of new rates. The Board of Commissioners of Public Utilities shall make the final determination on the details of the refund to remaining ratepayers;*
> *7) Newfoundland Power's portion of the Rate Stabilization Plan Surplus shall be distributed as a direct payment or rebate to its ratepayers and shall not be in the form of an electricity rate adjustment; and*
> *8) Newfoundland and Labrador Hydro's General Rate Application shall be based on a 2013 test year in the determination of new electricity rates for customers.*

This direction was amended by OC2013-207 changing the amount of the credit to the Industrial Customer RSP from \$56.5 million to \$49 million and also changing the June 30, 2013 and July 1, 2013 dates to August, 31, 2013 and September 1, 2013, respectively.

On August 30, 2013 the Board issued Order No. P.U. 26(2013) ordering that the Industrial Customer RSP be credited with \$49 million, approving, on an interim basis, existing Island Industrial customers base rates with no RSP adjustment. On September 30, 2013 in Order No. P.U. 29(2013) the Board finalized the Island Industrial customer rates that were in place from January 1, 2008 to August 31, 2013 and continued the existing rates on an interim basis for Island Industrial customers, except that a new RSP rate was established for Teck Resources Limited.

On November 18, 2013 Hydro filed an application seeking interim rate relief in advance of the conclusion of the general rate application. Hydro requested implementation of new interim rates effective January 1, 2014 for most of its customers, or, in the alternative, a deferral and recovery mechanism for a revenue shortfall between existing and approved rates. On December 13, 2013 the Board issued Order No. P.U. 40(2013) approving an amendment to the RSP rules to suspend the January 1, 2014 RSP adjustment for Island Industrial customers, deferring consideration of Hydro's proposals for interim rate changes pending resolution of the issues and concerns raised in the interim rate application.

On January 17, 2014 Hydro filed another application for interim relief, which it stated was supplemental to its November 18, 2013 application, changing its proposals in relation to several matters, including rates for Newfoundland Power and certain Rural customers. On

February 11, 2014 Hydro withdrew this application and filed an amended application, requesting new rates for Island Industrial customers and a deferral mechanism for any revenue shortfall between interim and final rates for other customers. On April 25, 2014 the Board, having considered the application, found in Order No. P.U. 13(2014), at page 10:

> *The Board believes that at this stage Hydro's proposals and the impacts of its proposals should be clear. After three applications, four rounds of information requests, and 166 responses to information requests there appears to be no clear understanding of what Hydro is proposing and the impact on customers. The Board is especially concerned about approving this application given the size of the increase in base rates proposed to be reflected in a deferral account. The Amended Interim Rate Application proposes a deferral account to collect a revenue shortfall based on an overall average increase in base rates for Newfoundland Power of 18.7% and for Labrador Interconnected customers of 23.3%.*
>
> *The Board acknowledges Vale's concerns in relation to delays in the implementation of the phase-in of Island Industrial customer rates. The Board also acknowledges Hydro's concerns in relation to its rate of return for 2014. Unfortunately, the Board finds that Hydro has not filed an application with supporting evidence setting out a comprehensive, unambiguous set of proposals. The Board must therefore dismiss the Amended Interim Rate Application. It is open for Hydro to file another application which contains clear and unambiguous proposals supported with comprehensive and consistent evidence.*

On May 12, 2014, following Order No. P.U. 13(2014), Hydro filed this Application again seeking interim relief.

On June 6, 2014 Hydro advised by letter that in the fall of 2014 it would be amending its general rate application to provide forecast information for 2014 and a 2015 test year. Hydro explained that revisions to the general rate application are necessary to update financial information to provide a more current and relevant basis for rate setting purposes but it did not amend or withdraw this Application. Hydro noted that the amendment of the general rate application is dependent on an amendment to OC2013-089 which directs that rates be based on a 2013 test year. The Intervenors in the general rate application did not object to Hydro's proposal to amend the general rate application or the resulting postponement of the hearing which was scheduled to begin on July 9, 2014. Hydro advised that it expected that the hearing would now proceed in early 2015.

The Application seeks an Order of the Board approving i) the transfer on an interim basis of the amount of $29.4 million to be recognized as revenue by Hydro in 2014 and ii) changes to Island Industrial customer rates for 2014 on an interim basis.

i) <u>Transfer of $29.4 Million to Revenue in 2014</u>

The Application requests an interim order pursuant to section 75 of the *Act* approving on an interim basis a transfer of $29.4 million from the credit balance in the Hydraulic Production Variation component of the RSP to be recognized as revenue by Hydro in 2014 to provide an opportunity to earn a reasonable return on rate base in 2014. Hydro submits that its proposals provide a reasonable balance of the interests of Hydro and its customers.

In its evidence Hydro submits that the current forecast of a net income loss based on existing rates combined with uncertainty in relation to the timing of the conclusion of the general rate application creates uncertainty as to its opportunity to earn a reasonable return in 2014. Hydro states that Board approval of the proposed rates in its general rate application effective January 1, 2014 would have provided a 2014 forecast net income of $33.2 million. Hydro notes that the general rate application forecast net income for 2014 under existing rates is $3.8 million, which corresponds to a 1.1% return on equity and a return on rate base of 5.84%, and results in a forecast 2014 net income shortfall of $29.4 million. Hydro further explains that its 2014 financial outlook has changed materially since the filing of the general rate application forecast, noting that additional supply costs of $10 million were incurred in the first quarter of 2014. Hydro also states that it will incur additional costs in 2014 associated with the Board's ongoing review of the Island Interconnected System supply issues and power outages. Hydro submits that the Application demonstrates its requirement for additional revenue in 2014 and balances the objectives of reasonable cost recovery and customer impacts.

Hydro states that the proposed interim approach to use the credit in the Hydraulic Production Variation RSP balance to provide 2014 revenue to Hydro does not create any negative impact on customers and provides a reasonable balance of the interests of Hydro and its customers. Hydro explains that the Hydraulic Production Variation component of the RSP had a balance owing to customers of $40 million at December 31, 2013 and $68.6 million at March 30, 2014. Hydro submits that implementing a rate increase would impose hardship on customers as the $29.4 million net income shortfall reflects approximately 5.8% of customer billings at existing rates.

The Application proposes that, upon approval of final rates, the actual 2014 shortfall and recovery methodology will be determined by the Board.

<u>Submissions</u>

Newfoundland Power does not support Hydro's proposed transfer of an amount from the RSP to be recognized by Hydro as revenue in 2014. Newfoundland Power submits that the evidence in support of the Application is neither comprehensive nor consistent and provides no greater evidentiary basis for approval than the evidence filed in support of Hydro's previous application for interim relief. Newfoundland Power states:

> *In this regard, it is Newfoundland Power's submission that Hydro's evidence with respect to a forecast net income shortfall in 2014 is not comprehensive, as it does not include evidence that Hydro's forecast 2014 revenue shortfall relates to costs that should be recovered from customers.* (Newfoundland Power Submission, July 11, 2014, page 4)

Newfoundland Power submits that the evidence does not contain detailed information regarding the reasons for the 2014 forecast net income shortfall and whether the shortfall is related to costs that were necessary to provide service during 2014. Newfoundland Power states:

> *Furthermore, the amount of the proposed transfer of $29.4 million is based on Hydro's proposed 2013 test year. In light of current regulatory uncertainty regarding Hydro's GRA, and the likelihood that Hydro's 2013 costs will not be tested, the Board must consider whether this is a reasonable evidentiary basis for the amount of the proposed transfer.* (Newfoundland Power Submission, July 11, 2014, page 3)

Newfoundland Power states that it is not clear what the interim nature of the $29.4 million implies. Newfoundland Power submits that Hydro does not provide an evidentiary basis that is consistent with the Board's previous practice in relation to cost or revenue deferrals and there is no regulatory precedent in this jurisdiction for the proposed transfer on an interim basis.

The Consumer Advocate supports Hydro's application for interim rate relief in light of the significantly deteriorated nature of Hydro's financial position, with the proviso that there is subsequently a full prudence review and rates are adjusted accordingly. The Consumer Advocate notes that the proposed amount of the transfer of $29.4 million is based on the target return on equity set out in OC2009-063, which would be 8.80%, and submits that the amount should instead reflect the lower return on equity of 4.47% last determined by the Board. The Consumer Advocate states:

> *....in the view of the Consumer Advocate to insist upon a full record at this stage in order to pinpoint the reasons for or the precise size of the alleged revenue shortfall before entertaining an interim relief application is not necessary so long as the relief ordered is interim pending a full 2014 revenue requirement review. It is the subsequent process to test the legitimacy, reasonableness and prudency of 2014 test year costs that is the regulatory regime's protection mechanism – one that allows for retrospective adjustments to any relief granted on an interim basis.* (Consumer Advocate Submission, July 11, 2014, page 2)

The Consumer Advocate further submits that the Board's power and authority includes the power to make an interim disposition of a portion of the RSP balance and, in 2015 or later, subsequently order a transfer into the deferral account for rate setting purposes for the benefit of customers.

The Industrial Customer Group submits that the revenue relief sought by Hydro is without regulatory precedent but agrees that the Board has the authority to provide relief of the nature that Hydro is seeking. The Industrial Customer Group states that the specific regulatory relief that Hydro is seeking – the transfer from the RSP of $29.4 million to Hydro's revenue in 2014 – raises very significant evidentiary and procedural concerns.

The Industrial Customer Group submits that it is not clear that the policy direction contained in OC2009-063, which directs that the target return on equity used for calculating the return on rate base for Hydro be equivalent to that most recently set for Newfoundland Power, was intended to apply in advance of the setting of new customer rates through a completed general rate application. The Industrial Customer Group states:

> *On the foregoing analysis, the $29.4 million forecasted revenue shortfall may be considered to be overstated based on Government's direction, even before consideration is given to the additional concerns arising from the very preliminary and largely untested evidentiary basis for that forecasted revenue shortfall, and from the as-yet unexamined reasons for that the* [sic] *forecasted shortfall.* (Industrial Customer Group Submission, July 11, 2014, page 4)

The Industrial Customer Group notes Hydro's response in IR-PUB-NLH-21 which suggests that the forecast rate of return on equity for 2014, assuming the proposals in the general rate application are implemented effective January 1, 2014, is 9.38%. The Industrial Customer Group estimates that adjusting the amount to reflect an 8.80% return on equity would lower the requested transfer by $2.058 million. The Industrial Customer Group states:

> *In the submission of the IIC Group, if the Board deems fit to exercise its legal jurisdiction to grant some measure of interim 2014 revenue relief to Hydro, the foregoing concerns militate towards the granting of such relief at a level substantially less than the $29.4 million sought by Hydro.* (Industrial Customer Group Submission, July 11, 2014, page 5)

Vale states that it is prepared to accept that Hydro may require some form of interim relief subject to Hydro demonstrating through evidence filed as part of the general rate application process that its 2014 expenses justify the revenue sought. Vale explains that it has concerns in relation to:

(i) whether the revenue transfer is good regulatory practice, noting that the precedents cited are qualitatively different;
(ii) whether the revenue transfer achieves the stated goal since it provides no certainty;
(iii) the fact that the revenue shortfall relates to all Hydro customers but the transfer is from a fund owed only to some of its customers; and
(iv) whether the proposed amount reflects Hydro's revenue shortfall as Hydro has not provided any evidence to support the amounts claimed.

Vale also states that an order for interim relief has the potential to cause further delays in the general rate application process and suggests that, if Hydro does not file the evidence necessary to establish its shortfall on or before October 15, 2014 or should it fail to meet procedural timelines, the transfer should be automatically reversed. Vale further requests that:

> *Once the revenue shortfall is determined, the parties should then have an opportunity to make submissions with respect to what percentage of that shortfall should be recoverable, what percentage of the shortfall should be recovered from each customer group and how the shortfall should be recovered (i.e. by making the transfer from the*

hydraulic component of the RSP permanent or through another means). (Vale Submission, July 11, 2014, page 4)

Hydro submits that the implementation of interim rates in advance of the conclusion of a general rate application is common in Canada and the United States and that its proposal for a revenue transfer is comparable to previous applications approved by the Board. Hydro states that it is proposing the revenue recognition on an interim basis for 2014 to address the forecast net income shortfall resulting from the delayed implementation of the proposed general rate application rates. Hydro states:

> *In the current circumstances, the uncertainty concerning Hydro's opportunity to earn a reasonable return in 2014 can be alleviated only if the Board provides an interim order approving either revenue recognition or cost deferral in 2014.* (Hydro Submission, July 16, 2014, page 2)

In its submission Hydro sets out a number of specific increases in non-controllable costs and reasons for the lack of growth of revenue since the 2007 test year. Hydro argues that:

> *...financial results for 2013 and the first quarter of 2014 combined with its cost challenges and revenue stagnation since 2007 provides adequate evidence of a shortfall to justify interim revenue relief until the Board has an opportunity to fully test costs in 2014.* (Hydro Submission, July 16, 2014, page 7)

Hydro submits that approval of its proposal would provide it with the opportunity to earn a reasonable return while providing an opportunity to fully test 2014 and 2015 costs following the filing of the amended application. Hydro does not believe that waiting until the conclusion of the general rate application to determine the 2014 net income shortfall is a reasonable approach. Hydro states:

> *From Hydro's perspective, dealing with the forecast net income shortfall in advance of completion of the GRA process will enable Hydro to plan for reasonable cost recovery in 2014 and provide more certainty to lenders and other stakeholders that it will have an opportunity to earn a reasonable return in 2014. Approval of the Application will also provide Hydro clarity on its financial outlook for 2014 to assess what adjustments to its cost management efforts are required.* (Hydro Submission, July 16, 2014, page 10)

Hydro explains that in the amended general rate application to be filed in the fall it will seek the approval of the existing rates on a final basis for 2014 for Newfoundland Power and Hydro Rural customers. Hydro states:

> *Only the tested revenue requirement of 2014 will be ultimately recovered from customers through rates. For financial reporting, the difference between the actual and the forecast $29.4 million net income shortfall for 2014 will be recognized as an adjustment in 2015 or over some other time period, subject to an order of the Board.* (Hydro Submission, July 16, 2014, page 3)

Hydro states that it believes that the proposed revenue transfer is lower than the 2014 revenue requirement shortfall that will result upon testing the 2014 costs and therefore no downward adjustment is required.

Board Findings

The issue to be determined by the Board is whether it should, in the circumstances, approve the proposed revenue transfer of $29.4 million or some other amount. The Board notes that while there is no provision in the *Act* that expressly empowers it to approve the revenue transfer requested by Hydro, it has broad powers in relation to the revenue, expenses and return of a utility. The parties accept that the Board has the jurisdiction to approve the proposed revenue transfer, though the Board notes Newfoundland Power's submission that the Board's authority is not entirely clear in relation to the approval of a cost or revenue deferral on an interim basis. The Board agrees that it has the jurisdiction to approve the revenue transfer and finds that the issue to be determined is whether it should, in the circumstances, exercise its discretion. In making this determination the Board must be satisfied that it is appropriate and necessary to approve the revenue transfer as requested and that such approval balances the competing interests of both the utility and its customers.

The Application requests approval to transfer, on an interim basis, $29.4 million from an existing deferral account (the RSP) to be recognized as revenue by Hydro in 2014, with adjustments to be made in future years following a full review by the Board. According to Hydro, the purpose of the revenue transfer, as set out in paragraph 10 of the Application, is to *"provide an opportunity to earn a reasonable return on rate base in 2014."* The Board agrees that Hydro is entitled to earn annually a just and reasonable return on its rate base, as provided for in section 80 of the *Act*, but notes that Hydro is not guaranteed to earn the established return. The rate of return is, where practicable, established by the Board on a prospective basis and Hydro must manage its business, working within the existing regulatory framework, so as to minimize the risks and maximize its opportunity for a just and reasonable return. The Newfoundland and Labrador Court of Appeal addressed this issue in Newfoundland (Board of Commissioners of Public Utilities), Re (1998), 164 Nfld and P.E.I. R.60, stating at paragraph 31:

> *[31] This leads to another point: because the setting of the rate of return is based on projections one cannot be sure that the rate of return will be achieved in practice. Although the utility is "entitled" by s. 80 of the Act to have the Board determine a just and reasonable rate of return based on appropriate predictive techniques and methodologies, it is not "entitled", in the sense of being guaranteed, to that rate of return[34]. The utility therefore takes the risk that its chosen management techniques and the future economic climate may not yield its expected success. Although some of the activities of the utility are regulated within the framework of the statutory objectives, the utility nevertheless remains subject to business risks and effects of management decisions. To that extent, the financial risks associated with the operation of the utility, just as in the case of any private business, are to be born by the investors in the enterprise, not the customer of the service.*

As indicated by the Court of Appeal in paragraph 32 *"...the powers of the Board must be regulative and corrective, but not managerial, and they do not therefore contemplate a retroactive adjustment of the actions of management."* Under the existing regulatory framework the determination of a just and reasonable return on rate base is undertaken in the context of a general rate application where all costs are fully tested to ensure that only those costs that are required for the provision of service are included in rates to customers.

The $29.4 million proposed by Hydro to be transferred is the forecast 2014 revenue shortfall based on the difference between the forecast revenue from existing rates and the forecast revenue from the 2014 rates proposed in the general rate application using a 2013 test year. Hydro has now advised that it plans to file an amended general rate application with updated forecast information for 2014, replacing the 2013 test year with a 2015 test year. Hydro explains that its 2014 financial outlook has changed materially since the filing of the general rate application forecast and that revisions to the general rate application are necessary at this time to update the financial information to provide a more current and relevant basis for rate setting purposes. In light of this explanation, it is likely that the forecast revenue shortfall for 2014 will be significantly different than that set out in the Application which is based on the general rate application evidence. The Board therefore has concerns as to whether the evidence filed in support of the Application continues to be relevant and properly forms the basis for the approval of a revenue transfer.

Hydro is requesting approval of the transfer of almost $30 million, to be recognized as revenue on an interim basis in 2014, from an existing RSP credit balance which represents amounts owing to customers. According to Hydro the difference between the $29.4 million and the actual shortfall which is determined after a full review will be recognized as a revenue adjustment in future years. (SIR-PUB-NLH-015) Hydro explains that it will be proposing the allocation of the shortfall to customers based on a 2015 cost of service yet to be filed and, further, that there may be a prospective adjustment to rates for customers on the Labrador Interconnected system because they do not share in the RSP. Hydro submits that the interim nature of the revenue transfer means that customers will not be negatively impacted since the Board retains the ability to order all or part of the amount be reversed following review at a later date. However, the Board notes Newfoundland Power's concern expressed in SIR-NLH-NP-006 with respect to what the interim nature of the transfer implies. According to Newfoundland Power its customers may ultimately be denied the benefit of part or all of $29.4 million in the current credit balance in the RSP. While Hydro submits that the proposed transfer does not have any negative impact on customers the Board finds that, based on the evidence, and in light of the uncertainty surrounding the amendment of the general rate application, the impact of Hydro's proposal on customers is not clear.

While the Consumer Advocate, the Industrial Customer Group and Vale do not oppose the Application the Board notes the significant concerns and conditions which are expressed by these parties. The Consumer Advocate qualifies his support with the proviso that there is a full prudence review of 2014 costs and further that rates be adjusted accordingly. The Consumer Advocate also suggests that the amount of the revenue transfer be adjusted to reflect a lower return on equity. The Industrial Customer Group states that the Board must ensure that the relief is interim and must be partially or wholly reversible if Hydro's filing of the amended general rate application is delayed. The Industrial Customer Group also submits that relief should be granted at a level substantially less than $29.4 million. Vale raises several concerns in relation to the proposed transfer and suggests that any relief be made conditional on Hydro filing and observing time lines and that the actual revenue shortfall must be proven in the general rate application. Vale further asks that an opportunity be provided to the parties to address issues related to the amount of Hydro's recovery, how each customer group will contribute and the manner of recovery.

While the Board has in the past approved the use of deferral accounts, it has not to date been asked to approve a revenue transfer as proposed by Hydro in this Application. Hydro proposes a "revenue transfer" to address an overall "revenue shortfall" in a year which is not a test year and where no rate changes are proposed, with the review of the transfer and any necessary adjustments to be made in a subsequent year. The Board notes that the approval of interim relief in advance of the conclusion of a general rate application is an extraordinary measure which must be fully justified in the circumstances. Hydro now advises that its 2014 financial outlook has changed materially since the filing of the general rate application and that it plans to file an amended general rate application with updated forecasts. The Board finds that it is not clear that the evidence filed reflects Hydro's financial circumstances for 2014 and further that the evidence does not adequately address customer impacts. Hydro has failed to provide a reasonable evidentiary basis consistent with good utility practice to justify the proposed revenue transfer.

Hydro proposes in its submission that an alternative to approval of the revenue transfer is the approval on an interim basis of a $29.4 million cost deferral account for 2014 with recovery to be determined following the testing of 2014 costs. The Board's concerns in relation to the evidence which was filed in support of this Application, and Hydro's stated intention to amend its general rate application also apply in the case of the proposed deferral account. The Board finds that Hydro has not demonstrated that it is appropriate in the circumstances to set aside the proposed revenue shortfall in a deferral account at this time.

ii) Industrial Customer 2014 Interim Rates

The following table summarizes Hydro's interim rate proposals for Island Industrial customers:

Summary of IC Interim Rate Proposals				
	Existing	**Jan. 1, 2014**	**July 1, 2014**	**Sept. 1, 2014**
Firm Demand Charge ($ per kW)	$6.68	$6.68	$6.68	$6.68
Base Energy Charge (¢ per kWh)	3.676	3.676	3.676	3.676
RSP Fuel Rider	0.0	1.490	1.490	1.490
Current Balance Rider (¢ per kWh)	0.0	0.0	0.168	0.168
RSP Surplus Credit (¢ per kWh)	0.0	(1.490)	(1.490)	(0.745)
Teck Rider (¢ per kWh)	(1.111)	(1.111)	(1.111)	(1.111)
Average Rate Change excluding Teck	n/a	0%	3.4%	14.6%
Rate Change for Teck	n/a	0%	4.0%	16.9%

Application Evidence, page 10

Hydro states that the proposed changes to the Island Industrial customer rates are in accordance with the direction provided by Government to implement the phase-in of Island Industrial customer rates. According to Hydro's evidence:

> *Hydro is required by Government directive to use the RSP Surplus assigned to the IC to offset the customer impacts of moving to cost-based rates over a three-year phase-in period. The Government directive also required the IC be subject to rate changes as a result of the operation of the RSP during 2014.* (Application Evidence, page 8)

The existing Island Industrial customer rates are based on a 2007 test year and do not include a fuel rider to recover the difference in test year and actual costs for Holyrood fuel, as provided for in the RSP rules. Hydro states that the fuel rider, if implemented effective January 1, 2014, would have been 1.490¢ per kWh. Hydro proposes to implement this fuel rider on an interim basis effective January 1, 2014 but to offset the total impact on Island Industrial customer billings by adding an Industrial Customer RSP Surplus credit of 1.490¢ per kWh, to be funded from the Industrial Customer RSP Surplus. Hydro proposes that effective September 1, 2014 the Industrial Customer RSP Surplus credit be reduced from 1.490¢ per kWh to 0.745¢. Hydro also proposes that on July 1, 2014 a current RSP recovery rate of 0.168¢ per kWh be implemented, calculated based on the December 31, 2013 Industrial Customer RSP plan balance. Hydro states this proposal is in compliance with the intent of OC2013-089.

Submissions

In its submission Newfoundland Power states it does not have a direct interest in the proposed Island Industrial customer rate changes, which are aimed at complying with the various Orders in Council, and does not have any specific comment on these proposals.

The Consumer Advocate submits at page 3 that it is "*...very important that IC rates be increased to the full cost of service as quickly as possible to eliminate the cross-subsidy that has been provided to the ICs by other customers on the system since 2008.*" The Consumer Advocate supports Hydro's proposal for Island Industrial customer rates provided there is a full review of costs during the amended general rate application to ensure the Island Industrial customers pay the full cost of power by September 1, 2015 as directed in OC2013-089.

The Industrial Customer Group submits at page 3 that since September 1, 2013 the Island Industrial customers have been *"subject to an escalating, unstable and unpredictable regime."* The Industrial Customer Group argues that if new rates are ordered it should be implemented in a manner that promotes rate stability and avoids rate shock and intergenerational inequity. The Industrial Customer Group submits that these objections would best be achieved if, in addition, the Board orders an interim allocation of the segregated RSP Load Variation balance as proposed by Hydro in the general rate application. They state:

> *The IIC Group submit that if new interim rates are ordered for the industrial customers, this should be implemented, to the extent reasonably possible, in a manner that promotes rate stability and avoids rate shock and intergenerational inequity. The IIC Group submits that these regulatory objectives would be best achieved by ordering new interim rates in accordance with the allocation, on an interim basis, of the segregated load variation balance, and revision of rate riders, identified in the response to SIR-IC-NLH-015.* (Industrial Customer Group Submission, July 11, 2014, page 1)

The Industrial Customer Group notes that both Hydro and Newfoundland Power do not raise any substantive objection to such interim allocation. They also note that the Consumer Advocate's expert has not stated any reasonable or principled objection.

Vale states that continued use of interim ràtes negatively affects Island Industrial customers such as Vale since such rates create uncertainty in budgeting and revenue forecasting. According to Vale Hydro's proposal in this Application involves a fundamental shift in the manner in which the Industrial Customer RSP Surplus is drawn down to phase in rates. Vale states that, in the RSP application filed on July 30, 2013, Hydro proposed applying the RSP Surplus to a combination of energy charges, demand charges and specifically assigned charges being sought in the general rate application. This proposal was to ensure an equitable phase-in for each Island Industrial Customer. Vale notes that Hydro has repeatedly defended this proposal on the basis that it was the schedule contemplated by Government when it directed that $49 million of the total Industrial Customer RSP Surplus be used to phase in Island Industrial customer rates. With respect to the current Application Vale states:

> *...Hydro is seeking to use the RSP Surplus only to provide a rebate on the fuel rider charged to industrial customers. This fundamental change in the manner in which the RSP Surplus is to be used has the potential to negatively impact one or more of the Industrial Customers. While Vale is not contesting that Hydro should be granted interim rates for a defined period of time, any Order for interim rates should include a provision that the change in the scheduled drawdown of the RSP Surplus will not discriminate against any single Industrial Customer.* (Vale Submission, July 11, 2014, page 1)

In its submission Hydro states that its proposed approach for Island Industrial customer rates for 2014 is consistent with the manner in which the RSP rate components for Newfoundland Power are currently developed. The impacts of the proposed RSP rate changes will be partially offset through the use of the Industrial Customer RSP Surplus. Hydro states:

> *Hydro's current intention is to finalize the 2014 RSP based on the 2007 Test Year data, rather than ultimately restating the 2014 RSP year based on updated 2014 Test Year data. For the purpose of establishing rates for 2015, Hydro will be filing a 2015 Test Year forecast and a 2015 Test Year Cost of Service Study. The 2015 Test Year Cost of Service Study will include the forecast variables for use in operation of the RSP beginning in 2015.* (Hydro Submission, July 16, 2014, page 11)

Hydro states that, if the Board approves the Industrial Customer Group's proposal to allocate on an interim basis the segregated RSP Load Variation balance in the manner proposed in the general rate application, Hydro would modify the proposed recovery rate to be effective July 1, 2014 to reflect the adjusted Industrial Customer RSP current balance as of December 31, 2013.

In addressing Vale's concern that Hydro has taken a new approach in this Application in relation to the phase-in of rate changes for the Island Industrial customers Hydro states:

> *The GRA proposed phase-in approach was based upon the target base rate included in the GRA. The target base rate for 2015 will not be available until Hydro files an amended application in the fall of 2014. Therefore Hydro submits that implementing the RSP rate components for 2014 is the most practical way to phase-in cost-based rates to IC.* (Hydro Submission, July 16, 2014, page 12)

Hydro submits that its proposals for Island Industrial customer rates are consistent with the Government directive to phase in rate increases to the Island Industrial customers.

<u>Board Findings</u>

The Application proposes new interim Island Industrial customer rates with rate increases offset in part by amounts from the RSP Surplus. The issue to be determined by the Board is whether it will exercise its discretion, pursuant to section 75 of the *Act,* to approve, on an interim basis, increases in the Island Industrial customer RSP rates, effective January 1, 2014, and whether amounts in the RSP Surplus should be used to offset part of the RSP rate increase.

The Board notes that the Industrial Customer Group and Vale, as the customers directly affected, are not in agreement in relation to Hydro's proposals. The Industrial Customer Group does not oppose the Application but suggests that the Board should also implement Hydro's general rate application proposal in relation to the allocation of the segregated RSP Load Variation balance. Vale does not address this Industrial Customer Group suggestion but expresses concern with the new approach taken by Hydro in the Application. Vale submits that Hydro's proposal to use the RSP Surplus to provide a rebate on the fuel rider charged to Island Industrial customers is a fundamental change in the manner in which the RSP Surplus is to be used and has the potential to negatively impact one or more of the Island Industrial customers.

The Board agrees with Vale that the proposals in the Application in relation to the Island Industrial customer rates are substantially different than the proposals in the general rate application, the other interim rate applications and the application filed on July 30, 2013 in relation to the Island Industrial customer rates. The Application proposes to use amounts in the RSP Surplus to offset increases in the RSP rates rather than increases in base rates and specifically assigned charges as originally proposed. The Board notes that OC2013-089 states that the RSP Surplus is to be used to fund a three-year phase-in of rate increases for Island Industrial customers but the Application does not set out a three-year phase-in of rates. Further OC2013-089 states that the funding amount of $49 million was the estimated amount required to phase in rates, based on Hydro's general rate application. The Board finds that there is uncertainty as to whether the Application proposals are consistent with the Government direction.

In its submission Hydro explains that since the proposed base rates for 2015 will not be known until the amended general rate application is filed, implementing the RSP rate components for 2014 is the most practical way to phase-in cost based rates for the Island Industrial customers. While Hydro states that its proposal is intended to move the Island Industrial customer rates closer to cost-based rates, the Board is concerned that, in light of shifting loads within the Island Industrial customer class, its proposals could have different long-term consequences for individual customers. In SIR-IC-NLH-010 Hydro states that the 2015 test year cost of service study will include an allocation of the 2014 net income shortfall among customer classes. In the context of Hydro's intention to file an amended general rate application the Board shares Vale's concerns in relation to the uncertainty surrounding the ultimate impact on Island Industrial customers.

In considering whether to approve the implementation of the proposed interim rates for the Island Industrial customers the Board must be satisfied that the rates, either interim or final, approved and charged to Island Industrial customers for 2014 do not result in inequity or unfairness for a customer. This includes consideration of the principle of intergenerational equity and the future allocation to customers of balances that have accrued over past periods. The Board must also in this case consider the direction from Government and generally accepted sound public utility practice. These matters can and should, in the Board's

Board's view, be addressed in the context of a general rate application with complete and supported proposals for cost-based rates that reflect the actual cost of providing service and allocation of these costs to customers in accordance with established rate making principles. Until Hydro files its amended general rate application the Board has little basis upon which to assess the proposal for interim rates in this Application. In the Board's view the uncertainties and concerns surrounding this Application do not support approval of Hydro's proposals at this time. The Board finds that, based on the evidence, the proposed changes to interim rates for the Island Industrial customers should not be approved.

In light of the Board's findings with respect to Hydro's proposal to implement new interim rates for Island Industrial customers, it is unnecessary for the Board to address the Industrial Customer Group's proposal that the Board order that Hydro allocate the segregated RSP Load Variation balance based on the proposals in the general rate application.

IT IS THEREFORE ORDERED THAT:

1. The Application is denied.

2. Newfoundland and Labrador Hydro shall pay all expenses of the Board arising from this Application.

DATED at St. John's, Newfoundland and Labrador, this 17th day of September 2014.

Andy Wells
Chair & Chief Executive Officer

Dwanda Newman, LL.B.
Commissioner

James Oxford
Commissioner

B. Sheppard
Bobbi Sheppard
Assistant Board Secretary