



Hydro Place, 500 Columbus Drive,  
P.O. Box 12400, St. John's, NL  
Canada A1B 4K7  
t. 709.737.1400 f. 709.737.1800  
www.nlh.nl.ca

June 2, 2015

Board of Commissioners of Public Utilities  
Prince Charles Building  
120 Torbay Road, P.O. Box 21040  
St. John's, NL  
A1A 5B2

**ATTENTION: Ms. Cheryl Blundon**  
**Director of Corporate Services & Board Secretary**

Dear Ms. Blundon:

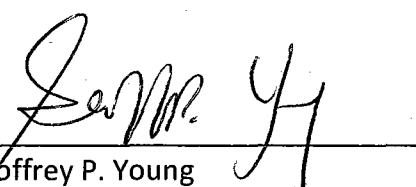
**Re: Newfoundland Power Inc. - 2016 Deferred Cost Recovery Application**

Enclosed please find the original plus 12 copies of Newfoundland and Labrador Hydro's submission with regard to the above-noted application.

Should you have any questions, please contact the undersigned.

Yours truly,

**NEWFOUNDLAND AND LABRADOR HYDRO**

  
\_\_\_\_\_  
Geoffrey P. Young  
Senior Legal Counsel

GPY/cp

cc: Gerard Hayes – Newfoundland Power

Thomas Johnson – Consumer Advocate

**NEWFOUNDLAND AND LABRADOR HYDRO  
SUBMISSION REGARDING  
NEWFOUNDLAND POWER'S  
2016 DEFERRED COST RECOVERY APPLICATION**

June 2015



## Table of Contents

1.0	Background .....	1
2.0	2016 Cost Uncertainty .....	1
3.0	Conclusion.....	4

## 1.0 Background

By Order No. P.U. 13(2013), Newfoundland Power (NP) was required to file its next general rate application with a 2016 test year on or before June 1, 2015 unless otherwise directed by the Board.

On April 15, 2015, NP filed an application with the Board of Commissioners of Public Utilities (the Board) requesting that the Board approve, on a final basis:

- I. a 2016 forecast average rate base for Newfoundland Power of \$1,054,192,000;
- II. a just and reasonable 2016 rate of return on rate base for Newfoundland Power of 7.38% in a range of 7.20% to 7.56%;
- III. deferred cost recovery of \$3,991,000 for 2016;
- IV. direction to Newfoundland Power to file its next general rate application by June 1, 2016 with a 2017 test year; and
- V. continuation of Newfoundland Power's existing rates, tolls and charges until modified by further order of the Board (the "Application").<sup>1</sup>

The reasons cited justifying approval of the Application are that it permits the orderly establishment of rates to be charged to customers, is consistent with regulatory principle and practice before the Board, and is consistent with regulatory efficiency.<sup>2</sup>

In the Application, NP states that without the requested \$4.0 million deferral, its forecast 2016 regulated return on equity will be 8.08% vs. the 8.80% approved by the Board in 2013. NP's Application is requesting that the Board grant additional revenue relief on a final basis for 2016 without providing the Board the opportunity to (i) test NP's costs for 2016 or (ii) to determine whether the 8.80% return on 45.0% common equity is reasonable for 2016.

## 2.0 2016 Cost Uncertainty

There is substantial uncertainty with respect to NP's 2016 forecast which has been proposed as a basis for approving additional revenue requirement and for the finalization of customer rates. NP's forecast return for 2016 can vary materially dependent on variances from the sales forecast and power purchase expense. There are also outstanding studies on depreciation and cost of capital which can have a material impact in determining whether a return shortfall even exists for 2016.

---

<sup>1</sup> See item 9 in the Application.

<sup>2</sup> See item 10 in the Application.

### **Forecast Revenue Uncertainty**

Hydro submits that there is uncertainty surrounding NP's Forecast Revenues. In the Application, NP's forecast regulated return on common equity of 8.08% assumes sales growth of 1.6%. The response to NLH-NP-043 indicates that over the past five years, NP's actual average sales growth has been 2.2%.

An increase in NP's forecasted 2016 weather normalized sales growth could have a material impact on forecast revenue deficiency. An increase in weather normalized sales growth from NP's forecast by 1.0% reduces the forecast revenue shortfall by \$2.1 million in 2016, more than 50% of the cost deferral requested in the Application.<sup>3</sup>

NP's forecasts have been shown to be conservative in two of the past three test years, as noted in the response to NLH-NP-041. Further, as NP is proposing final approval of its forecast shortfall of revenue requirement, no deferral mechanism exists to capture or share variances in forecast revenue growth in 2016. Therefore, any amount resulting from sales growth exceeding the 2016 forecast would accrue to NP's shareholder.

### **Forecast Power Purchase Uncertainty**

Hydro submits that a level of uncertainty also exists with respect to NP's forecast power purchase expense. While the majority of NP's power comes from Hydro, a portion is from NP's own hydraulic generation. To the extent that NP's hydraulic storage increases or decreases in a given year, there is a corresponding increase or decrease in power purchases expense in that same year.

As noted in the response to NLH-NP-055, variances in hydraulic storage can vary power purchase expense by as much as \$2.4 million.<sup>4</sup> Reduced year-end hydraulic storage from that forecast by NP could materially reduce NP's forecast revenue shortfall for 2016.

### **Cost of Capital Uncertainty**

In Order No. P.U. 13(2013), the Board required NP to file a report in relation to its capital structure with its next GRA. That Order also required NP to file its next GRA on or before June 1, 2015. To date, NP has not had an expert complete a review of the Company's cost of capital for 2016.<sup>5</sup> Hydro submits that the outstanding cost of capital study creates uncertainty with respect to NP's 2016 forecast, particularly in the context of recent cost of capital reviews in other regulatory jurisdictions in Canada.

NP's common equity ratio of 45.0% for ratemaking is among the highest in Canada.<sup>6</sup> However, other Canadian utilities, with common equity ratios lower than that of NP's, recently had its

---

<sup>3</sup> NP RFI response NLH-NP-046.

<sup>4</sup> NP RFI response NLH-NP-055, 2011A.

<sup>5</sup> NP RFI response NLH-NP-030.

<sup>6</sup> NP RFI response NLH-NP-036, Attachment B, Page 2 of 6.

common equity ratios reduced through cost of capital hearings. The Alberta Utilities Commission on March 23, 2015, reduced the common equity ratio for 13 of 14 Alberta utilities by 1.0%. Included in this group was FortisAlberta, whose common equity was reduced from 41.0% to 40.0%.<sup>7</sup> The British Columbia Utilities Commission on May 10, 2013 reduced the common equity ratio of FortisBC by 1.5% to 38.5%.<sup>8</sup>

A change in NP's common equity ratio for 2016 could have a material impact on 2016 revenue requirement. If, for example, NP's common equity ratio was to match that of FortisAlberta at 40.0%, this would reduce the forecast revenue shortfall reflected in the Application by approximately \$2.0 million.<sup>9</sup>

With respect to comparative common equity ratios, NP's response to NLH-NP-072 NP states:

“In GRAs, there is typically no controversy as to what other utilities’ capital structures are. The primary issue is the appropriateness of Newfoundland Power’s capital structure given the specific risks to which it is exposed. Comparative capital structures typically provide some assistance to the Board by way of context.”

Hydro submits that the context given by recent decisions in Alberta and British Columbia is that the risks of similar utilities in Canada have changed since NP's last expert review of its capital structure in September 2012.<sup>10</sup> Hydro submits that the decisions from other jurisdictions, recognizing the change in risk and corresponding reductions of common equity ratios, is cause for uncertainty as to the continued appropriateness of NP's 45.0% common equity component for 2016, especially in the absence of NP's own expert review as required by the Board in P.U. 13(2013).

### ***Depreciation Uncertainty***

In Order No. P.U. 13(2013), the Board also required NP to file a new depreciation study with its next GRA. NP's consultant has not yet completed the required depreciation study.<sup>11</sup> Hydro submits that the absence of an updated depreciation study creates uncertainty around the reasonableness of NP's forecast 2016 depreciation expense.

---

<sup>7</sup> PUB-NLH-004, Attachment B, Page 104 of 113, Alberta Utilities Commission Decision 2191-D01-2015 dated March 23, 2015, Table 10 “Equity ratio findings”.

<sup>8</sup> PUB-NLH-004, Attachment A, Page 63 of 335, British Columbia Utilities Commission, Generic Cost of Capital Proceeding dated May 10, 2013.

<sup>9</sup> A 40.0% common equity ratio would reduce NP's 2016 Forecast Income Before Income Taxes by approximately \$2.0 million per RFI response NLH-NP-026, Attachment A, Page 1 of 1 (\$54,492 per the Application Schedule 1, Exhibit 1, Line 22 less \$52,507 per NLH-NP-026, Attachment A, Page 1 of 1, Line 21).

<sup>10</sup> NP 2013/2014 General Rate Application, Volume 3, “Opinion on Capital Structure and Return on Equity for Newfoundland Power”, dated September 2012.

<sup>11</sup> NP RFI response NLH-NP-007.

In its 1996 GRA, Newfoundland Power decreased its 1997 revenue requirement by approximately \$6.7 million from its original filing, primarily the result of a change in depreciation expense due to the 1995 Depreciation Study. The 1995 Depreciation Study was not filed as part of the original GRA filing.<sup>12</sup>

Further, in each of the past six GRAs NP's composite depreciation rate has changed between test years. This change has been as large as 0.15%.<sup>13</sup> A change in composite depreciation rate of 0.15% would be material to the amount requested in the Application. If NP's 2016 composite depreciation ratio were to reduce by 0.15%, as it did in 2008, the result would be a reduction in 2016 depreciation expense of \$2.5 million.<sup>14</sup>

As stated by NP in response NLH-NP-008, the actual variability in NP's composite depreciation rate will not be known until NP's next depreciation study is complete. Hydro submits that without a completed depreciation study, uncertainty exists around the depreciation expense to be used in finalizing customer rates for 2016.

### 3.0 Conclusion

NP has requested approval of the \$4.0 million in the Application on a *final* basis. However, Hydro submits that NP's application contains substantial uncertainty as to a just and reasonable deferred cost amount. NP states in its response to NLH-NP-069:

"Newfoundland Power is proposing deferred cost recovery of approximately \$4 million which represents the additional cost to finance the increased 2016 rate base resulting from capital expenditures required to provide service to customers. The additional 2016 cost is calculated in a manner consistent with existing practice for the annual regulation of Newfoundland Power's forecast returns on rate base for years that are not test years. Because the amount proposed for cost recovery deferral is calculated in a manner consistent with regulatory practice, it should provide the Board with a high degree of confidence that the amount of recovery is appropriate in the circumstances."

Hydro does not agree with this assertion by NP. Hydro submits that NP's calculation method, in and of itself, does not provide the confidence required to grant approval of the amount requested on a *final* basis. Hydro submits that regardless of the calculation method, NP's justification for the \$4.0 million deferral in the Application is based on assumptions that contain uncertainties. For example, NP's application is based upon a 2016 forecast return on equity of

---

<sup>12</sup> See response to NLH-NP-064.

<sup>13</sup> NP RFI response NLH-NP-008, change in composite depreciation rate between 2004 (3.44%) and 2008 (3.29%).

<sup>14</sup> Increase in 2016 Income Before Taxes per NLH-NP-073 (\$54,492 per the Application Schedule 1, Exhibit 1, Line 22 less \$59,117 per NLH-NP-073, Attachment A, Page 1 of 1, Line 22 equals \$4.6 million) less the impact of 1.0% sales growth per NLH-NP-046 (\$2.1 million).

8.08%. Hydro submits this forecast contains a great deal of uncertainty as to how much, if any, of the \$4.0 million will be needed for NP to achieve its approved rate of return in 2016.

As noted in this submission, uncertainty exists around NP's:

- 1) forecast revenue growth;
- 2) power purchase expense;
- 3) cost of capital; and
- 4) depreciation expense.

In aggregate, these uncertainties could total \$9.0 million which far exceed the amount requested in the Application of \$4.0 million.

Since 2010, NP's actual return on equity has exceeded the 8.80% allowed in Order No. P.U. 13 (2013). In fact, in all but one of the past five years, NP's actual return on equity has exceeded 9.00%, with an average actual return on equity of 9.10% over this same period.<sup>15</sup> Hydro submits that this history of earnings exceeding the approved return on equity for establishing customer rates combined with \$9.0 million of forecast uncertainty requires further review by the Board of 2016 costs prior to finalization of customer rates for 2016.

NP's response to NLH-NP-067 states as follows:

Furthermore, there is no provision in the Act which governs the deferral of costs on an *interim* basis. Given this, Newfoundland Power is uncertain as to how deferral on an interim basis would practically work and still be consistent with the prospective nature of utility regulation in the province.

Hydro respectfully disagrees with this assertion that the absence of a specific statutory power limits the Board's jurisdiction to grant an interim order approving a deferral account. As stated by the Court of Appeal in the *Stated Case*:

[36] 3. Failure to identify a specific statutory power in the Board to undertake a particular impugned action does not mean that the jurisdiction of the Board is thereby circumscribed; so long as the contemplated action can be said to be "appropriate or necessary" to carry out the identified statutory power and can be broadly said to advance the purposes and policies of the legislation, the Board will generally be regarded as having such an implied or incidental power.<sup>16</sup>

---

<sup>15</sup> NP RFI response NLH-NP-031.

<sup>16</sup> The *Stated Case*, paragraph 35. Also, at paragraph 18 of the *Stated Case*, the Court of Appeal stated:  
[18] It follows from these provisions that a literal and technocratic interpretation and application of the Act is to be avoided, in favour of an interpretation which will advance the underlying purpose of the legislation, as well as the power policy of the province and be consistent with generally accepted sound public utility practice.



Indeed, there is no express provision in the Act that gives the Board the power to approve a deferral account, either final or interim; that power arises from as a statutorily necessary implied power that permits the Board to carry out its rate making functions. In the 2010 decision of the Newfoundland and Labrador Court of Appeal on the RSP, the Court stated (per Green, C.J.A.):

[63] The operation of deferral accounts is permissible under the existing regulatory scheme in this province regardless of whether it might be argued they incidentally have retrospective or retroactive effect. Deferral accounts are utilized in public utility regulation to deal with the effects of uncertain or volatile costs in a manner that ensures that rates are reasonable, not unjustly discriminatory and that the utility earns a just and reasonable return. They permit the recovery or rebate in a subsequent period of any deficiency or excess between forecast and actual costs. Regulatory regimes generally permit the operation of deferral accounts. See *Bell Canada 2009* at paras. 54-55; *Atco Gas* at paras. 33-44; *City of Edmonton v. Northwestern Utilities Ltd.*, [1961] S.C.R. 392 at p. 406. It was properly acknowledged by all parties that the *PUB Act* authorizes the utilization of deferral accounts. See *Stated Case* at paras. 93-98.<sup>17</sup>

The Court of Appeal has determined that the Board has broad discretion in dealing with deferral accounts.<sup>18</sup> The Board also has the authority derived from section 75 of the Act to issue an interim order, either upon an application or unilaterally. If the Board chooses to deal with a deferral account on an interim basis, such that it may later revisit and reconsider the

---

<sup>17</sup> *Newfoundland and Labrador Hydro v. Newfoundland and Labrador (Board of Commissioners of Public Utilities)*, 2012 NLCA 38, at paragraph 63.

<sup>18</sup> *Newfoundland and Labrador Hydro v. Newfoundland and Labrador (Board of Commissioners of Public Utilities)*, 2012 NLCA 38. With respect to deferral accounts:, at paragraph 64, the Court of Appeal stated:

[64] In *Bell Canada 2009* the use of deferral accounts to ensure that rates return to a utility the actual - not forecast - costs, was held to preclude a finding of retroactivity or retrospectivity:

[ 63] In my view, the credits ordered out of the deferral accounts in the case before us are neither retroactive nor retrospective. They do not vary the original rate as approved, which included the deferral accounts, nor do they seek to remedy a deficiency in the rate order through later measures, since these credits or reductions were contemplated as a possible disposition of the deferral account balances from the beginning. These funds can properly be characterized as encumbered revenues, because the rates *always* remained subject to the deferral accounts mechanism established in the Price Caps Decision. The use of deferral accounts therefore precludes a finding of retroactivity or retrospectivity. **Furthermore, using deferral accounts to account for the difference between forecast and actual costs and revenues has traditionally been held not to constitute retroactive rate-setting** (*EPCOR Generation Inc. v. Energy and Utilities Board*, [2003 ABCA 374 \(CanLII\)](#), 346 A.R. 281, at para. 12, and *Reference Re Section 101 of the Public Utilities Act* (1998), [1998 CanLII 18064 \(NL CA\)](#), 164 Nfld. & P.E.I.R. 60 (Nfld. C.A.), at paras. 97-98 and 175). (Emphasis added.)

underlying factual basis and assumptions that were in place at the time of the issuance of the ordering of the deferral account, it may do so. There is nothing in the Act that restricts the Board from doing so; therefore, the Board should not impose any such jurisdictional restriction upon its actions.

Giving consideration of the 2016 forecast uncertainty and the potential impact of final approval of NP's proposal on the consuming public, Hydro believes that NP's request for final approval of additional revenue requirement for 2016, based on untested costs, is unreasonable. Hydro respectfully submits that given the uncertainty in NP's 2016 forecast, the \$4.0 million 2016 Deferred Cost Recovery should be approved for deferral, however only on an interim basis. Recovery of any portion of the \$4.0 million should be subject to a future Order of the Board once NP's costs have been tested in detail through a general rate application in the fall of 2016.

As noted in the *Stated Case*, the Board has a "broad discretion, and hence a large jurisdiction, in its choice of methodologies and approaches to be adopted to achieve the purposes of the legislation and to implement provincial power policy" (paragraph 36, item 2). In doing so the Board must "balance the interests, as identified in the legislation, of the utility against those of the consuming public" paragraph 36, item 4). It is Hydro's submission that it would be premature and improper at this juncture for the Board to grant final approval to NP's request and thereby restricting in any manner its power to further review the proposed deferral account. This is especially true in light of the uncertainties of NP's forecasts and the outstanding depreciation and cost of capital studies that are required in testing 2016 costs.