Q. Further to Newfoundland Power's response to NLH-NP-014 which states:

"The impact on Newfoundland Power's 2016 financial results of approval of deferred recovery on an interim basis is that such an approval would not provide Newfoundland Power with a reasonable opportunity to earn a just and reasonable return for 2016 within the meaning of Section 80 of the Act."

Please explain how approval of deferred costs on an interim basis, in accordance with Section 75 of the Public Utilities Act, that are subject to further review by the Board prior to granting final cost recovery to Newfoundland Power would remove the opportunity for Newfoundland Power to earn a just and reasonable return for 2016 within the meaning of Section 80 of the Act.

A. Section 75 of the *Public Utilities Act* (the "Act") provides that the Board may make an interim order approving a schedule of *rates, tolls and charges* submitted by a public utility upon the terms and conditions that it may decide. Section 75 of the Act does not provide for the approval of *costs* on an interim basis. 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.[1]

For this reason, the Application does not seek approval of deferred costs on an interim basis with cost recovery to be addressed in a subsequent process. In Newfoundland Power's view, such an approach would not be consistent with the prospective nature of utility regulation in the Province.[2]

Section 80 (1) of the Act provides that a public utility is "entitled to earn annually" a just and reasonable return on its rate base. For that entitlement to be meaningful practically requires that the utility be accorded a reasonable opportunity to earn its allowed return.

As stated in the majority opinion of the Newfoundland and Labrador Court of Appeal in a stated case presented by the Board in 1996:

> "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. 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

[1] For further information on the reasons why Order No. P.U. 58 (2014) does not provide additional clarity on this matter, see the response to Request for Information NLH-NP-074.

[2] See the response to Request for Information PUB-NP-006, pages 2-3 and NLH-NP-066.

> statutory objectives, the utility nevertheless remains subject to business risks and the effects of management decisions…
>
> The corollary of this position is that the utility must be accorded a degree of managerial flexibility in decision-making in order to be able to minimize the risks to which it must respond."[3]

These considerations underscore the importance of prospective rate making to the entitlement of Newfoundland Power to an opportunity to earn a just and reasonable return in a given year. To the extent that utility regulation operates retrospectively, as opposed to prospectively, it can deprive management of the flexibility to respond to the risks to which the utility is exposed.

The current regulatory agenda before the Board illustrates some of the hazards associated with deferring costs for which recovery is uncertain. Hydro's current general rate application ("Hydro's current GRA") will consider, among other things, the appropriateness of Hydro's recovery of approximately $56 million associated with 2014 costs and a forecast 2015 net income deficiency of approximately $68 million. It is likely that the Order on Hydro's current GRA which will determine the appropriate level of recovery of this approximate $124 million associated with 2014 and 2015 will not be issued until 2016. This is not consistent with the prospective nature of rate regulation in Newfoundland and Labrador and, in Newfoundland Power's view, is not desirable from a regulatory perspective.

[3] See Stated Case, paragraphs 31-32.