October 15, 2021

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

Attention: G. Cheryl Blundon
Director of Corporate Services
and Board Secretary

Dear Ms. Blundon:

Re: Newfoundland and Labrador Hydro – Supply Cost Accounting Application

A. Introduction

On July 29, 2021, Newfoundland and Labrador Hydro ("Hydro") filed its Supply Cost Accounting Application (the "Application"), requesting approval of:

(i) Deferral account proposals to address material changes in system costs associated with the commissioning of the Muskrat Falls Project (the "Project"), including the discontinuance of Hydro's longstanding Rate Stabilization Plan ("RSP");

(ii) Deferred recovery of accelerated deprecation costs associated with Hydro's Holyrood Thermal Generating Station ("Holyrood"); and

(iii) International Financial Reporting Standards ("IFRS") deviations to allow Hydro to recognize expenses related to the purchase of post-commissioning energy in accordance with the commercial terms of the Muskrat Falls Power Purchase Agreement (the "Muskrat PPA") and the Transmission Funding Agreement (the "TFA", or collectively, the "Project Agreements").

On July 28, 2021, the governments of Canada and Newfoundland and Labrador announced an agreement in principle for the financial restructuring of the Project. In connection with the agreement in principle, the Provincial Government updated its mitigated customer rate target to 14.7 ¢/kWh, approximately 9% higher than the previously indicated target of 13.5 ¢/kWh.[1] Hydro submits that while the financial restructuring would reduce Hydro's required payments under the Project Agreements, it would not change the requirement for Hydro to begin making payments under the Project Agreements as commissioning proceeds. Further, Hydro states the implementation of the announced financial restructuring would not require modification to any of Hydro's proposals detailed in the Application.

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[1] (14.7 - 13.5) / 13.5 = 0.089, or approximately 9%.

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The Board has requested that comments on the Application be filed by October 15, 2021. Part B of this response provides Newfoundland Power Inc.'s ("Newfoundland Power" or the "Company") comments on Hydro's supply cost variance deferral account proposals. Part C provides the Company's comments on other Application proposals.

B. Supply Cost Variance Deferral Account Proposals

Based on information on the record of this proceeding, it is Newfoundland Power's understanding that:

(i) Contractual payments associated with the Project Agreements are forecast to materially impact Hydro's net income beginning in 2021.[2]

Rate mitigation funding is expected to largely offset: (i) Hydro's required payments under the Project Agreements; and (ii) increased system costs resulting from the Project that would otherwise be borne by Newfoundland Power's customers.[3] However, contractual payments under the Project Agreements may be required before rate mitigation funding amounts are received by Hydro.

(ii) According to Hydro, all proposed supply cost deferral account changes, including the discontinuance of Hydro's RSP mechanism, are necessary to account for supply cost variances post-commissioning of the Project.[4]

Hydro provides that if the proposed supply cost deferral account changes were limited solely to the approval of a deferral account for Project costs and credits, fuel savings that would occur as a result of reduced thermal generation due to energy purchases from the Project would accrue to Hydro's net income rather than to the benefit of customers.[5]

Further, Hydro illustrated that the proposed supply cost mechanisms will work with the current wholesale rate charged to Newfoundland Power by Hydro to produce a similar effect on Hydro's net income resulting from the operation of existing supply cost mechanisms.[6]

(iii) The proposed Supply Cost Variance Deferral Account is a temporary measure to manage the transition to incorporating Project costs into customer rates.[7]

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2 See, for example, responses to Requests for Information NP-NLH-001 and NP-NLH-007.
3 See response to Request for Information IIC-NLH-003, Attachment 1, page 9.
4 See responses to Requests for Information PUB-NLH-014, PUB-NLH-015, PUB-NLH-019, PUB-NLH-020 and PUB-NLH-021 (Revision 1 – October 5, 2021).
5 See response to Request for Information PUB-NLH-021 (Revision 1 – October 5, 2021).
6 See response to Request for Information NP-NLH-021.
7 See response to Request for Information PUB-NLH-003.

Hydro states that in its next general rate application ("GRA"), it will provide evidence in support of a proposal to incorporate Project costs and rate mitigation into customer rates and present additional evidence on a long-term approach to the Supply Cost Variance Deferral Account.[8]

(iv) The Provincial Government has been informed of Hydro's proposed approach to defer Project costs until rate mitigation funding is provided or customer rates are revised to reflect Project costs.[9]

In Newfoundland Power's view, it is important for the parties charged with implementing rate mitigation to understand how Project costs are being treated by Hydro, including the recognition of large balances owing from Newfoundland Power's customers.[10]

Ultimately, rate mitigation funds should be received in a manner (i.e. timing and amount) that is conducive to achieving targeted rate mitigation levels for customers in 2022 and over the long-term.

(v) Anticipated customer rate increases in 2022 resulting from the recovery of Project costs are forecast to be offset to some degree by Hydro's annual July 1st Utility RSP rate adjustment update (the "RSP update").

Hydro anticipates customer rates will increase in 2022 due to the commencement of recovery of Project costs.[11] In its July 2021 announcement, the Provincial Government indicated the targeted mitigated rate would come into effect in 2022.[12]

Hydro anticipates customer rates will decrease in 2022 as a result of the RSP update, effective July 1, 2022.[13] If the proposed deferral account changes are approved, Hydro estimates the RSP update would reduce retail customer rates by approximately 8%.[14]

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8 Ibid.
9 See response to Request for Information PUB-NLH-022.
10 See response to Request for Information NP-NLH-007.
11 See response to Request for Information PUB-NLH-040.
12 See response to Request for Information IIC-NLH-003, Attachment 1, page 9.
13 See responses to Requests for Information PUB-NLH-035 and PUB-NLH-040.
14 See response to Request for Information NP-NLH-010. Hydro states that the estimate assumes approximately $85 million in supply costs are transferred to the new Supply Cost Variance Deferral Account for future allocation and recovery from customers, of which $66 million relates to the hydraulic variation component of the RSP. In the response to Request for Information PUB-NLH-038, Hydro provides that if the historical 25% allocation of the hydraulic variation component was included in the RSP Current Plan balances prior to transferring the balance to the proposed Supply Cost Variance Deferral Account, it would result in an approximate 2.1% increase in retail customer rates.

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Hydro indicates the finalization of the rate mitigation plan by the Provincial Government could influence the rate adjustment proposals reflected in the July 1, 2022 RSP update application.[15]

(vi) Hydro is proposing to calculate finance charges on the proposed Supply Cost Variance Deferral Account on a monthly basis using Hydro's approved test year weighted average cost of capital ("WACC").[16]

Hydro's existing supply cost variance deferral accounts do not provide for finance charges to be applied to monthly balances.[17] Rather, the balances are included in its test year rate base in determining test year revenue requirement.[18]

Hydro provides that due to the material uncertainty in the forecast balances in the proposed Supply Cost Variance Deferral Account, Hydro is intending to exclude the Supply Cost Variance Deferral Account in its calculation of rate base in its next GRA. Hydro further states that applying finance charges using a WACC would be consistent with the finance charge calculations applied to Hydro's RSP.

Hydro plans to utilize short-term borrowings to make contractual payments until funding is available from the Provincial Government through the rate mitigation plan.[19]

Based on this understanding, Newfoundland Power is supportive of Hydro's supply cost deferral account proposals, with the exception of Hydro's proposal to calculate finance charges on the Supply Cost Variance Deferral Account on a monthly basis using Hydro's approved test year WACC.[20]

Newfoundland Power agrees there is material uncertainty in the forecast Supply Cost Variance Deferral Account balances. However, the Company submits that different treatment is not justified at this time when compared to Hydro's existing supply cost variance deferral accounts or Hydro's proposed Sustaining Capital Deferral Account, none of which provide for finance charges to be applied to monthly balances at Hydro's WACC. While the RSP has historically attracted finance charges at WACC on a monthly basis, the RSP is a longstanding regulatory mechanism that provided recovery of supply costs from customers on an annual basis and is proposed to be discontinued as part of the Application.

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15 See response to Request for Information PUB-NLH-035.
16 See response to Request for Information NP-NLH-018.
17 See response to Request for Information NP-NLH-028.
18 Ibid.
19 See response to Request for Information PUB-NLH-022.
20 Hydro's approved test year WACC is consistent with its approved test year rate of return on rate base.

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Hydro has stated that the proposed Supply Cost Variance Deferral Account is a temporary measure to manage the transition from incorporating Project costs into customer rates to a long-term approach to be determined in its next GRA. Newfoundland Power submits that the determination of how the Supply Cost Variance Deferral Account is treated with respect to rate base and return on rate base calculations should occur at that time. This approach would be consistent with Hydro's approach to its proposed Sustaining Capital Deferral Account.[21]

In Newfoundland Power's view, the Application is extraordinary in nature. The Application seeks deferred recovery of Project costs that are the result of the Project Agreements and government direction, rather than being justified as reasonable as required by provincial power policy. Consistent with the proposed deferred recovery of costs associated with the Project, Newfoundland Power submits that Hydro should be able to recover its short-term debt costs associated with financing Supply Cost Variance Deferral Account balances until the long-term approach is determined through its next GRA.[22]

Finally, Newfoundland Power is concerned with the material deferred supply cost balances forecasted by Hydro. While rate mitigation funding is expected to largely offset these amounts, it remains uncertain when, and to what extent, rate mitigation will occur. Newfoundland Power submits that Hydro should include reporting on Supply Cost Variance Deferral Account balances in its quarterly update regarding the timing of its next GRA.

C. Other Application Proposals

Newfoundland Power is supportive of Hydro's proposed Holyrood Accelerated Depreciation Deferral Account. Depreciation expense associated with Holyrood is forecast to be materially higher in 2022 than what is reflected in current customer rates.

The Company observes that 2023 depreciation expense associated with Holyrood is forecast to be materially lower than what is reflected in current customer rates.[23] For this reason, Newfoundland Power submits that Hydro's proposed Holyrood Accelerated Depreciation Deferral Account should also include 2023 to ensure that customers only pay for actual depreciation expense associated with Holyrood rather than a test year forecast, which could materially differ from actuals, given the accelerated depreciation treatment currently in effect.

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21 See response to Request for Information PUB-NLH-028. Hydro states that the definition of the Sustaining Capital Deferral Account does not include the calculation of interest on the balance and the determination of whether Hydro will request to include the deferral balance in rate base will be addressed as part of Hydro's next GRA.

22 Hydro plans to utilize short-term borrowings to make contractual payments until funding is available from the Provincial Government through the rate mitigation plan. See response to Request for Information PUB-NLH-022.

23 See *Application, Schedule 1: Evidence*, Table 6, page 28.

Newfoundland Power is supportive of Hydro's proposed IFRS deviations to allow Hydro to recognize expenses related to the purchase of post-commissioning energy in accordance with the commercial terms of the Project Agreements. Hydro confirms that the IFRS deviation deferral is the same as the deferral previously approved by the Board in Order No. P.U. 9 (2021) for pre-commissioning energy, is non-cash and will not be included in rate base.[24] Based on these facts, it is Newfoundland Power's understanding that the approval of proposed IFRS deviations will not impact the Company or its customers.

If you have any questions regarding the enclosed, please contact the undersigned at your convenience.

Yours truly,

NEWFOUNDLAND POWER INC.

Lindsay Hollett

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[24] See response to Request for Information PUB-NLH-026.