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Board of Commissioners of Public Utilities

Newfoundland Power Inc.

2022-2023 General Rate Application
Financial Consultants Amended Application Report

January 17, 2022

Contents

Restrictions, Qualifications and Independence

This report is not intended for general circulation or publication nor is it to be reproduced or used for any purpose other than that outlined herein without our prior written permission in each specific instance. Notwithstanding the above, we understand that our report may be disclosed as a part of a public hearing process. We have given the Board our consent to use our report for this purpose.

The procedures undertaken in the course of our review do not constitute an audit of Newfoundland Power Inc.'s ("the Company") ("Newfoundland Power") financial information and consequently, we do not express an opinion on the financial information provided by Newfoundland Power. In preparing this report, we have relied upon information provided by Newfoundland Power.

We acknowledge that the Board is bound by the Access to Information and Protection of Privacy Act 2015 and agree that the Board may use its sole discretion in any determination of whether and, if so, in what form, this Report may be required to be released under this Act.

We reserve the right, but will be under no obligation, to review and/or revise the contents of this report in light of information which becomes known to us after the date of our report.

Introduction and Scope

On May 27, 2021, Newfoundland Power submitted its 2022/2023 General Rate Application (the “Original Application”) to the Board of Commissioners of Public Utilities (“the Board”).

On December 7, 2021, the Company submitted an amended Application and revised Exhibits (the “Amended Application”) to the Board with respect to matters pertaining to the Settlement Agreement (the “Settlement Agreement”) which was filed with the Board on November 23, 2021.

Grant Thornton LLP (“Grant Thornton”) has undertaken a review of the Amended Application focusing on the changes to Newfoundland Power’s 2022 and 2023 test years’ forecast revenue requirement, forecast average rate base and forecast rate of return on average rate base. In conducting our review, we have performed the following procedures:

- Reviewed the Amended Application, including the exhibits thereto containing certain Financial Schedules, to assess whether the settled issues contained in the Settlement Agreement are appropriately reflected in the Amended Application;

- Ensured that revisions to the 2022 and 2023 proposed revenue requirements were made in accordance with the Settlement Agreement;

- Ensured that revisions to the 2022 and 2023 average rate base were made in accordance with Settlement Agreement;

- Ensured the Company’s depreciation expense calculation incorporates the changes reflected in the Settlement Agreement, and

- Verified that the Company’s schedule of rates, tolls and charges as set out in Schedule A of the Amended Application incorporates the changes reflected in the Settlement Agreement.

Observations and Findings

Revenue Requirements

As a result of the Settlement Agreement the forecast revenue requirements from rates for the 2022 and 2023 test years included in the Company's Amended Application are calculated to be $704,861,000 and $699,245,000 respectively, which is a net decrease of $10,503,000 and $13,558,000 respectively from those proposed by the Company in its Original Application filed May 27, 2021. The breakdown of these changes is as follows:

Change in 2022 Test Year Revenue Requirement	**2022**	
(000's)		
Revenue Requirement from rates, per Original Application	$ 715,364	
(Decrease) Increase due to Settlement Agreement		
Operating Costs	(2,499)	1
Deferred Cost Recoveries and Amortization	233	2
Depreciation	(24)	3
Income Taxes	(3,107)	4
Return on Rate Base	(7,280)	5
Other Revenue	(5)	6
Other Transfers RSA	2,179	7
	(10,503)	
Revenue Requirement from rates, per Amended Application	$ 704,861	

Note 1: The decrease in operating costs of $2,499,000 is a result of a reduction in the amortization of hearing costs of $294,000 related to these costs being recovered through the Rate Stabilization Account ("RSA"), $26,000 in short-term incentive program costs being reduced due to only 50% of the expense included in revenue requirement associated with the cash flow component of the corporate target, a reduction in the amortization of Conservation and Demand Management ("CDM") costs of $2,045,000 related to the forecast and historical CDM costs being amortized over a 10-year period, and a reduction in the amortization of electrification costs of $134,000 being removed from test year forecast.

Note 2: Amortization of deferred cost recoveries has increased by $233,000. This is the result of a change in the 2022 revenue shortfall due to a reduction in return on equity to 8.5%. The forecast revenue shortfall of $930,000 was agreed to in Clause 22 of the Settlement Agreement. We have recalculated the 2022 revenue shortfall and amortization:

	Original Application	Amended Application	Change
Opening revenue shortfall	$ (1,262,000)	$ (930,000)	332,000
2022 amortization	370,000	274,000	(96,000)
Rounding	-	(3,000)	(3,000)
Revenue requirement impact	$ (892,000)	$ (659,000)	$ 233,000

Note 3: Depreciation decreased by $24,000 as a result of the removal of Electric Vehicle Charging Stations from plant investment.

Note 4: Income taxes have decreased $3,107,000. This is primarily due to the lower forecast return on common equity.

Note 5: Return on rate base has decreased by $7,280,000 as a result of the change in return on equity from 9.8% to 8.5% pursuant to Clause 13 of the Settlement Agreement.

Note 6: Interest relating to RSA decreased due to RSA transfers of extending CDM amortization period from 7 to 10 years.

Note 7: Other Transfers RSA has increased by $2,179,000 as result of a reduction in the amortization of CDM costs of $2,045,000 related to the forecast and historical CDM costs being amortized over a 10-year period and a reduction in the amortization of electrification costs of $134,000 being removed from test year forecast.

Change in 2023 Test Year Revenue Requirement

(000's)	2023	
Revenue Requirement from rates, per Original Application	$ 712,803	
(Decrease) Increase due to Settlement Agreement		
Operating Costs	(2,501)	1
Deferred Cost Recoveries and Amortization	(1,260)	2
Depreciation	(794)	3
Income Taxes	(3,254)	4
Return on Rate Base	(7,569)	5
Other Transfers to RSA	1,820	6
	(13,558)	
Revenue Requirement from rates, per Amended Application	$ 699,245	

Note 1: The decrease in operating costs of $2,501,000 is a result of a reduction in the amortization of hearing costs of $353,000 related to these costs being recovered through the RSA, $27,000 in short-term incentive program costs being reduced due to only 50% of the expense included in revenue requirement associated with the cash flow component of the corporate target, a reduction in the amortization of CDM costs of $1,386,000 related to the forecast and historical CDM costs being amortized over a 10-year period, a reduction in the amortization of electrification costs of $435,000 being removed from test year forecast and a reduction of $300,000 in operating costs to reflect operating efficiencies.

Note 2: Amortization of deferred cost recoveries has decreased by $1,260,000. This is the result of a change in the 2022 revenue shortfall due to a reduction in return on equity to 8.5% and use of deferral account to offset the impact of the proposed income tax impact in capitalizing pension costs with amortization of the recovery of $1,427,000 over 5-year period pursuant to Clause 17(a) of the Settlement Agreement. We have recalculated the 2023 amortizations below:

	Original Application	Amended Application	Change
Opening revenue shortfall	$ (892,000)	$ (659,000)	$ 233,000
2023 amortization	444,000	328,000	(116,000)
Unamortized shortfall	(448,000)	(331,000)	117,000
Revenue requirement impact	$ 444,000	$ 328,000	$ (116,000)
Total Tax Impact of Pension Capitalization	$ -	$ (1,427,000)	$ (1,427,000)
2023 amortization	-	284,000	284,000
Revenue requirement impact	$ -	$ (1,143,000)	$ (1,143,000)
Rounding		$ (1,000)	$ (1,000)
Overall Revenue requirement impact	$ 444,000	$ (816,000)	$ (1,260,000)

Note 3: Depreciation decreased by $794,000 as a result of correcting the appropriate service life of the Customer Information System (18 years) and the removal of Electric Vehicle Charging Stations from plant investment.

Note 4: Income taxes have decreased $3,254,000. This is primarily due to the lower forecast return on common equity.

Note 5: Return on rate base has decreased by $7,569,000 as a result of the change in return on equity from 9.8% to 8.5% pursuant to Clause 13 of the Settlement Agreement.

Note 6: Other Transfers RSA has increased by $1,820,000 as a result of a reduction in the amortization of CDM costs of $1,386,000 related to the forecast and historical CDM costs being amortized over a 10-year period and a reduction in the amortization of electrification costs of $435,000 being removed from test year forecast, less $1,000 for rounding.

We have reviewed the forecast revenue requirement for 2022 and 2023 included in the Amended Application and obtained appropriate evidence to support the revisions as a result of the Settlement Agreement.

Average Rate Base and Rate of Return on Average Rate Base

2022 forecast average rate base included in the Amended Application decreased by $473,000 compared to the Original Application that was filed on May 27, 2021 ($1,239,558,000 in the Original Application versus $1,239,085,000 in the Amended Application).

2023 forecast average rate base included in the Amended Application decreased by $1,955,000 compared to the Original Application that was filed on May 27, 2021 ($1,289,405,000 in the Original Application versus $1,287,450,000 in the Amended Application).

The decrease in the return on common equity from 9.8% to 8.5% resulted in a decrease in the forecast rate of return on average rate base for:

- 2022 from 7.19% in the Original Application to 6.61% in the Amended Application with a range of 6.43% to 6.79%; and,
- 2023 from 6.97% in the Original Application to 6.39% in the Amended Application with a range of 6.21% to 6.57%.

The decrease in forecast average rate base was due to the following:

Change in 2022 Forecast Average Rate Base

(000's)	2022	Note
Change in Plant Investment	$ (754)	1
Change in Cost Recovery Deferral - Hearing Cost	(247)	2
Change in Cost Recovery Deferral - Conservation	2,591	3
Change in Cost Recovery Deferral - Electrification	(1,944)	4
Change in Cost Recovery Deferral - 2022 Revenue Shortfall	(82)	5
Change in Accumulated Deferred Income Tax	24	6
Change in Cash Working Capital Allowance	(61)	7
	$ (473)	

Change in 2023 Forecast Average Rate Base

(000's)	2023	Note
Change in Plant Investment	$ (1,340)	1
Change in Cost Recovery Deferral - Hearing Cost	(371)	2
Change in Cost Recovery Deferral - Conservation	3,792	3
Change in Cost Recovery Deferral - Electrification	(4,180)	4
Change in Cost Recovery Deferral - 2022 Revenue Shortfall	(123)	5
Change in Cost Recovery Deferral - Pension Capitalization	400	8
Change in Accumulated Deferred Income Tax	(45)	6
Change in Cash Working Capital Allowance	(88)	7
	$ (1,955)	

Note 1: The change in Plant Investment is due to the correction for the appropriate service life of the Customer Information System (18 years) and to remove Electric Vehicle Charging Stations from plant investment. The impact on 2022 and 2023 average rate base was a decrease of $754,000 and $1,340,000 respectively.

Note 2: The change is due to actual Board and Consumer Advocate costs related to the Application being recovered through the RSA pursuant to Clause 21 of the Settlement Agreement.

Note 3: The change is due to an increase in the amortization period for customer forecast and historical CDM program costs being amortized over a 10-year period.

Note 4: The change is due to all electrification infrastructure and program costs removed from the proposed rate base in the Amended Application.

Note 5: The change in the 2022 Revenue Shortfall was due to a reduction in return on equity from 9.8% to 8.5%. The impact on 2022 and 2023 forecast average rate base was a decrease of $82,000 and $123,000 respectively.

Note 6: The change in Accumulated Deferred Income Tax is due to the impact on the removal of Electric Vehicle Charging Stations from plant investment for 2022 and 2023 and the correction of appropriate service life of the Customer Information System from 10 to 18 years in 2023.

Note 7: The decrease in cash working capital allowance is primarily due to the elimination of electrification costs and a reduction in income taxes.

Note 8: The increase in 2023 is due to the use of a deferral account to offset the impact of the proposed change in capitalizing pension cost, with amortization of the recovery of $1,427,000 over 5-year period commencing January 1, 2023.

Rates, Tolls and Charges

We can confirm that the Company’s schedule of rates as set out in Schedule A of the Amended Application incorporates the terms of the Settlement Agreement.

Other Matters

2022 and 2023 Revenue Requirements included in the Settlement Agreement

During our review we noted differences in the 2022 and 2023 revenue requirements filed in the Amended Application in comparison to the Settlement Agreement. The Settlement Agreement Clause 23 states that a revenue requirement of $704,843,000 for 2022 and $699,260,000 for 2023 should be approved. The Amended Application asks for approval of $704,861,000 for 2022 and $699,245,000 for 2023. We asked the Company to explain the variations and they provided the following response:

> *"Similar to the Compliance Filing of the 2020 GRA, a final quality assurance process was completed on the Amended Application financial forecasts. As a result of this review, a number of minor adjustments were made to ensure the Amended Application correctly reflected the terms of the Settlement Agreement.*
>
> *The impact of these adjustments is minimal. The result is an increase in revenue requirements of $18,000 in 2022 and reduction in revenue requirements of $15,000 in 2023 compared to the Settlement Agreement forecasts."*

We reviewed the revenue requirements for 2022 and 2023 filed in the Amended Application to ensure they were prepared in accordance with the Settlement Agreement and found no exceptions.

2023 Rate Base included in the Settlement Agreement

During our review we noted a difference in the 2023 rate base filed in the Amended Application in comparison to the Settlement Agreement. The Settlement Agreement clause 15 states that a forecast average rate base of $1,287,665,000 should be approved. The Amended Application asks for approval of $1,287,450,000. We asked the Company to explain the variation and they provided the following response:

> *"Similar to the Compliance Filing of the 2020 GRA, a final quality assurance process was completed on the Amended Application financial forecasts. As a result of this review, a number of minor adjustments were made to ensure the Amended Application correctly reflected the terms of the Settlement Agreement.*
>
> *The result of these adjustments is minimal. The 2022 forecast average rate base is unchanged from the Settlement Agreement. For 2023, the forecast average rate base is lower by $215,000 when compared to the Settlement Agreement. This is primarily due to the removal in 2023 of $460,000 in capital costs related to the Electrification program."*[1]

We reviewed the rate base for 2023 filed in the Amended Application to ensure it was prepared in accordance with the Settlement Agreement and found no exceptions.

Proposed Changes to the Rate Stabilization Clause

During our review we noted that the Company is seeking approval of Rate Stabilization Clause II.9, including *"the recovery of costs charged annually to the Electrification Cost Deferral Account over a 10-year period, commencing in the year following the year in which the Electrification Cost Deferral is charged to the Electrification Cost Deferral Account."*[2]

We confirmed with the Company they are seeking approval of Rate Stabilization Clause II.9 in relation to the Electrification Cost Deferral Account. We also asked the Company to confirm if there are any costs to be recovered from the RSA in 2022 and 2023 and if there are any costs included in the 2022 and 2023 revenue requirement. The Company provided the following response:

[1] Refer to Settlement Agreement, Clauses 7 and 23(e)
[2] Newfoundland Power Inc. 2022-2023 Amended General Rate Application – Exhibit 14, lines 36 to 39

> *"It is confirmed that in this Amended Application, Newfoundland Power is seeking approval of Rate Stabilization Clause II.9 as proposed in the 2022/2023 General Rate Application and in accordance with the final settlement agreement.*[3]
>
> *As the electrification cost deferral account did not exist in 2021, there were no charges to the account in 2021. Therefore, there would be no transfer from the account to the Rate Stabilization Account in 2022.*
>
> *If the electrification deferral account is approved in 2022… there will be transfers to the account in 2022 and thus recovery through the RSA in the 2023 transfer (1/10th of the 2022 balance). It would only be associated with electrification infrastructure and program related costs in accordance with Board orders, such as the EV charger supplemental capital expenditures approved by the Board in Order No. P.U. 30 (2021), per the account definition.*
>
> *And it is confirmed there are no electrification costs (infrastructure and program that would go through the deferral account) included in 2022 and 2023 revenue requirement. This is consistent with paragraph 8(b) of the settlement agreement. There would be non-program general costs associated with electrification included in operating costs in revenue requirement that would not be recovered through the deferral account per the account definition. "*

We are not aware if the recovery of costs charged annually to the Electrification Cost Deferral Account over a 10-year period was intended to be included as a settled issue as part of the Settlement Agreement as it was not specifically addressed.

[3] According to the Company, "*on November 23, 2021, Newfoundland Power, Hydro, and the Consumer Advocate filed with the Board an agreement reflecting the settlement of all issues arising from Newfoundland Power's 2022/2023 General Rate Application.*"

Conclusion

Based on our review of the Amended Application and the completion of the procedures described in the scope of our report, we present the following findings for the Board's consideration:

- the revised forecast 2022 and 2023 test year revenue requirement to be recovered from electrical rates, of $704,861,000 and $699,245,000 respectively, appropriately incorporates the impact of the Settlement Agreement;

- the revised forecast 2022 and 2023 average rate base of $1,239,085,000 and $1,287,450,000, respectively, appropriately incorporates the impact of the Settlement Agreement;

- the proposed revised rates of return on average rate base of 6.61% and 6.39% for 2022 and 2023, respectively, appropriately incorporates the impact of the Settlement Agreement; and,

- the forecast revenue requirement from rates, as proposed by the Company is calculated based upon the proposed Schedule of Rates, Tolls and Charges effective March 1, 2022, which is located in Schedule A of the Amended Application.

Grant Thornton LLP

St. John's, Canada
January 17, 2022

Chartered Professional Accountants