IN THE MATTER OF
the Public Utilities Act, RSNL 1990,
Chapter P-47 (the "Act"); and

IN THE MATTER OF
a General Rate Application (the "Amended Application") by Newfoundland and Labrador Hydro for approvals of, under Sections 70 and 75 of the Act, changes in the rates to be charged for the supply of power and energy to Newfoundland Power, Rural Customers and Industrial Customers; and under Section 71 of the Act, changes in the Rules and Regulations applicable to the supply of electricity to Rural Customers.

To: The Board of Commissioners of Public Utilities (the "Board")

CONSUMER ADVOCATE'S FINAL WRITTEN SUBMISSIONS

December 23, 2015

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A. AMENDED APPLICATION – BACKGROUND

On November 10, 2014 Newfoundland and Labrador Hydro (hereinafter, "NLH" or "Hydro") filed an Amended General Rate Application with the Board ("Amended Application"). Previously on July 30, 2013 Hydro had filed a GRA based upon a 2013 test year. On or about June 6, 2014 approximately one month prior to the commencement of the hearing, Hydro gave notice to the Board and parties that Hydro planned to file an amended application in the Fall of 2014 based on updated financial information. Hydro's Amended GRA was made pursuant to Sections 58, 64, 70, 71, 75, 76, 78 and 80 of the *Public Utilities Act* and made various proposals concerning Revenue Requirement, Regulatory Accounting and Cost of Service, Rate Stabilization Plan (RSP), Interim Rates for Industrial Customers and Newfoundland Power as well as in relation to a 2014 Revenue Deficiency and other General Rate Proposals.

As regards to Interim Rates, Hydro sought:

> *(21) that rates for 2015 be approved on an interim basis for Island Industrial Customers effective January 1, 2015 in accordance with Order in Council OC 2013-089, as amended, as set out in the evidence in support of the Amended Application;*
>
> *(22) that rates be approved on an interim basis for Newfoundland Power and Hydro Rural customers, effective February 1, 2015, with the revenue shortfall associated with the delayed implementation to be recovered through a rate rider, as set out in the evidence in support of the Amended Application.*

As regards the 2014 Revenue Deficiency, Hydro sought an order:

> *(23) (a) that the RSP credit balance be used, where appropriate, to offset the 2014 Revenue Deficiency attributable to the Island Interconnected System;*
>
> *(b) that the portion of the 2014 Revenue Deficiency not recovered using the RSP credit balance be deferred for future recovery through a rate rider.*

Prior to Hydro's filing its Amended GRA on November 10, 2014, the Board had made the rates to be charged both to Island Interconnected Customers and to Newfoundland Power Inc. for electrical consumption on and after September 1, 2013 interim in Order No. P.U. 29 (2013) dated September 30, 2013.

On November 28, 2014 Hydro filed an application for approval of the deferral and recovery of $45.9 million associated with a forecast revenue deficiency in 2014. In Order No. P.U. 58 (2014) filed December 24, 2014 the Board approved the creation of a deferral account and the segregation in the account of $45.9 million as of December 31, 2014, but did approve Hydro's proposals for recovery. Schedule "A" to P.U. 58 (2014) provided the approved definition of the 2014 Cost Deferral Account as follows:

> *This account shall be charged with the variance of $45.9 million between forecast operating costs, amortizations and cost of capital for 2014 and forecast revenue for 2014.*

On January 28, 2015 Hydro filed an application with the Board seeking, among other things, approval of increases in base rates on an interim basis (the "2015 Interim Rate Application") in advance of the conclusion of its Amended GRA. The Application requested:

> *An interim Order pursuant to Section 75 of the act, approving*
>
> *(i) The schedule of rates, tolls and charges set out in Schedule 1 to this 2015 Interim Rates Application to be effective on and after March 1, 2015, until superseded by a final order of the Board;*
>
> *(ii) Changes to the RSP rules to implement the phase-in of changes to the IIC rates and to remove the requirement for the RSP rate adjustment to NP scheduled for July 1, 2015, as set out in Schedule 1 of this 2015 Interim Rates Application, as follows:*
>
> *(a) to provide for the allocation and disposition of the RSP load variation balance effective December 31, 2014;*
>
> *(b) to provide for a one-time transfer from the IIC Surplus balance effective December 31, 2014 to provide recovery of the IIC current plan balance;*
>
> *(c) to approve the proposed RSP Surplus Credit Adjustments to mitigate the rate impacts of implementing 2015 test year IIC base rates; and*

(d) *to suspend for 2015 the requirement for the July 1, RSP adjustment for Utility rates.*

On May 8, 2015, the Board issued Order No. P.U. (2015) in respect of Hydro's Application. While the Board did not approve the Application as filed, it did accept that Hydro required interim revenue relief and considering Hydro's financial need and the impact on customers the Board approved, effective July 1, 2015:

i) An interim increase of 8.0% in the base rate for Newfoundland Power;
ii) An interim increase of 50% of the proposed increase in the rates for government Diesel customers;
iii) An interim increase of 10.0% in the base rate for Island Industrial customers;
iv) Changes to the RSP rules to allow a transfer from the IC RSP Surplus and to implement an IC RSP rate so that there is an effective interim increase of 2.7% in Island Industrial customer rates, including Teck; and
v) Changes to the RSP rules to allow a transfer from the IC RSP Surplus to fund the full amount of the 2014 year-end IC RSP current balance.

Hydro will be required to re-file a proposed Schedule of Rates, Tolls and Charges and RSP rules reflecting the findings of the Board in this decision and Order. The re-filing should include updated evidence detailing the impact on customer rates, Hydro's forecast 2015 revenue requirement, revenue and rate of return, including an updated Table 5 from the evidence with additional columns showing the overall rate impacts for all customers effective July 1, 2015 and the impacts on rates including the effect of the Northern Strategic Plan.

On May 27, 2015 Hydro filed a compliance application to give effect to the findings of the Board in Order No. P.U. 14 (2015) and also requesting approval of the RSP rate to be charged to Newfoundland Power for the period July 1, 2015 to June 30, 2016. In response to clarifying requirements from the Board, Hydro filed a revised application on June 5, 2015. On June 23, 2015 the Board filed Order No. P.U. 17 (2015) approving the rates to be charged by Hydro to Newfoundland Power and Government Diesel customers to be effective on or after July 1, 2015, on an interim basis. Hydro was also ordered to file a revised Schedule of Rates, Tolls and Charges and RSP Rules, effective July 1, 2015, to reflect for Island Industrial Customers:

> i) *An interim base rate increase of 10.0%;*
>
> ii) *Interim RSP rate adjustments which will result in an effective 2.7% base rate increase for each Island Industrial customer including Teck Resources Limited;*
>
> iii) *A transfer from the IC RSP Surplus to fund the difference between the approved 10.0% base rate increase and the effective 2.7% base rate increase; and*
>
> iv) *A transfer from the IC RSP Surplus to fund the full amount of the 2014 year-end IC RSP current balance.*

In PUB-NLH-485, Hydro updated its Table 4.15 to reflect the impact of the interim rate orders, using both the fuel forecast in the Amended GRA and the fuel forecast in the interim rates application[1]

On October 28, 2015 Hydro filed a revised 2015 test year No. 6 fuel cost per barrel reflecting the 2016 forecast fuel price of $64.40 per barrel. Table 2 to Hydro's correspondence provided a comparison of revenues and RSP at rates as approved on July 1, 2015 versus revised 2015 test year rates based on the 2016 forecast fuel price.

B. THE 2014 REVENUE DEFICIENCY

NLH filed an Amended 2013 General Rate Application Nov 10, 2014. Hydro states at page 1 of the Application:

> *3. On July 30, 2013, Hydro filed a General Rate Application (GRA) based upon a 2013 Test Year. Due to the duration of the on-going GRA process, Hydro determined that rates would be more properly set based upon updated financial information and forecast Test Years of 2014 and 2015. As such, Hydro is filing the present Amended Application.*

With respect to the 2014 Test Year, the Application proposes:

[1] Hydro amended GRA reflected a final cost forecast of $93.32 per barrel; the interim rates application reflected a fuel cost forecast of $73.35 per barrel.

(1) (a) that Hydro's 2014 Test Year Revenue Requirement of $562,855,000 be approved;

...

(2) (a) that Hydro's forecast average rate base for 2014 of $1,692,567,000 be approved;

...

(3) (a) that Hydro's forecast capital structure for 2014, as set out in the evidence in support of this Amended Application, be approved with a weighted average cost of capital of 7.32% be approved;

In addition, the Application proposes:

2014 Revenue Deficiency

(23) (a) that the RSP credit balance be used, where appropriate, to offset the 2014 Revenue Deficiency attributable to the Island Interconnected System;
(b) that the portion of the 2014 Revenue Deficiency not recovered using the RSP credit balance be deferred for future recovery through a rate rider;

The amount of the revenue deficiency that it is seeking to recover in this manner is identified at page 3.4, lines 6-9):

The 2014 Test Year filed in this Amended Application identifies a 2014 Revenue Deficiency of $45.9 million. Hydro's 2014 revenue requirement has increased by $131.8 million since 2007 and is contributing to the Revenue Deficiency of $45.9 million. In the Amended Application, Hydro is requesting the recovery of this amount. Refer to Section 3.2 of this evidence.

Order No. P.U. 58 (2014) allowed Hydro to establish a deferral account that defers this 2014 forecast net income deficiency of $45.9 million, with disposition subject to a future prudency review. The required information to make a final decision on the disposition is now on the record.

Hydro's 2014 net income deficiency amount of $45.9 million is based on the 2014 Test Year Revenue Requirement amount of $562,855,000. This figure is presented in Table 3.1 at page

3.7 of Hydro's Application. The Consumer Advocate contests Hydro's claim of a revenue deficiency on two distinct grounds.

First, Hydro's revenue requirement "forecast" is clearly not a forecast consistent with the standard practice for the preparation of the revenue requirement to be used for rate setting purposes in the context of a future test year rate-setting regime. Hydro's revenue requirement figure is, in fact, a "projection" that was filed on the 10th day of the 11th month of the test year. The Consumer Advocate submits that the appropriate revenue requirement to use for determining rates is an amount that reflects a credible and prudent forecast of its revenue requirement that was prepared on a timely basis for a GRA filing. The standard regulatory practice is for test year forecasts to be prepared and filed several months in advance of the test year.

Second, even if the Board were to determine that due to the exceptional circumstances surrounding Hydro's 2013 GRA, it will make an exception to general accepted regulatory practice and allow Hydro to base its determination of the revenue deficiency for the 2014 test year on this revenue requirement projection, rather than a timely revenue requirement forecast, the Consumer Advocate submits that a large portion of the costs included in Hydro's application are not appropriate to recognize for purposes of determining its 2014 deficiency, in any event.

B.1. Hydro's Application is not Based on a Revenue Requirement Forecast

The Board's regulatory regime, like that of other Canadian regulators of electric utilities, establishes rates based on a future test year ("FTY"). The essence of any FTY regime is that the regulated utility is required to file its rate application in advance of the test year, as the term "future" test year implies. FTY filings are typically considered to be late if they are not filed with sufficient time to permit the regulatory process, including the final decision, to be completed prior to the commencement of the rate year.

Although Hydro's application is not seeking to have rates set for 2014, it is seeking recovery of its claimed 2014 FTY revenue deficiency based on its projected revenue requirement. A FTY rate application serves the same purpose – to recover a FTY revenue deficiency through increased rates. Whatever recovery method is used, an application seeking recovery of a revenue deficiency is a FTY revenue requirement application and the principle of basing the quantum of the revenue deficiency on a forecast of costs is the same. Hydro's application was extremely late relative to the general accepted time frame for FTY revenue requirement applications.

An important feature of the FTY regulatory model is that the utility's revenue requirement that is to be recovered from customers is based on a forecast of costs. The regulator determines the level of costs that is prudent based on this forward-looking view of the utility's operations. Variances from the forecast, whether positive or negative are borne by the utility, with the exception of specific cost items that receive explicit pass-through treatment by means of pre-approved variance accounts. Variance accounts track variances from forecast for cost items that the regulator accepts are beyond the control of the utility and should be passed through to customers without risk to the utility. Variance accounts are not used to pass through to customers the variances from forecast in costs that are subject to a degree of management control.

Excluding most cost categories, and particularly all controllable costs, from pass-through treatment provides an incentive for the utility to maintain spending within the implicit cost envelope that is approved by the regulator and used as the basis for setting rates. This operating principle for the design of a FTY regime is defeated if the utility is permitted to recover its actual test year costs, rather than being accountable for failing to manage within a pre-approved revenue requirement "budget". The FTY methodology not only creates an important incentive for the company to avoid spending that is in excess of the prudent level of anticipated costs, it also embeds an incentive to find cost efficiencies that will offset unanticipated costs that are above forecasts and will result in increased net income relative to forecast. If rates or a recoverable revenue deficiency is based on actual spending for part or all of the test year, the incentive to control costs is defeated.

The future test year methodology does not preclude a late filing in exceptional circumstances; however, it would be inconsistent with the fundamental principles of a FTY regime to allow a late filing to establish a revenue requirement that is based on actual incurred costs during the test year, rather than basing the revenue requirement on a defensible forecast of costs that is made in advance of the test year. A FTY revenue requirement, by definition, must be based on foresight; it is not made with the benefit of hindsight.

It is inconsistent with the principles on which FTY ratemaking is based to allow the recovery of a projection of costs that is made well into the test year, as Hydro is proposing in this application. To establish the precedent of allowing a cost projection prepared well into the test year to be used as the basis for determining a utility's revenue deficiency would undermine the important principle that the company will be accountable for variances from a revenue requirement forecast that the regulator deems to be prudent. Unanticipated costs that arise in the test year should not be recoverable whether or not they were prudently incurred. The only exception to this generally principle is in a case where a major incident arises and the utility obtains approval through an accounting order to track the cost consequences of a significant event beyond its control.

It is clear that Hydro's approach to determining its 2014 revenue requirement deficiency was to base it on its actual costs for a portion of the year. By the time the application was filed, Hydro should have been in a strong position to project with a high degree of confidence its actual costs for the full year. The 2014 revenue requirement was a projection, not a forecast. A revenue requirement "projection", differs from a forecast, in that a projection is based on part year actual costs. It can be expected that Hydro's projection filed on the 10th day of the 11th month of the test year would be reasonably close to its actual costs rather than a legitimate forecast of costs.

There is no information on the record of this proceeding that supports a forecast of Hydro's 2014 revenue requirement that represents a financial view prior to January 1, 2014. An acceptable forecast for purpose of a future test year filing would have been prepared and filed with the Board several months in advance of the 2014 test year.

The Consumer Advocate submits that in the absence of a credible forecast that represents a 2014 revenue requirement that could have been defended as reasonable and prudent in 2013, had it been filed on a timely basis, the evidence needed to justify recovery of a 2014 revenue deficiency does not exist. Hydro's burden of proof to demonstrate that it would have forecast a revenue deficiency in 2014 on the basis of generally accepted FTY ratemaking principles has not, and cannot, be met. Consequently, its application should be denied.

Permitting recovery of a test year revenue requirement deficiency in a FTY jurisdiction on the basis of a projection prepared during the test year would establish a precedent that would undermine the principles of FTY rate regulation not only in Newfoundland and Labrador, but also other FTY jurisdictions in Canada and elsewhere.

The Consumer Advocate further submits that the only circumstances that might justify consideration of a revenue requirement based on a retrospective view of Hydro's costs would be if the company's financial integrity were at risk. It may be in the interest of customers to allow prior year costs to be recovered if the company's ability to provide safe reliable service would otherwise be compromised. It is clear, however, that compromised financial integrity is not the basis on which Hydro is seeking to recover its projected 2014 revenue requirement. Hydro is not claiming that its creditworthiness is at risk and failure to recover the funds will compromise either its or the Province's credit rating. (Tr. November 16, 2015, page 181, 7-13) Table 3.12 in the filing shows Total Regulated Equity is almost $400 million. Consequently, credit risk issues are not a rationale to deviate from normal and prudent regulatory practice.

Furthermore, the Consumer Advocate considers the following observations to be relevant to the Board's decision:

First, finalizing the test year revenue requirement based on a prospective view of costs is important because the risk adjusted ROE that utilities are normally allowed to earn takes into account the business risk associated with the fact that uncontrollable events create risk. The allowed ROE is based on the principle that the utility should have a reasonable opportunity to earn the allowed rate of return, but there is no guarantee that the allowed return will actually be achieved. If the revenue requirement is based on a projection rather than a forecast, the financial risk associated with unanticipated cost pressures will be reduced. The risk adjusted ROE that is appropriate when rates are set in advance of the test year will be excessive if the company's financial risk is reduced because its revenue requirement is a projection based on actual costs for part of the year.

Although Hydro's ROE is set by government directive to be equal NP's risk adjusted ROE, it would be inconsistent for the Board to accept a methodology that determines the revenue requirement in a manner that mitigates Hydro's risk when it cannot adjust the ROE to maintain a reasonable risk versus return on equity balance.

Second, the delays in the 2013 GRA process did not preclude Hydro from filing 2014, 2015 and 2016 GRAs in an orderly fashion (i.e., prior to the relevant test years). In essence, Hydro could have filed its forecasts of costs and revenue requirements in advance of each test year. The applications could have been followed by applications for the rates in those years to be made interim (either at the existing rate or at a higher rate). The review of those applications could then have proceeded according to the Board schedule. In that case, there would have been clear forecast of costs to use as a basis for setting rates. Instead, Hydro seems to be filing for recovery of their actual costs – or at least a forecast that is updated after a significant portion of the year has passed.

B.2. Costs That Should be Excluded From 2014 Revenue Deficiency

As discussed in this preceding section, Hydro should not be permitted recovery of any of its proposed 2014 revenue deficiency. However, if the Board decides otherwise, Hydro's request to recover for 2014 should be reduced by:

a) costs arising from imprudency, and
b) costs attributable to Hydro's claim for a ROE of 8.8%.

B.2.1. Costs Arising from Findings of Imprudency

In a July 6, 2015 report entitled *Prudence Review of Newfoundland and Labrador Hydro Decisions and Actions Final Report*, Liberty Consulting Group reviews the prudence of certain decisions and actions of Hydro within the scope of the Island Interconnected System outages experienced during the preceding two winters of 2013 and 2014. Liberty notes (page ES-1) that some of its review concerns "*earlier decisions and actions where the Board deferred recovery of the associated costs, pending further review*". Liberty's review identified the costs of decisions and actions that in its view were not prudently incurred (page ES-1) "*according to accepted standards for examining the prudence of utility decisions and actions*" *(page ES-11).*

Liberty reviewed (page ES-1) "*twelve Hydro decisions or actions (eleven specific projects or programs and one deficiency account established by Hydro to reflect a shortfall in its 2014 revenue*". Most items examined by Liberty (page ES-1) "*involved requests to the Board for approval of the underlying work or for deferral of certain costs. Hydro typically made those* *requests using estimates. Hydro reported to Liberty that actual costs (some offset by insurance recovery) have proven lower in some cases*".

Liberty concluded that Hydro acted imprudently in seven specific projects or programs set for examination by the Board and identified adverse cost consequences in six of these seven projects or programs. In a seventh project, Liberty found that planning and execution was imprudent, but concluded (Page ES-2) "*Hydro would have borne essentially the same costs even in the absence of such imprudence*". In three of the specific projects or programs, Liberty found that Hydro had acted prudently. In one specific project or program, Liberty concluded that Hydro acted prudently in making its decision, but (page ES-2) "*some of the costs incurred were influenced by imprudent prior actions*". In the 12th project or program, Liberty identified (page ES-2) "*2014 actual capital costs and operating expenses that could be attributed to imprudence. This identification lays a foundation for later efforts that seek to identify any such expenses that may form part of Hydro's estimation of a 2014 Revenue Deficiency of $45.9 million*".

Liberty concluded (page ES-2) "*the costs that Hydro could have avoided in the absence of the instances of imprudence found by Liberty were:*

- *Actual 2014 capital costs of $10.9 million (as reported by Hydro)*
- *Actual 2014 operating expenses of $13.4 million.*
- *Estimated 2015 operating expenses of $2.6 million.*"

Hydro submitted reply evidence on August 7, 2015 (on September 23, 2015 Hydro submitted a revision to page 7 of Appendix A). Hydro concluded (page 32):

> *Hydro appreciates the opportunity to provide this Reply Evidence. As noted above, Hydro does not believe its actions have been imprudent, but rather that it has acted in a responsible manner to provide least cost, safe and reliable electrical service to its customers. <u>If the Board nevertheless determines any disallowances are required, Hydro has provided (or will provide in an ultimate compliance filing) the information required to ensure these amounts are accurately determined</u>.* (emphasis added)

As noted, Hydro takes issue with many of Liberty's claims of imprudence. However, in a letter to the Board dated December 16, 2015, Hydro acknowledges:

> *Accordingly, the Hydro personnel directly involved in the 2009-2010 Holyrood maintenance review did recommend that the DC emergency lube oil pump be checked when the unit was off-line to ensure that it performed as required, however, the maintenance actions implemented did not fully address the recommendation provided. The relevance and status of this line item recommendation was not fully understood by management of Hydro involved in the hearing until the preparation of Undertaking 85 was being carried out.*

Accordingly, Hydro indicated in its letter that it takes full responsibility for any cost consequences attributable to the failure of the DC lube oil pumping system at Holyrood Unit 1.

On September 7, 2015 Liberty submitted evidence in response to Hydro's reply evidence in a report entitled *Reply Evidence – Prudence Review of Newfoundland and Labrador Hydro Decisions and Actions*. Liberty stated (page 1, lines 5 to 7) "*Our review disclosed nothing that would influence our opinions with respect to prudence of the decisions and actions reviewed. However, based on new information Hydro provided, we have adjusted some of the costs that we recommended be disallowed*". With respect to cost adjustments, Liberty indicates (page 16, lines 17 to 26) that $504,610 relating to Holyrood 1 replacement power costs should be deducted to avoid double counting.

Hydro submitted surrebuttal evidence on October 14, 2015 and concluded (page 11, lines 23 to 26) "*As noted in various instances above, Hydro believes many of the comments made by Liberty in its Reply Evidence are not reflective of the totality of the evidence provided by Hydro in this proceeding. Hydro's actions were based on its overall approach to least-cost reliable supply and decision making at the various times in question that took the best information then known into account*".

The Consumer Advocate submits that considerable time and effort was put into Liberty's prudence study. In its reply evidence, Liberty did not rescind any of its conclusions on what projects or programs that it believes were imprudent in spite of Hydro's reply evidence and an extensive number of Requests for Information. Further, Hydro has since admitted that it takes full responsibility for cost consequences attributable to the failure of the DC lube oil pumping system at Holyrood Unit 1. Liberty did admit in its reply evidence that some adjustment of the costs it determined were imprudent was necessary. In this regard, the Consumer Advocate asked Hydro to provide (PR-CA-NLH-014 (Revision 1, Oct 15-15)) *"a table summarizing each cost item that Liberty has determined to be imprudent, the cost determined by Liberty to be imprudent, the amount of this cost that Hydro believes has been over-stated by Liberty (and the reasons; i.e., double counting, recovery not requested from ratepayers, etc.), and the revised cost and year charged to ratepayers assuming the Board determines that disallowances are required"*. The table included in Hydro's response is summarized below. Hydro notes that adjustments may be necessary as part of any compliance filings for the 2014 and 2015 test years.

Estimates of Imprudently Incurred Costs – Totals for 2014 and 2015 ($ millions)

	Liberty	Hydro Adjustment
Capital & Deferred Assets	17.8	15.3
Accumulated Amortization	2.4	3.7
Net Book Value of Capital & Deferred Assets	15.4	11.6
Operating Costs (excluding Amortization)	13.4	3.6
Total	31.2	18.9

As can be seen, there is a significant difference of $12.3 million between the cost figures filed by Liberty and the figures following removal of costs owing to double counting, recovery not requested from ratepayers, etc. Although requested in PR-CA-NLH-014, Hydro did not break the costs down by year. It is difficult to slot costs determined to be imprudent to 2014 and 2015 because: 1) Liberty did not tie its estimate of imprudent costs to a test year revenue requirement calculation, only to a specific calendar year, 2) Liberty did not translate capital costs to annual costs as is done in a test year, and 3) on some occasions, Hydro has requested a deferral account to recover costs (so they are not included in either the 2014 or 2015 revenue requirement, but would be included in a future year if the Board allows cost recovery through a deferral account. The Consumer Advocate notes that Liberty attributed all but $2.6 million of imprudently incurred operating costs to 2014. As stated by Hydro in PR-CA-NLH-014 (page 2 of 5), '*There was no amortization noted in Liberty's report for 2015. However, for purposes of this exercise, it is assumed that in 2015 the amortization (totaling $2.4 M) would appropriately result in a reduction in Capital Assets from $17.8M to $15.4M*'.

In any event, the Consumer Advocate submits that owing to the imprudence of Hydro actions relating to the outage events of 2013 and 2014, the Board should deny Hydro recovery of as much as $31.2 million of the 2014 costs upon which it based its 2014 revenue deficiency. The determination of the amount to be deducted from any 2014 revenue deficiency recovery should follow the process as recommended by the Consumer Advocate in a later section, "Prudency Related Reductions to Revenue Requirement".

B.2.2. Costs Arising from a Claimed Entitlement to a ROE of 8.8% in 2014

A significant portion of the claimed 2014 Revenue Deficiency is Hydro's stated ROE requirement for 2014 of $30.5 million –the reason for $22.5 million of the claimed revenue deficiency. [Table 3.1, p. 3.7] The Consumer Advocate submits that Hydro has no right to claim any entitlement to a 8.8% ROE in calculating its 2014 revenue deficiency.

Hydro's Amended GRA is based on a 2014 test year for the purposes of recovery of a 2014 revenue deficiency and is based on a 2015 test year for the purposes of setting rates for customers. [Reference: Application, Section 3.1, p. 3.3, lines 4 – 6]

As admitted by Ms. Russell, normally a utility would use a test year to set rates with the rates being designed based on the forecast test year to recover the revenue requirement. [November 19, p. 33] Ms. Russell could not point to any practice from other jurisdictions of using a test year to recover a revenue deficiency. [November 19, 2015, pp. 36-37]

There is no precedent in this jurisdiction of using a test year to recover a deficiency. General Rate Applications in this jurisdiction have used a forward looking test year to set rates on a prospective basis. A General Rate Application that does other than that is unfamiliar to this jurisdiction, and indeed to Hydro. It was in this context that the Government of Newfoundland and Labrador in 2009 issued O.C. 2009-063 (copy at NP-NLH-056). It stated *inter alia*:

> *Under the authority of section 5.1 of the Electrical Power control Act, 1994, the Lieutenant Governor in Council is pleased to direct the Board of Commissioners of Public Utilities to adopt policies as follows for all future General Rate Applications by Newfoundland and Labrador Hydro, commencing with the final General Rate Application by Newfoundland and Labrador Hydro after January 1, 2009:*

> (i) *In calculating the return on rate base for Newfoundland and Labrador Hydro, to set the same target return on equity as was most recently set for Newfoundland Power. Through a General Rate Application or calculated through the Newfoundland Power Automatic Adjustment Mechanism. . . .*

The Consumer Advocate concurs with the position of Newfoundland Power in its submission as reflected in Board Order No. P.U. 58 (2014) where the Board stated:

> *Newfoundland Power notes that Hydro's current return on equity for rate making purposes, effectively approved by the Board in the 2007 general rate application, is 4.47%. Newfoundland Power states that the assumption of an 8.8% return on equity <u>where the Board is not approving new rates</u> does not conform with the direction provided by the Government in OC2009-063.* (emphasis added)

Therefore, the Consumer Advocate submits that the Board should deny Hydro recovery of its proposed 2014 revenue deficiency, but if the Board deems that Hydro should be allowed recovery of its proposed 2014 revenue deficiency, the amount should be reduced to account for costs that have been determined to be imprudently incurred, and amounts relating to Hydro's claim to any entitlement to an 8.8% ROE in calculating its 2014 revenue deficiency.

C. REVENUE REQUIREMENT

C.1. Depreciation Expense

At p. 114 of the Financial Consultant's report it states (lines 21-26):

> *Hydro indicated in its response to CA-NLH-326[2] that the forecast expenditures of $169.6 million are lower than budgeted expenditures of $282.1 million due to work on the Labrador West Transmission Line being suspended until Alderon completes the financing plan for the Kami Mine. Hydro also stated 'with the exception of the forecast underspend for the Labrador West Transmission Line Project, Hydro has planned and*

[2] In CA-NLH-326, the Consumer Advocate asked ". . . please discuss Hydro's expectation to achieve its forecasted 2014 and 2015 capital expenses."

expects to achieve its forecasted capital expenditures, with a variance that is consistent with the level of estimates'.

In Undertaking No. 158 Hydro recently stated that instead of reaching $119.6 million in capital expenditures, it is forecasting $94.6 million, which continues a trend whereby Hydro has been consistently under budget/forecast on its capital expenditures, a trend referenced in the Financial Consultant's report . [Reference: Financial Consultant's report, p. 110, Table 85, lines 8-9]

A reduction in capital expenditures reduces depreciation expense in the test year. The Consumer Advocate recommends that the Board order that an allowance of 20% be applied to 2015 forecast capital expenditures for determination of revenue requirement. A 20% allowance is in keeping with not only Hydro's forecast underspending in 2015 but also its underspending over the 2012 to 2014 period. [Reference: Financial Consultant's Report, Table 85]

C.2. Fuel

C.2.1. Test Year Price of No. 6 Fuel

On October 28, 2015 Hydro provided the Board with the revised 2015 test year forecast No. 6 fuel cost per barrel of $64.41 ($ Cdn).

[Reference: Information No. 50, filed December 3, 2015]

The Consumer Advocate takes no issue with the revised forecast price of No. 6 fuel for the 2015 test year.

C.2.2 Conversion Factor at Holyrood

Hydro bears the onus of establishing that the test year conversion factor it proposes is reasonable. Hydro has used a forecast conversion factor for the 2015 test year of 607 kWh/bbl. Hydro's evidence states that this forecast results from a five-year regression analysis of conversion factor versus Holyrood gross monthly average unit loading, adjusted for fuel heating content (in BTUs/bbl). Hydro states that there is a station service factor of 6.6% applicable to the gross energy production, a station service factor that is based on the average experience over the five-year period from June 2009 to May 2014.

[Reference: Regulated Activities Evidence, p. 2.75, lines 14-19]

The Industrial Customers' expert, Mr. Patrick Bowman pointed out both in his report and during his direct evidence that Hydro's station service factor of 6.6% of gross generation (approximately 43 kWh/bbl) as an estimate of station service (to be deducted from a gross efficiency figure of 650 kWh/bbl as proposed by Hydro) is too high.

First, Mr. P. Bowman observes that Hydro's use of the average station service rate from the past five years, a period of load which is not representative of the test year, results in Hydro's station service estimate being too high. During the June 2009 to May 2014 period, Hydro generation was as low as half the output forecast for 2015.

[Reference: Pre-filed testimony of Patrick Bowman and H. Najmidinov, June 4, 2015, p. 25, lines 708]

Mr. Bowman's report states that utilizing actual data from 2000-2013 and forecast from 2014-2016, the station service, based solely on past trends should be in the order of 5.85% (i.e. 36 kWh/bbl used in station service vs. 43 kWh/bbl as proposed by Hydro, an improvement of 7 kWh/bbl).

Mr. Bowman testified that even that is a "bit generous" because this data comes from earlier years before Hydro undertook efficiency upgrade works at Holyrood.

[Reference: Transcript, September 30, 2015, p. 106, lines 3-8]

Mr. Bowman's second observation was that Hydro had undertaken projects to improve fuel efficiency and in particular, reduce station service. As an example, Hydro is implementing a Variable Frequency Drive project[3] which is projected to increase Holyrood efficiency by 8 kWh/bbl. The variable frequency driver allows forced draft motors to operate at varying speeds

[3]The "Install Variable Frequency Drive on Forced Draft Fans – Holyrood (2013) indicated that once operational, the Variable Frequency Drives would provide an annual fuel savings of $4.7 million. The project was budgeted at $697,000 (2013) and 2,659,200 (2014)

resulting in energy savings. Mr. Bowman stated that Hydro had not given full consideration to providing ratepayers (whose rates reflect the cost of such projects) with the energy efficiency benefits arising from such projects.

[Reference: Report, p. 27, lines 9-11]

With this further station service adjustment of 8 kWh/bbl, Mr. Bowman concludes that a test year conversion factor of 622 kWh/bbl would be appropriate, not the 607 kWh/bbl used by Hydro.

Hydro's analysis in support of its proposed conversion factor of 607 kWh/bbl has been put into serious question by the foregoing evidence. Hydro did not challenge Mr. Bowman's evidence on these matters during the hearing, though Mr. Bowman expressly reiterated his report's findings during his direct examination.

[Reference: Direct Examination of September 30, 2015, pp. 103 to 108, and Hydro's cross-examination at pp. 132-133].

The Consumer Advocate submits that Hydro has not met the onus upon it to establish that its test year conversion factor of 607 kWh/bbl is reasonable. Mr. Bowman's evidence, if anything, appears conservative.

The Consumer Advocate recommends that the Board order that the Holyrood Conversion Factor remain at 630 kWh/bbl as currently reflected in customers' rates, or, in the alternative no higher than 622 kWh/bbl as proposed by Mr. Bowman.

C.2.3 Diesel Fuel Price

On October 28, 2015 (Information No. 50) Hydro also provided an update to its forecast No. 2 fuel cost based on the updated fuel price forecast applied to the 2015 test year load forecast for Hydro Rural Isolated Systems. Hydro's revised test year forecast is $1.01 per litre for a total forecast cost of $19,959,582.

The Consumer Advocate takes no issue with the revised diesel fuel price for the 2015 test year.

C.3 Other Costs

C.3.1. Hydro's Onus of Proof

Hydro has the burden of providing evidence to demonstrate to the Board that the costs to be recovered in this Amended Application are appropriate to ensure safe, reliable and least cost electricity. Hydro accepts this burden [September 23, 2015 – Evidence of Robert Henderson, p. 113]. In fact, Hydro's Introduction [p. 1.35, lines 13 to 16] states that its Evidence "will demonstrate" that the costs to be recovered in the proposed rates are appropriate to ensure that continued safe, environmentally responsible, reliable and least cost electricity supply is available to customers to meet current demand and future growth.

The Board in its 2001 Hydro GRA Order stated there was an onus on Hydro in its GRA to bring forward performance measures which "clearly demonstrate the efficiency of its operations."

At the hearing, the Consumer Advocate asked Mr. Henderson what specific performance measures Hydro was relying upon to demonstrate the efficiency of its operations. Mr. Henderson replied (September 23, 2015) at pp. 157 to 158:

> *A. So the performance measures are management to our budget, the performance of our--it's the reliability that we are demonstrating. I would suggest that the overall matrix that were put forward in the KPI, the report that we talked about earlier, we talked about targets on them, but those measures in particular can be referenced to compare Hydro to other similar utilities on those dollar per installed kilowatt or dollar per kilowatt hour delivered and they are available.*

> *Q. So you've talked about, you would look to your ability to manage, to your budget that would be part of the demonstration of the efficiency of your operations?*

> *A. It's that in the context of inflation and how we are doing with regard to that, in comparison to inflation and that's why we put forward the charts that we did is to assist in demonstrating the cost and how they're varying with respect to inflation and certainly that's part of the measure.*

Q. So the use of inflation and where you are relative to inflation, that should be an indicator of how efficient you're being?

A. That can be, it's part of a measure to show that. The thing that you have to also take into consideration is change in circumstances, that the company is in a situation where we do have aging infrastructure that requires additional attention from a maintenance perspective. There's a growing capital program, there's also growing customer requirements, all of those are variables that do not necessarily track inflation and they can drive costs to a different place than inflation. So it's not, you can't look at inflation in isolation.

It is respectfully submitted that the evidence adduced during this proceeding and the hearing in no manner demonstrates that Hydro is managed efficiently.

C.3.2. Controllable Cost Increases at Hydro

Hydro's evidence states, (p. 1.28, lines 3 to 5) that the primary area where Hydro exercises cost management in the short term is Operating Expenses. Operating expenses have increased by $40.5 million from 2007 to 2015. These Operating Expenses include salaries and benefits, system equipment maintenance, professional fees, travel and other cost and cost recoveries (p. 1.28, footnote 25).

To put this controllable cost increase into perspective, the following evidence assists:

- Operation and maintenance costs have increased 33.2% on an inflation adjusted basis from $93.4 million in 2007 to $138.2 million in the 2015 test year (NP-NLH-315).
- Gross Salaries have increased 43.3% on an inflation adjustment basis from $55.7 million in 2007 to $86.0 million in the 2015 test year (NP-NLH-314).
- Home based FTEs in 2013 were 813. In 2014 FTEs increased to 865 and increased again to 903 in the 2015 test year [CA-NLH-104; Financial Consultants Report p. 64, lines 4 to 7].
- Average salary per net FTE has increased from $59,453 in 2007 to $84,704 in the 2015 test year [Financial Consultants Report p. 68, Table 46 and 47].

- Non-Union salaries increased on average by 6.3% per year over the period from 2007 to 2015 (f) with a total cumulative increase of 56.9% for non-union positions over the period [CA-NLH-234, Rev. 1].
- Both (i) FTE growth and (ii) increases in salaries and benefits have contributed to the increases in salaries and benefits expense over the 2008 to 2015 (f) period. [Reference: NP-NLH-092, Table 1].

As noted above, FTEs increased dramatically in 2014 and again in the 2015 test year. Undertaking No. 51 shows the FTEs by position that were added in each of 2014 and 2015 test year.

The evidence is that Hydro is not in a position to state whether it has reasonable labour productivity. Mr. Henderson said he had not looked into benchmarking or inquired into other means of assessing Hydro's labour productivity [September 23, 2015 p. 153-154]. Nalcor's past VP of HROE, Mr. McDonald "couldn't think of a measure that we use on productivity." [September 16, 2015 p. 166, line 12]

The evidence shows that the Department of Human Resources and Organizational Effectiveness does not consider FTE growth in Hydro as part of its accountability [September 17, 2015 p. 13]. Nor has Hydro reached outside of its organization to retain assistance in identifying more efficient work execution practices [September 23, 2015 p. 145-146].

It is a concern that over 2014 and 2015 when Hydro dramatically increased its workforce, this was not the subject of either an internal or external report or study whereby this dramatic increase was thoroughly assessed. [Reference: Transcript, September 24, 2015, pp. 6-7]

It is a concern that there appears to have been no directed, focused effort at Hydro to identify efficiencies within Hydro [September 23, 2015 p. 133]. Instead, what has been described in the hearing is a process whereby each manager in the budget process is expected to establish that their work is being done in the most efficient manner. As put by Mr. Henderson:

> *There isn't a one subscribed "this is an efficiency improvement program", it's expected each and every manager is working to establish their work to be done in the most efficient manner.* [September 23, 2015 p. 133, lines 16-20]

The problem with Hydro's approach to cost management is that it is an approach that has been demonstrated to have yielded extremely modest efficiencies as was clear from the evidence of Mr. Henderson [on September 23, 2015 – pp. 137-145]. During the hearing, Mr. Henderson was referred by the Consumer Advocate to Hydro's reply to NP-NLH-057 in which Hydro was asked to identify (other than sharing of services with Nalcor) the efficiency initiatives and management's estimate of cost savings referenced in the test years. The reply is striking because of its lack of identified efficiencies. Under the category of "Work Execution Practices", estimated annual savings of a grand total of $67,000 are identified, with a grand total of $35,000 under "Human Resources Cost Savings" in its operations. This meagre record of identifying efficiencies in an operation the size of Hydro's demonstrates that Hydro does not have a suitable focus on identifying efficiencies in its operations.

Hydro's performance contracts clearly put little emphasis on maintaining cost controls. Mr. Henderson's 2015 Performance Contract awards just 5 points out of 70 points in Divisional Targets to management to operating and maintenance budget. Safety, while important, is 20%. In 2014, the VP's performance contract ascribed 7.14 points out of 70 points in the divisional target to management to budget. Safety was nearly 30 points. [Reference: Undertaking No. 2]

Non-union salaries, as noted, increased an average 6.3% per year for 2015 (f), a cumulative total increase of 56.9%. This cumulative increase vastly exceeded the wage increases of employees in the province. In fact, Mr. McDonald testified that over the same period the cumulative increase in the average index in this province over the same period was around 36 percent. [Reference: Transcript, September 17, 2015, p. 139, lines 2-5]

When Hydro last retained Mercer's to assess the competitiveness of Hydro's non-union compensation, Mercer's were not asked to consider Hydro's competitiveness in other areas of non-cash compensation such as pension and retirement benefits. [Reference: Mr. Roberts, September 17, 2015, p. 104, lines 10-24] While Mr. Roberts acknowledged that Hydro's deferred benefit plan is "*in fact one of the key aspects to our ability to recruit and retain people*" [Reference: September 17, 2015, p. 115, lines 19-20] there has not been an analysis taken on the differences in pension offerings amongst utilities in Atlantic Canada (p. 111, lines 11-18). Nor do the annual surveys that Hydro receives compare non-cash compensation (p. 113, lines 13-15).

Mr. Roberts nevertheless stated that Hydro "*would take under advisement each category separately because you do need to be competitive in each category separately, but then we do look at it holistically as well to see how that comes out on balance.*" [Reference: Transcript, September 17,, 2-15, p. 109, lines 22-25; p. 110, lines 102]

This description of Hydro's "holistic", "taking under advisement" process does not demonstrate in the least that customers are receiving adequate credit for the fact that their rates are supporting an increasingly rare defined pension benefit plan as well as retiring allowances. Newfoundland Power closed its defined pension benefit plan to new entrants in 2004, more than a decade ago. [Reference: Transcript, September 17, p. 117, lines 9-13] New Brunswick Power ceased paying retirement allowances in 2013 for non-union employees (September 17, 2015, p. 119, lines 10-11). Maritime Electric does not have a policy to pay retiring allowances as a matter of right. They may be extended on an *ad hoc* or special case basis. [Reference: Undertaking No. 18] Mr. Roberts, when informed during cross-examination that retirement allowances are forecast to cost $1.1 million in 2014 and $1.4 million in 2015 stated, "*I didn't think it was that large a number. . .*" Mr. Roberts had stated these were $100,000 to $130,000 per year. [Reference: Transcript, September 17, 2015, p. 122, line 15-16; p. 121, lines 1-2]

The Consumer Advocate submits that the Board order Hydro in its next general rate application to file an expert analysis of its total compensation package compared to Atlantic Canada Utilities, taking into consideration *inter alia* Hydro's deferred benefit pension and retirement allowance benefits.

C.3.3 Vacancy Allowance

Hydro has assumed a vacancy allowance of 40 FTEs which would give rise to a forecast vacancy amount of $3,336,000 based on $83,000 per vacant FTE [IC-NLH-005 (Rev. 1)].

This vacancy assumption is too low. Vacancies may be caused by occurrences such as retirements, resignations, leaves of absences and the like.

Hydro's recent vacancy experience in 2012, 2013 and 2014 has shown that Hydro has had vacancies in the low 50s [NP-NLH-310].

Hydro has in the past underestimated its test year vacancy allowance and the Board has had to substitute a more reasonable and reflective vacancy rate assumption.

For example, in Order No. P.U. 7 (2002-2003) the Board stated (p. 66):

> *NLH has not convinced the Board that a* ***2 ½%*** *vacancy allowance is adequate and reflects recent experience. The Board finds that a vacancy credit in the amount of $1,500,000 should be used in the test year 2002. This is 500,000 more than proposed by NLH.*

In Order No. P.U.14 (2004) at p. 62 the Board once again stated that it was not satisfied that NLH's forecast of $1,000,000 for normal vacancies was adequate based on Hydro's then recent experience. Accordingly, the Board directed Hydro to reduce its 2004 test year salary expense by $500,000 to reflect a higher vacancy allowance.

At the hearing, Mr. McDonald testified that as of the end of July, 2015 the 2015 vacancy forecast was 65 FTEs [September 16, 2015]. He testified that he did not expect that Hydro would achieve the assumed 40 vacancies by the end of the year, but that "*for rate case purposes and for the longer term - - - meeting the longer term, yes, we believe 40 is an appropriate vacancy factor.*"

The Consumer Advocate submits that in this proceeding we are setting rates based on a 2015 test year, a test year where 65 vacancies are forecast. Accordingly, the Consumer Advocate recommends that the Board order Hydro to use 65 vacancies as the basis for setting revenue requirement.

[Reference: Transcript, September 16, 2015 p. 182]

Should the Board nevertheless decide that it is appropriate to adjust the vacancy factor downward from 65, the Consumer Advocate submits that a vacancy factor no lower than the low 50s be used as the basis for stablishing the revenue requirement given Hydro's actual vacancy experience and the fact that with an increased level of FTEs at Hydro over historical levels, Hydro can reasonably expect to experience greater numbers of leaves and the like which impact the vacancy rate.

C.3.4. Productivity Allowance

In addition to a Vacancy Allowance discussed below the Consumer Advocate recommends that the Board order Hydro to make a productivity allowance to adjust Hydro's 2015 test year revenue requirement.

The onus was on Hydro to bring forward performance measures which clearly demonstrated the efficiency of its operations. Hydro has not satisfied this onus in this proceeding. Hydro's costs have vastly outpaced inflation, as discussed. Moreover, the lack of an overall, focused and directed effort to identify efficiencies within Hydro has deprived Hydro's customers of meaningful potential test year savings and efficiencies.

In Order No. P.U. 7 (2002-2003) the Board applied a $2,000,000 productivity allowance from Hydro for the 2002 test year. The amount of $2,000,000 ordered in that GRA was at that time relative to a salary and fringe benefit forecast of approximately $62,400,000 which then constituted 63% of Hydro's total "other costs" (approximately $99,000,000). [Reference: P.U. 7 2002-2003, p. 63]

In this present Amended GRA, Hydro's salary and fringe benefit forecast for 2015 is approximately $111,500,000, or 63.8% of total forecast 2015 other costs of $174,663,000. [Reference: Financial Consultant's Report, p. 61]

The current equivalent of the $2,000,000 productivity allowance ordered in 2002, from a proportional perspective (relative to "total other costs") would be approximately $3,500,000 – about 2% of the forecast $174,663,000 for 2015.

The Consumer Advocate submits that in order to provide Hydro an incentive to become more efficient, the Board order a productivity allowance of at least $3,500,000 – after other adjustments as may be made by the Board to Hydro's revenue requirement.

C.3.5. Prudency Related Reductions to 2015 Test Year Revenue Requirement

As discussed earlier in this Final Argument, it appears that $31.2 million of Hydro's 2014 and 2015 costs relating to the outage events of 2014 and 2015 were imprudently incurred (as determined by Liberty Consulting). Hydro should not be allowed recovery of costs that have been identified as imprudently incurred. Although requested in PR-CA-NLH-014, Hydro did not break the costs down by year. Nonetheless, some of these imprudently incurred costs were included by Hydro in the 2015 test year revenue requirement. Further, for some of these costs, Hydro has requested deferral accounts for recovery in future years to be determined by the Board.

The Consumer Advocate therefore submits that the Board:

1. Accept the projects or programs identified by Liberty as imprudent.
2. Deny recovery of the $18.9 million of costs identified by Hydro in its response to PR-CA-NLH-014 (Revision 1, Oct 15-15)).
3. Require Hydro to break down these costs by year to accommodate adjustments necessary as part of any compliance filings for the 2014 and 2015 test years.
4. Once the Hydro breakdown by year is received, have the Board's financial consultant review the filing to ensure imprudently incurred costs are truly excluded from cost recovery.
5. Order Hydro to adjust the revenue requirement accordingly.

C.3.6. Vale Load Forecast and Cost Implications

As can be seen in CA-NLH-304, the load for the Island Industrial Customer class is forecast to increase dramatically in 2016 and 2017 over levels included in the 2015 Test Year cost of service study. This dramatic increase in demand is driven by the ramping up of operations at Vale and Praxair. In 2016, the Island Industrial Customer class energy sales are forecast to increase by 25.2% over levels assumed in the 2015 test year. In contrast, NP energy sales are forecast to increase by only 2.06%, and Island Rural Customer Class energy sales are forecast to decrease by 0.6%. In 2017, Island Industrial Customer Class energy sales are forecast to increase by 40.6% over levels assumed in the 2015 test year, while NP energy sales are forecast to increase only 2.2%, and Island Rural Customer class energy sales are forecast to decrease by 5.3%. The rates proposed in the Amended 2013 GRA based on a 2015 test year will not be in effect at all in 2015, and perhaps not before the second half of 2016. Therefore, the rates derived in the 2015 test year based on 2015 forecast loads cannot be considered just and reasonable.

Hydro now indicates that Vale load will be much reduced from the levels forecast in evidence filed in the Amended 2013 GRA.[4] According to the October 21, 2015 Transcript (page 32, lines 6 to 25, cross examination of Mr. Humphries) Vale load is now forecast to be in the range of 25 MW lower in 2016 than previously anticipated, and about 30 MW lower in 2017. Further, Newfoundland Power load is forecast to be 20 to 25 MW lower in the 2017/18 time frame. This has repercussions as Hydro has spent money to serve load that it now says will not materialize. As shown in the Application by Newfoundland and Labrador Hydro for Approval of the Procurement of 12MW of Diesel Generation at Holyrood, Hydro is now well-above its minimum generation reserve requirement. The Application indicates (accompanying report, pages 6 and 7, and Tables 1 and 2) that under a P90 load forecast, at least 240 MW of reserve generation capacity is needed on the system. Table 2 shows that without the diesel units, capacity reserves will bottom out at 292 MW in 2017/18, well above the 240 MW minimum. It now appears that Hydro has at least 50 MW more capacity than needed.

The Board must consider the impact of this new information on customers. In particular, are the capacity assistance agreements with Vale and Corner Brook Pulp & Paper still needed? The capacity assistance agreement with Vale was driven in large part by its own erroneous forecast. As noted by Mr. Humphries under cross-examination by the Consumer Advocate relating to the Vale load forecast (October 21, 2015 Transcript, page 34, lines 9 to 15), "Yeah, you know, we have open communications with them and we can only base it on the information they're providing us. We can't get in and do an analysis on what's going on inside the plant and what equipment is coming on and those types of things." Vale should not be rewarded with a capacity assistance agreement, resulting in a reduction in its electricity bill of $442,400 annually[5], when

[4] Hydro also over-forecasted Island Industrial Customer load at the 2007 GRA which led to the interim rates introduced on January 1, 2008 as ordered by the Board in Order No. P.U. 25(2010).

[5] According to the December 1, 2014 Capacity Assistance Agreement between Vale and Hydro, the capacity assistance to be provided by Vale is 15.8 MW (para. 1.01 (a)) at a payment of $28/kW/year (para. 1.01 (e)), for a total annual cost of $442,400.

the need for the capacity assistance was driven in large part by its own misleading load forecast.

It is also questionable that the Supplemental Capacity Assistance Agreement with CBPP is needed. The Supplemental Capacity Assistance Agreement "provides for an additional net capacity assistance of approximately 22 MW through a further interruption by CBPP of its operating load that is normally provided by the CBPP hydro generating facilities (CA-NLH-296, page 4 of 4, lines 4 to 7)". At $28/kW/year (CA-NLH-296, page 3 of 4, lines 16 to 22), the annual payment for the CBPP Supplemental Capacity Assistance Agreement is $616,000.

The combined annual cost of the Vale and CBPP Supplemental capacity assistance agreements is greater than $1 million annually. According to the December 1, 2014 Capacity Assistance Agreement between Vale and Hydro (para. 5.01), either party may terminate the agreement by providing advance written notice between March 31 and June 30 for termination in the following winter.

The Consumer Advocate submits that Hydro should not be allowed future cost recovery for the Vale and CBPP Supplemental capacity assistance agreements. Further, the Consumer Advocate recommends that the Board order Hydro to file a report identifying all costs associated with the significant over-forecasting of load at Vale and suggest means for saving harmless the small customers of the Province. The timing of this report should enable termination of the Vale and CBPP Supplemental Capacity Assistance Agreements prior to the 2016/17 winter period.

D. FINANCE AND RATE BASE RELATED ISSUES

D.1. Debt Guarantee Fee

Hydro stated at the hearing that it accepts that there is no legislative obligation for rate payers to pay the cost of a debt guarantee fee in their rates (November 17, 2015, p. 174). However, Hydro maintains that Government has directed Hydro to pay it a guarantee fee for the use of the Province's guarantee. The Consumer Advocate submits that Hydro has not been properly and legally directed to pay Government a debt guarantee fee. Section 32 of the *Hydro Corporation Act* (1990) required Hydro to "pay annually to the Minister of Finance a fee in respect of loans guaranteed under [the] Act." The Hydro Corporation Act has since been repealed. The most current legislation, the *Hydro Corporation Act*, 2007, contains no provision for payment of a debt guarantee fee from Hydro. The Order in Council (O.C. 2011-218) that Hydro puts forward (NP-NLH-254, lines 15-16) as grounding the government policy for Hydro to pay the guarantee fee specifically refers to sections 21 to 25 of the *Hydro Corporation Act*, 2007 as the basis of a debt guarantee fee. These sections do not provide the authority to require Hydro to pay a guarantee fee. The Consumer Advocate objects to the cost of the inclusion of the debt guarantee fee in customers' rates in the absence of a legislative basis mandating its payment.

Moreover, Hydro acknowledges that it bears the burden of demonstrating that any debt guarantee fee put forward by it is reasonable [Reference, Transcript, November 17, 2015, p. 174]. Mr. Pelley acknowledged that ratepayers have a right to a least cost guarantee fee (p. 183). Hydro has not established that its proposal is least cost.

Mr. Pelley accepted that the Board's Financial Consultant's report of June, 2015 was indicating that the proposed guarantee fee may not be the least cost option (p. 183, lines 13-15).

Grant Thornton's report of June 12, 2015 noted amongst other issues, that Hydro's approach (based on Scotiabank's October 2013 Guarantee Fee Analysis) did not apportion the benefit of the cost savings (measured as the difference between the yields on bonds issued by the Province and those issued by Hydro, as a standalone entity) between the recipient and the guarantor. Grant Thornton observed that "*The payment of the entire 'cost savings' associated (sic) the guarantee back to the guarantor in the form of a guarantee fee eliminates the incentive for obtaining the guarantee.*" Notably, Grant Thornton also observed that the average difference on long term debt yielded ranged from 35.6 bps to 47.8 bps "*already below the 50 bps paid by Hydro. Apportioning the benefits of the guarantee would lower these ranges further, which may bring into question the 50 bps guarantee fee paid by Hydro on long term debt.*"

In the result, Grant Thornton's analysis concluded (page 20) that further examination was required to determine an appropriate methodology to apportion the benefit of the guarantee on both short and long term debt yields. Grant Thornton also recommended that the Board advise Hydro to propose an equitable methodology to apportion this benefit. It bears noting that the Board's Financial Consultants had stated the same conclusion in their report of April 25, 2014 in relation to Hydro's 2013 GRA.

In the wake of the Board's Financial Consultant's reports, Hydro did not update its Scotiabank analysis. It did not file further evidence. Nor did Hydro seek to cross-examine Grant Thornton on its analysis. Nor has Hydro approached Government and explained that in light of Grant Thornton's analysis that there might be a problem with the guarantee fee request.

The onus on Hydro to substantiate the reasonableness of its proposed guarantee fee has not been met. No guarantee fee ought to be permitted in customer rates unless and until the Board has been provided with an equitable methodology to apportion the benefits of the guarantee and a proper legislative basis exists for its payment. The Consumer Advocate therefore submits that the Board deny inclusion of Hydro's proposed debt guarantee fee in the revenue requirement.

D.2 Rate Base Treatment of New Holyrood CT and Other Assets not in Service at end of 2014

$148,000,000 of asset additions did not go into service in 2014 as Hydro planned. Of the $148,000,000, $110,000,000 relates to the Holyrood CT Project [PUB-NLH-487 Revision 1, p. 1 of 20, lines 19-20]. Hydro states [ibid, p. 2 of 2] that this would give rise to a reduction in the 2015 Test Year Revenue Requirement of $5.1 million. However, Hydro wishes to depart from the normal rules whereby the adjustment to its test year rate base and revenue requirement would be made. Instead, Hydro is asking that these assets be treated from a rate base and revenue requirement perspective for rate setting purposes as if they had been in service at the end of 2014. [Reference: November 19, p. 66 – Testimony of Carla Russell]

Hydro appears to support this abnormal treatment on the basis that without these assets being deemed to be in service at the end of 2014, Hydro would earn below the lower end of the range of its return in 2016. [Reference: November 19, pp. 70-71 – Testimony of Ms. Lutz]

There is no expert testimony supporting Hydro's approach. Nor is there regulatory precedent supporting this approach. Nor are we in this proceeding testing any of Hydro's other 2016 costs, which may be lower than established by use of the 2015 test year costs. Hydro's approach amounts to "single expense category ratemaking" in isolation of an examination of its other costs in 2016.

The Consumer Advocate submits that the Board order Hydro to maintain the rate base that was presented in its 2015 Test Year without adjustment for the assets that were not in service at the end of 2014 On the basis that Hydro has not put forward a proper justification for its position.

D. 3. Proposed Energy Supply Cost Deferral Mechanisms

In the Amended GRA, Hydro, pursuant to a government directive seeks a dramatically higher return on equity than that allowed by the approach established the Board following an exhaustive cost of capital hearing which gave rise to the Board's Order in P.U. 14 (2004). In P.U. 14 (2004), the Board concluded that an appropriate ROE for Hydro was a ROE equivalent to the Province's marginal cost of debt. Notably, in P.U. 14 (2004) the Board held that any change in this determination would depend on Hydro justifying to the Board in a subsequent application that it should be treated comparably to an investor owned utility or providing other suitable rationale supporting an increased ROE.

The revenue requirement impact of increasing the return to 8.80% and including all rural assets, which had been previously excluded, in rate base is $23,085,152. [Reference: PUB NLH 056, Attachment 1 (Rev. 1) p. 1 of 1, line 22]

It is in this context that Hydro's proposals for new energy supply cost deferral mechanisms have been made. Hydro has sought:

a. Isolated Systems Supply Cost Variance Deferral Account (ISSCDA)
b. Energy Supply Cost Variance Deferral Account (ESCVDA)
c. Holyrood Conversion Factor Deferral Account

These accounts are discussed respectively in Section 3.8.2 of Hydro's Evidence. Other than proposing a (plus or minus) $500,000 deadband prior to any transfer to/from the ISSCDA and the ESCVDA, these accounts, if approved, will shift all of the risks of cost variances away from Hydro and onto its customers.

Dr. Wilson, the Board's consultant, stated in his report that these mechanisms further shift business risk that Hydro now faces on to its customers. Dr. Wilson states, "*When such risk* *shifting is permitted by regulators, it is appropriately accompanied by offsetting changes to the utility's allowed equity return."*

[Reference: Updated Report to the Newfoundland and Labrador board of Commissioners of Public Utilities on Cost Allocation and Rate Design Issues in the Newfoundland and Labrador Hydro ("Hydro") November 10, 2014 Amended General Rate Application]

Dr. Wilson goes on to state that this will not occur, *"if Hydro's equity return level is automatically set at the level of Newfoundland Power's allowed equity return."* Dr. Wilson states the "end result would be a double burden to customers."

Dr. Wilson's evidence was not challenged at the hearing by Hydro. Hydro called no cost of capital evidence to counter the view of this experienced and respected independent witness. Hydro's Finance Panel was not put forward as an expert panel and Mr. Pelley agreed that he would defer to Dr. Wilson's opinion. Mr. Pelley testified that he would have no basis to say that Dr. Wilson was incorrect in his assertion that the end result would be a double burden to customers. [Reference: Transcript, November 17, 2014, pp. 149-150]

Likewise, Mr. Doug Bowman, the Consumer Advocate's expert witness, recommended against the establishing of these deferral accounts on a similar basis. [Reference: Report of C. Douglas Bowman, June 1, 2015, pp. 16-17]

The Consumer Advocate submits that the Board should reject Hydro's proposal to effectively visit a double burden on customers.

The Consumer Advocate would also encourage the Board to consider the fact that this is Hydro's first GRA since 2006, a very lengthy period. While Hydro effectively complains, for example, that the 630 kWh per barrel conversion factor set in its last GRA exposed it to financial consequences [see Table 2.21] over the years, the fact is that Hydro was at liberty to file another GRA to seek to establish another more appropriate fuel conversion factor if it so chose.

A further problem with Hydro's proposals, particularly after its long absence from a GRA, is that these sorts of mechanisms increase the potential that Hydro can avoid and again postpone

GRAs, as it will become financially insensitive to these cost variances. This is not to be encouraged.

Presently, customers pay Hydro to manage these supply cost risks. To take away any financial incentive from Hydro by allowing it to become (subject only to the proposed limited deadbands) financially indifferent to these risks at the same time as Hydro's cost of equity is increasing dramatically is an unjustified double burden.

The Consumer Advocate therefore submits that the Board reject Hydro's proposal to establish new energy supply cost variance accounts.

D.4. Return on Equity - Adjustments

Government directive has mandated that Hydro's return on equity be the same as Newfoundland Power's. In PUB-NLH-057, Hydro was asked whether Hydro proposed that if there were future adjustments to Newfoundland Power's allowed return on equity (whether by board order following a Newfoundland Power GRA or through the use of an Automatic Adjustment Formula AAF) that an adjustment be made to Hydro's return on equity, without a general rate application process. In the event that Hydro answered affirmatively, Hydro was further asked what process Hydro proposed for an adjustment in its return on equity. In reply, Hydro stated that "*Hydro anticipates that future adjustments to its return on equity would only occur as a result of a GRA.*"

At the hearing, Ms. Russell also allowed that it would also be reasonable to change Hydro's return on equity once Newfoundland Power had completed a general rate application. [Reference: Transcript, November 18, 2015, p. 173, lines 21-24]

The Consumer Advocate submits that the fairest and most reasonable approach is to indeed adjust Hydro's return on equity following the setting of Newfoundland Power's return either through a Newfoundland Power General Rate Application or through the use of an AAF, once same is reinstated for Newfoundland Power. In that fashion, Hydro's return on equity will reflect what the Board has most recently approved as a fair and reasonable return on equity after a full analysis or by operation of an approved formula. Accordingly, the Consumer Advocate recommends that the Board order Hydro to propose a process and mechanism for the Board's approval to accomplish such adjustments to Hydro's ROE.

E. "MATRIX" MODEL AND COST SHARING

E.1. Concerns with "Matrix" Organization

For the past several years, Hydro has been part of what has been termed a "matrix organization" within Nalcor. One feature of the Matrix organization model as applied at Nalcor is that Hydro has not had its own dedicated executive level leadership team whose sole focus is on Hydro. Instead, Nalcor executives essentially provide executive services to Hydro on a charge-in basis. These Nalcor executives were not formally accountable to and did not report to Mr. Robert Henderson, Vice President of Hydro – the executive said to have "single point accountability" for all matters at Hydro. During the hearing, Mr. John McIsaac was appointed President and CEO of Hydro and replaced Mr. Henderson as Hydro's single point of accountability. To date, no further corporate changes have been announced.

Hydro is a public utility with essential duties to serve a vital public service to customers throughout Newfoundland and Labrador. In the Consumer Advocate's submission, Hydro must have its own dedicated executive team with vice presidents who are responsible for key functions within Hydro (including, but not limited to, engineering and operations, finance, and planning) reporting directly to and being accountable to the President and CEO of Hydro. Clear, formal lines of reporting and accountability are critical to ensuring that Hydro's interests are prioritized and served.

A dedicated executive team will have the interests and operations of Hydro as their exclusive focus. The evidence during the hearing made it clear that the "matrix structure" was such that Nalcor Vice-Presidents with Nalcor-wide responsibilities in areas of Finance, Human Resources, Asset Management, Corporate Relations and Customer Service spent varying amounts of time (and in some cases quite low amounts of time) in the direct and sole service of Hydro. The same was the case with Mr. Martin, Nalcor's CEO, with full single point of accountability resting with Mr. Henderson who assumed duties in April, 2013 as Vice President of Newfoundland and Labrador Hydro.

The data on the hours charged by the Nalcor Executive to Hydro as reported in Table 49 of the Board's Financial Consultant's Report demonstrates that at least from a charging perspective, the hours charged in direct service to Hydro have for the most part been fairly low amongst Nalcor executives. Over the years 2011 to 2014 (actual), the VP, Finance and CFO typically charged below 100 hours, with the exception of 2014 at 258 hours.

The VP, HROE charged 996 hours in 2011 but only 392.5 and 302 in 2012 and 2013, respectively. The VP, Project Execution and Technical Services charged 697.00 hours in 2011, and 451.5, 365.5 and 522.00 over 2012 to 2014 respectively. The VP, Corporate Relations charged 697.00 hours in 2011 and 265.5 and 496.5 hours respectively in the next two years. The hours charged into Hydro by Nalcor-based executives increased markedly in 2014, the year of the widespread outages.

Mr. Martin, Nalcor's CEO, charged hours of 133.5, 154.5, 137 respectively from 2011 to 2013 and 561 hours in 2014, the year of the widespread outages. In certain instances, including Mr. Martin, executives who testified indicated that their charged-in hours were not reflective of the work they did for Hydro, as work of a more broad nature while benefiting Hydro, also benefited other lines of business and would not be charged to Hydro. It was also the case that time was not being entered into the time entry system on a frequent basis by all executives of Nalcor.

Hydro has not presented a clear picture of the true amounts of time spent by Nalcor-based executives in the service of Hydro. Accordingly, there is a lack of transparency which challenges the effective regulation of Hydro as a regulated utility.

Also lacking in the evidence are clear rules and procedures around resolving issues where Hydro's interests may be in conflict with those of Nalcor. During the hearing Mr. Henderson testified that such conflict matters did not arise, and if on a rare occasion it did, it would be resolved. Be that as it may, while Hydro remains part of this "matrix" organization, there must be clearly known and applicable rules governing the identification (and resolution) of conflicts or potential conflict situations in an effort to protect the interests of the regulated utility and its customers.

Hydro's Amended Application points to the challenge that Hydro is facing in the coming years in areas such as infrastructure renewal and increasing expenditures. Hydro has also seen its controllable costs escalate dramatically. Reliability and customer satisfaction has also been an area of challenge in recent years, even before the outage events of December of 2013 and early 2014. In the Consumer Advocate's assessment, these challenges cannot be adequately met and addressed without Hydro's having its own fully dedicated executive team who report to and are accountable to Hydro's President and CEO.

Due to the fact that Nalcor's model gives responsibilities to executives across a number of lines of business in the Nalcor group, by design, these executives have focuses besides Hydro. The Consumer Advocate believes that there is evidence that this model in practice, if not by design, has resulted in a dilution of the executive leadership capacity. One example of this is in the area of Human Resources and Organizational Effectiveness.

The VP, HROE is accountable to Nalcor's President and CEO, Mr. Ed Martin for providing executive level *leadership and direction* across all Nalcor lines of business in the areas of, amongst others, human resources, including labour relations and organizational effectiveness. However, Mr. McDonald described his role as an "internal consultant" in the areas of organizational effectiveness, a role of providing expertise, giving guidance and making suggestions. [Reference: Transcript, September 16, 2015, p. 58; September 17, p. 7]

Organizational effectiveness, as agreed by Mr. McDonald, involves making the optimal use of people within an organization. It also involves having the right number of people doing the job. [Reference: Transcript, September 17, 2015, pp. 12-13]

Organizational effectiveness is a key challenge for Hydro and is critical to Hydro's having success in controlling its costs. It is a particularly key area that requires undiluted executive leadership and direction within Hydro in the Consumer Advocate's submission. With the current structure, the NP of HROE has leadership and direction responsibilities in organizational effectiveness "on paper", but the reality as described by Mr. McDonald is that the levels of or growth of FTEs, which lies at the core of organizational effectiveness at Hydro, are not his department's accountability, with that accountability resting with Rob Henderson as Hydro's VP. [Reference: Transcript, September 17, 2015 , pp. 13-15]

E.2. Pricing Policy for Affiliate Common Services, Common Expenses and Corporate Services

As explained by Brad Rolph at the hearing (October 19, 2015, pp. 10-11) and in his June 1, 2015 report, Hydro provides certain common services in the areas of human resources, safety and health and information services to other companies in the Nalcor Group. [Reference: Report – Evaluating the Pricing Policy for Affiliate Common Services, Common Expenses and Corporate Services, June 1, 2015]

Mr. Rolph explained that Hydro determines the amount charged for rendering human resource and safety and health services to Nalcor and its other lines of business based on an indirect cost recovery method without a mark-up. Hydro calculates the human resource and safety and health related costs to be recovered by adding the relevant operating expenses, such as salary and fringe benefits, office supplies and professional services. Hydro then subtracts from that amount any re-charges for corporate services rendered to Nalcor or one of its other business lines. Mr. Rolph noted that in the case of human resource related costs, Hydro also subtracts payroll taxes and any advertising costs initially borne by Hydro that are charged back to Nalcor as another expense. Then Hydro allocates costs to be recovered based on FTEs. Mr. Rolph testified that in his opinion, it was reasonable for Hydro to charge for rendering human resources and safety and health services to Nalcor and other lines of business using this approach.

As regards the common service of information system services, Mr. Rolph explained that Hydro determines the amount charged for rendering information system services to Nalcor and its other lines of business on an indirect cost recovery method without a mark-up. Hydro calculates the information system costs to be recovered by adding relevant operating expenses, depreciation, and a return on rate base for capitalized relevant common assets, such as services and software. It then subtracts any re-charges for corporate services rendered to Nalcor or one of its other business lines, and software maintenance costs initially borne by Hydro which was charged back as an expense to Nalcor or one of its business lines. Hydro then allocates the costs to be recovered based on an average number of users. Mr. Rolph testified that in his opinion, it was reasonable for Hydro to determine the amount to charge for rendering information system services to Nalcor and its other lines of business using this approach.

Mr. Rolph raised a potential issue (October 19, 2015, p. 13) with the way in which Hydro allocated common expenses. Mr. Rolph pointed out that there was no indication in the evidence that Hydro included in its cost to render common services an amount to account for the share of common expenses attributable to the department of human resources, safety and health and information services. Mr. Rolph stated that if Hydro has not allocated the share of common expenses internally, then the cost to be recovered for rendering common services is not "fully burdened" with the result that the charge for common services to Nalcor and its other lines of business would be understated.

Mr. Rolph expressed the opinion in his report and at the hearing that there should be no mark-up on the common services provided by Hydro unless the recipient of the services included private interests and was not a crown entity. [Reference: Transcript, October 19, 2015, pp. 14-15]

Mr. Rolph stated that it would be inappropriate for Nalcor to mark-up the cost of charging corporate services to Hydro and he said that the "*same answer applies to situations in which Hydro is providing common or corporate services for the benefit of public energy projects to its affiliates.*" Mr. Rolph continued, "*To do otherwise would create a situation in which Hydro's revenue requirement would decline at the expense of Nalcor, one of the public energy projects or other lines of business or the province.*" Mr. Rolph acknowledged that the principle of determining whether there should be a mark-up based on the ownership of the entities involved had not been applied by any Canadian regulators. [Reference: Transcript, October 19, 2015, lines 8-13]

Mr. Rolph also testified that in the Canadian utilities he surveyed in Appendix B to his report, none applied a mark-up on common services or corporate services rendered to affiliated companies.

[Reference: Transcript, October 19, 2015, p. 16, lines 15-22]

E.2.1. Discussion

E.2.1.1. A Least Cost Structure?

It is important to note that Mr. Rolph's report was not designed to answer whether the manner in which Nalcor and Hydro had set up the shared services model was necessarily least cost to customers, a key regulatory issue.

Evidence in the RFI process and at the hearing indicates that had Nalcor and Hydro decided to employ those who perform common services outside of Hydro instead of within Hydro, the cost to ratepayers would be reduced. The reply to NP-NLH-204 (based on the original GRA) indicates that had all employees who provide common services been placed in Nalcor instead of Hydro, the cost to Hydro would have decreased by approximately $900,000, an amount that would have been picked up by other Nalcor lines of business. At the hearing, Ms. Lutz testified that this was not considered as a possible cost savings approach. [Reference: Transcript, November 19, 2015, p. 91].

The Consumer Advocate submits that as long as Hydro is going to be part of a common services model, the model must be shown to be least cost to Hydro. The present model has been established not to be least cost. The figures used in response to NP-NLH-204 were not updated during the hearing. The Consumer Advocate recommends that the Board order Hydro to adjust the 2015 test year revenue requirement by the amount of savings that could accrue to Hydro if common services employees were in the employ of Nalcor, instead of Hydro, based upon updated 2015 test year figures.

E.2.1.2. The Fully Burdened Issue

Ms. Lutz testified that Mr. Rolph's position was correct and confirmed that Hydro had not fully burdened common services charges. Hydro filed Undertaking 151 which estimates the impact to be $144,851 in the 2014 test year and $114,851 for the 2015 test year. The Consumer Advocate submits that the Board order Hydro to make these adjustments to its revenue requirement.

[Reference: Transcript, November 17, 2015, p. 80]

E.2.1.3. The Mark-Up Issue

Mr. Rolph testified that in an investor-owned utility scenario like Fortis and Newfoundland Power, if Newfoundland Power did not charge a mark-up in providing a service to Fortis Inc., Newfoundland Power "*wouldn't effectively be sharing in the profits of the fruit of their efforts for providing that service.*" [Reference: Transcript, October 19, 2015, p. 72, lines 1-10]

In that scenario, a mark-up would be applied. However, when asked why it would be inappropriate for Hydro to likewise provide a service with a mark-up, he stated, "*Because each of the entities are not profit entities and both of them are, in particular Hydro, its business is generated on a cost basis.*" [Reference: Transcript, October 19, 2015, p. 73, lines 8-11]

The Consumer Advocate disagrees that there should be a distinction drawn between the appropriateness of Newfoundland Power charging a mark-up to an affiliate and with Hydro including a mark-up in its charge to Nalcor or other lines of business. First, merely because Hydro and Nalcor are government-owned does not equate to their being "non-profit" entities. Both Hydro and Nalcor seek to earn a return on their shareholders' investment in the respective companies. Second, Hydro's customers should not be disadvantaged relative to Newfoundland Power's customers because Hydro is government owned.

The Consumer Advocate submits that Hydro should be ordered to include a mark-up for revenue requirement purposes in respect of the services that it provides to Nalcor and related businesses.

During the hearing, Ms. Lutz was referred during cross-examination to Grant Thornton's previous review of inter-company transactions (Transcript, November 18, 2015, pp. 22-24) wherein it was confirmed that charges for external billings were subject to a mark-up of 57% on wage rates. CFL Co. employees were marked up 80%, plus a fixed charge of $80.00 per day and a 25% profit margin. Given that these mark-ups constituted Hydro's assessment of arm's length charges, the Consumer Advocate recommends that the Board order Hydro to mark-up services Hydro employees perform for other lines of business within Nalcor to no less than 57% and adjust the revenue requirement accordingly.

F. RELIABILITY, CUSTOMER SERVICE, CDM AND REGULATORY

F.1. Reliability

Though the events of early 2014 which are commonly referred to as "Dark NL" gathered much attention and focus on reliability issues with Hydro's system, 2013 was not a satisfactory year in terms of reliability either.

In 2013, Hydro did not achieve any of the targets that it had set for itself across 8 key performance indicators related to reliability. These indicators included:

- Weighted Capability Factor (WCF)
- DAFOR
- T-SAIDI
- T-SAIFI
- T-SARI
- SAIDI
- SAIFI
- Underlying Load Shedding

[Reference: 2013 Annual report on Key Performance Indicators, Exhibit 2, p. E-5]

Hydro's 2013 results in its reliability measures were significantly below its 5 year average over the period 2009 to 2013. [Reference: Table at NP-NLH-303, p. 1 of 3] On January 11, 2013, a blizzard resulted in tripping of equipment in the Holyrood Thermal Station and transmission line on the Avalon Peninsula. The event which was the subject of examination at the Prudence Review interrupted power to over 140,000 customers as detailed in Undertaking 72, Attachments 1 and 2.

In 2014, Hydro again did not achieve its reliability key performance indicator targets, as evidenced in Appendix B to Hydro's December 31, 2014 quarterly report. [Reference: Information No. 5]

In Hydro's evidence (Section 2.3.4) Hydro has pointed to a number of initiatives it has made to improve reliability since the events of January, 2014. These initiatives include, amongst others:

- A General Manager for gas turbines and diesels
- Accelerated addition of the Holyrood CT
- A critical spare review
- Modification of the air blast circuit breaker replacement program
- A specific focus on protection and control improvements
- Completion of the remaining circuit breaker and transformer preventative maintenance work that was included in the six year recovery plan (2010 to 2015)
- Capacity assistance agreements
- Enhanced winter readiness program in all operating areas to prepare for the high winter demand period

F.1.1. Preventative Maintenance

A concern that still arises is in the area of preventative maintenance and in particular, its deferral. Mr. Henderson testified that decisions can be made to defer preventative maintenance. Mr. Henderson states that there were no specific guidelines to follow when considering the deferral of maintenance. Mr. Henderson stated that,

> *Each of these people are experienced engineers, managers, so they are required to exercise their judgment in the circumstances.*

[Reference: Transcript, September 23, 2015, pp. 46-47]

Though Mr. Henderson stated that the company had increased its target to 100% for preventative maintenance completion (September 23, 2015), there apparently was still not a complete acceptance of the fact that the deferral of preventative maintenance work exposes the utility and its customers to unknown risks and must not occur. The result was that Mr. Henderson believed that there was still room for a person who has knowledge of the equipment to make a judgment that preventative maintenance can wait (September 23, 2015, p. 57). While agreeing that there "*could be some unknown risk. . . you are relying on the technical expectation* *of the people who know the equipment and you would not make that decision [i.e. to defer] very easily or without good very strong consideration."*

In the light of the Liberty Report and the events of 2013 and 2014, the Consumer Advocate submits that this deferral of preventative maintenance should not occur, except in the most exceptional of circumstances, as it exposes customers to unknown risks. The Consumer Advocate recommends that the Board direct Hydro to file a report at least annually relating to performance and completion of preventative maintenance. The report should identify when for exceptional circumstances a preventative maintenance must be deferred, provide a date certain when it will be completed, and include a written analysis as to how the preventative maintenance being deferred has been deemed acceptable having regard to all reliability risks and considerations for the customers who may be impacted.

F.1.2. Performance Incentives for Hydro Management

There is not an alignment on the reliability-related key performance indicators that are reported to the Board and those that are used by Hydro's management to target and measure performance in this area. In his evidence, Mr. Martin stated that he did not use the KPIs reported to the Board to monitor performance. The performance measures and targets he uses were provided in Undertaking No. 6. [Reference: Transcript, September 15, 2015, p. 43] Mr. Martin stated that Hydro was receptive to working with the Board as regards as the reports the Board requires. [Reference: Transcript, September 2015, p. 75] In light of the present difference between what Hydro uses internally and that which is available to stakeholders, this should be done.

The Part "B" - Divisional Targets for Hydro's V.P., Robert Henderson do not, in the Consumer Advocate's submission, place enough emphasis on reliability (or financial performance either). Mr. Henderson's 2015 performance Contract (Undertaking No. 10) places, for example, 20% on safety but a combined 10% on SAIDI and SAIFI, two distinct reliability measures (and only 5% on adherence to budget).

While other categories such as Capital Budget Project Completions and Operation and Maintenance Plan for Winter Readiness are related to reliability and are allotted 5% each, the

Consumer Advocate submits that Hydro should be directing incentives for its senior management to a greater degree in areas that directly measures reliability results.

F.2. Customer Service

Hydro is in a state of attempting to recover its relationship with its customers, after declines in customer satisfaction scores (Ms. Dalley, Transcript, November 23, 2015, p. 7-8). Ms. Dalley, Vice President of Corporate Relations and Customer services stated that this has been a focus since 2012.

The record in this proceeding shows that Hydro's residential customer satisfaction slipped from 92% in 2010 to 80% in 2012 (Amended GRA, Vol. II, Exhibit 2. p. E-28). This was compared to Hydro's target of ≥ 90%.

In 2013, Hydro did not set a target for itself as regards customer satisfaction (Ms. Dalley, November 23, 2015, pp. 169-170) nor did Hydro survey customers as regards customer satisfaction in 2013. Hydro decided to survey every second year and its target for 2014 was set at ≥ 80% customer satisfaction, which Hydro achieved at 84%. Presently, Hydro's 2015 goal (Undertaking No. 6) is to "*complete 2015 initiatives in Customer Service Strategy Roadmap to result in Customer Service Satisfaction ≥ 80% in 2016.*" It is a concern that Hydro has lowered its target for customer satisfaction in this manner. Hydro essentially lowered the bar for itself. In fact, the stated objective in the Roadmap is to maintain an 80% customer satisfaction rating over the next 5 years. [Reference: Transcript, November 23, 2015, p. 189, lines 1-12]

It is also a concern that Mr. Henderson's performance contracts contained no targets as regards customer satisfaction. [Reference: Undertaking No. 10 - Mr. Henderson's Performance Contracts for 2015, 2014 and 2013] Likewise, Ms. Dalley testified that it was not part of her contract either. [Reference: Transcript, November 23, 2015, p. 176] The 2014 and 2015 Performance Contracts for the Hydro employees and Hydro Leadership Team show that none have customer service measures in their contracts. [Reference: Undertaking No. 3(a) and 3(b)]

Additionally, it is important to note that what Hydro reports in its KPIs is essentially an overall customer satisfaction number, derived from asking customers in general how satisfied they are with Hydro on a scale of one to ten. [Reference: Transcript, November 23, 2015, p. 198] Also surveyed by Hydro is customer satisfaction in regards to customer concern, supply of electricity, price, power restoration, customer service and reliability. The 2014 survey showed that results were lower in the price area and in the area of power outages. [Reference: Transcript, November 23, 2015, p. 199] The Consumer Advocate would recommend that when Hydro reports its customer satisfaction results it also provide the satisfaction levels in these key areas.

In summary, the Consumer Advocate recommends that the Board order Hydro to file annually with the Board and provide to the parties its key performance measures and results, identifying those areas requiring improvement and establishing targets for areas requiring improvement taking into consideration Hydro's historical performance and its performance relative to peers in the annual Peer Group Report. The indicators should include customer satisfaction, broken down by category as identified above, reliability measures, and other financial-related indicators that are already being reported in the Peer Group Report. The Board should review and approve the report, and once approved, Hydro should undertake to match its internal performance contracts with the performance indicators identified as needing improvement. In this manner, Hydro management objectives will be better aligned with the needs of its customers.

Further, in September of 2014, Hydro filed a Customer Service Strategic Roadmap with the Board. [Reference CA-NLH-322, Attachment 1] Ms. Dalley indicated that Hydro sees this as a 5-year plan with 2015 being year one. [Reference: Transcript, November 23, 2015, p. 184, lines 9-10] The Consumer Advocate is supportive of this initiative. However, as Mr. Doug Bowman stated in his pre-filed evidence (p. 10, lines 3-5) the Board should monitor its implementation with the results posted on Hydro's website so that customers and stakeholders are kept informed of Hydro's progress.

F.3. CDM

A concern in the CDM area is that despite the growing rural deficit and the fact that most isolated customers do not qualify for the provincial programs (because these programs are geared to those with electric heat) (NP-NLH-104; Mr. Brophy, November 23, 2015, p. 220) there was no targeting of isolated systems for energy efficiency initiatives until 2012 (November 24, 2015, p. 2). This would have been 3 years after the provincial "Take Charge" program was underway (November 24, 2015, p. 2).

Since 2012 a directed effort has been taken to target Isolated Customers in the province, with the retention of Summerhill, a private firm (November 24, 2015, p. 2). The program involves direct installs such as more efficient lighting, more efficient faucets, low flow shower heads and pipe insulation (November 24, 2015, p. 6). Mr. Brophy, who has been Hydro's Energy Efficiency Manager since July of 2014, stated that representatives of Summerhill have been in 83% of the residences in the isolated communities with the isolated community program contributing to 63% of Hydro's energy savings (November 24, 2015, p. 8). Cumulatively since 2012, the Isolated Systems Community Energy Conservation program has achieved 87% of Hydro's target for energy savings (Undertaking 187).

However, one can observe as well from Undertaking No. 187 that Hydro's annual targets for energy savings have decreased considerably from 1884 MWhs in 2013 to 813 MWhs and 650 MWhs respectively in 2014 and 2015. In both 2014 and 2015 these lowered targets were then exceeded by 167% and 169%. This, of course, contributes to the 87% cumulative performance. The Consumer Advocate has a concern as to whether Hydro is setting targets that are not ambitious enough.

Related to this concern is that the performance contracts for both Ms. Dalley (Undertaking No. 189) and for Mr. Henderson (Undertaking No. 2) contain no explicit targets for meeting CDM outcomes. Hydro services some 38,000 customers in over 200 communities throughout rural Newfoundland and Labrador. Yet one observes from Undertaking No. 188, Table 1 that Hydro's efficient Windows spending in 2014 and 2015 (f) was only $38,000 and $8,000 respectively. Insulation spending was merely $92,000 and $98,000 respectively, in 2014 and 2015 (f). These are extremely modest levels of spending in relation to CDM on initiatives that lower energy bills for customers. The lack of incentives in the performance contacts of key personnel who have influence over CDM delivery and outcomes is a serious weakness in Hydro's approach to CDM.

In this regard, the Consumer Advocate submits that the Board order Hydro to undertake a study in conjunction with Newfoundland Power with the goal of ramping up CDM initiatives. This study is timely in light of the significant change in marginal costs brought on by the new regime with Muskrat Falls and associated transmission. The trend is increasing electricity rates in the Province, so it is important that customers be given the opportunity to gain a measure of control over their electricity bills through CDM initiatives.

F.4. Regulatory and RSP Load Variation Balance

In the *Settlement Agreement* dated August 14, 2015, the Parties agreed (para. 23) that in preparation for the implementation of customer rates reflecting the costs of the Labrador-Island interconnection, Hydro will file the following studies with the Board:

> *(a) A marginal cost study no later than December 31, 2015;*
> *(b) A cost of service methodology report no later than March 31, 2016;*
> *(c) A report on the Rate Stabilization Plan and supply cost recovery mechanisms no later than June 15, 2016; and*
> *(d) A General Rate Application no later than March 31, 2017 for rate changes based on a 2018 test year.*
>
> *The Parties agree that the Board should in its Order direct Hydro to file these reports, studies and applications by the relevant dates set out in this paragraph. The Parties further agree that a generic cost of service hearing should be held following the filing of the reports outlined in (a) to (c) above.*

The Consumer Advocate cannot over-emphasize the importance of these undertakings. The inability of Hydro to meet its regulatory commitments has led to a rate regime that has been heavily tilted in favour of the Island Industrial Customers, and has resulted in lost opportunities for reducing the cost of power. For example:

- Hydro last filed a GRA in 2006. We are about to reach the 10 year anniversary of the last GRA, and still rates are interim as they have been for the Island Industrial Customers since January 1, 2008, and for Newfoundland Power since January 1, 2011.[6] Island Industrial Customer rates have been interim since the last GRA in spite of the persistent efforts of the Board directing Hydro to file final rates as summarized in Board Order No. P.U. 25(2010) (see pages 1 to 3).

[6] Board Order P.U. 29(2013) finalized the rates for the period through August 31, 2013, but the rates have continued to be interim from that point forward to this day (see Conclusions, pages 10 and 11).

- At the 2006 GRA, the Parties agreed to examine re-design of the RSP to better meet design objectives (see RSP-CA-NLH-6 Attachment 2, page 5 of 27). It was clear that the RSP design was not fair, and did not track the cost of service (see Amended GRA, page 4.37, lines 1 to 2). However, in spite of its commitment to study re-design of the RSP, Hydro failed to complete the study. The RSP study recommendations were to have been implemented by January 1, 2008 (RSP-CA-NLH-6, Attachment 1, page 1 of 1). The Board on several occasions asked Hydro to file the study as demonstrated in RSP-CA-6, Attachment 2, but in spite of the Board's efforts, Hydro never completed the study.

- A review of the Island Industrial Customer rate design was carried out following the 2006 GRA as a result of the Parties' Agreement (see Amended 2013 GRA, Volume II, Exhibit 12). Hydro and the Industrial Customers reached agreement on a rate design during the 2008 study, yet Hydro never proposed implementation of the rate design in spite of its statement in CA-NLH-78 that the rate design in Table 1, page 10 of Exhibit 12 "*would encourage economic efficiency while maintaining other rate design principles*".

With respect to the increase in the cost of supply, the Island Industrial Customer energy charge between 2008 and 2013 did not include a fuel rider, so did not recover the increased cost of fuel at Holyrood since the 2007 Test Year (Amended GRA, page 4.31, lines 23 to 24). The energy charge was far below the marginal cost of energy represented by the production cost at Holyrood. Because the Island Industrial Customer energy rate did not reflect marginal costs, the Island Industrial Customers were encouraged to use much more energy than economic efficiency would dictate, thus increasing the use of Holyrood and driving up the cost of supply. As already noted, Hydro submits that the rate design agreed to with the Island Industrial Customers (Table 1, page 10 of Exhibit 12) "*would encourage economic efficiency while maintaining other rate design principles*". Since the rate design was never implemented, there was a lost opportunity, and rates were at odds with the Province's energy efficiency initiatives. This is especially puzzling since Newfoundland Power has had a rate design in place during the 2007 through 2013 time frame that included a tail-block energy charge that reflected marginal costs. It is not at all clear why Hydro chose to implement an efficient utility rate, while choosing not to implement an efficient rate for the Island Industrial Customers.

The unfairness of the rate regime during the 2007 to 2013 time frame, and continuing today, is perhaps more of a concern. When the original 2013 GRA was filed, the Island Industrial

Customers were paying only 65.3% of the cost of power determined in the 2013 cost of service study (see RSP-CA-NLH-12, Attachment 1). In comparison, Newfoundland Power was paying 98.2% of the cost of power. The revenue to cost ratios show clearly that there has been a significant cross-subsidy in the rate regime. As stated by Hydro in RSP-CA-NLH-12, the cross-subsidy to the Island Industrial Customers granted through OC2013-089 is $37.6 million.[7] When asked about the $37.6 million subsidy and its equivalence to 1.7 years of free power for the Island Industrial Customers under cross-examination by the Consumer Advocate, Mr. Patrick Bowman, the expert witness for the Island Industrial Customer Group, responded (October 1, 2015 transcript, page 47, lines 14 to 17) "*it was a very unusual and unfortunate situation, luckily to the good side, but it wasn't what we would have recommended. No, I don't disagree with that.*" It certainly did work out to the "*good side*" from the perspective of the Island Industrial Customers. The $37.6 million subsidy received by the Island Industrial Customers is more than double the average annual revenue received from the entire Island Industrial Customer class during the period from 2008 to 2012 (CA-NLH-182), and equivalent to 1.7 years of free power (based on Island Industrial Customer class average annual consumption during 2008 to 2012 period – see CA-NLH-182). No such subsidy was offered Newfoundland Power's customers, but if it had, it would be equivalent to $627.3 million (based on average annual revenues received from Newfoundland Power during the 2008 to 2012 period – see CA-NLH-182). As the Board correctly points out in Order P.U. 40(2013) (page 3, line 48 and page 4, line 1), "*the RSP adjustment has not operated normally for the Industrial Customers since 2008*".

In summary, the Consumer Advocate submits:

1) It is of vital importance that the Board not only order Hydro to conduct the studies described in the Settlement Agreement dated August 14, 2015 (para. 23), but also to monitor and ensure Hydro conducts the studies according to the agreed-to schedule. We suggest that given Hydro's track record, if it becomes evident that Hydro will not meet

[7] On cross-examination by the Consumer Advocate, Mr. Fagan stated "*I don't know if I can accept the term subsidy.*" (October 6, 2015 Transcript, page 9, line 25 and page 10, line 1). Yet the response to RSP-CA-NLH-12 clearly states (lines 22 to 25, page 1 of 2) "*Hydro would consider the current load variation methodology one which creates cross-subsidization, as assigning the load variation to the class in which it occurs is not consistent with the cost causality principles reflected in Hydro's Cost of Service Study*". The response goes on to identify the amount of the cross-subsidy as $37.6 million. Later in the October 6, 2015 transcript (page 22, lines 5 to 9), Mr. Fagan admits "*Well, in hindsight, it's hard to argue that the industrial customer rates were below cost in that period. So if you deem that to be not reasonable, I mean, we probably could agree it's not reasonable*".

this schedule agreed to in the Settlement Agreement, the Board should itself hire an experienced consultant to complete the study at Hydro's expense.

2) The Consumer Advocate recommends that the Board transfer the balance in the Island Industrial Customer load variation component of the RSP that has accumulated from September 1, 2013 to the account of Newfoundland Power's RSP. While this amount is far less than the cross-subsidy transferred to the Island Industrial Customers through Order No. P.U. 26(2013), an Order transferring this balance from the Island Industrial Customer RSP account to Newfoundland Power's RSP account, although symbolic, would at least allow the Board to recognize the violation of cost of service and rate design principles that arose as a result of OC2013-089.

G. RURAL DEFICIT AND RATE SUBSIDY

The Rural Rate Subsidy has reached alarmingly high levels. Hydro states in the Amended GRA (Volume I, page 2.82, lines 28 to 29): "*The Rural Deficit has grown from $40.8 million in the 2007 Test Year to a forecast of $64.1 million in the 2015 Test Year*". The rural deficit adds approximately 13% to the bills of NP and Labrador Interconnected Rural customers based on the proposed allocation methodology (see Amended 2013 GRA, Volume II, Exhibit 13, Schedule 1.2, pages 2 of 6 and 6 of 6). This results in a serious distortion of the price signal.

G.1. Allocation of Rural Deficit

The currently approved methodology for allocation of the rural deficit between Newfoundland Power and the Labrador Interconnected customers is based on the Board's February 1993 report relating to the Cost of Service Methodology hearing (see Amended 2013 GRA, Volume I, page 4.7, footnote 5). Under the current allocation methodology, the proposed rate increase for Labrador Interconnected Rural Customers would be 27.8% versus 2.1% for Newfoundland Power's customers (Amended 2013 GRA, Volume I, page 4.7, lines 18 to 21), and the revenue to cost ratios would be 142% for Labrador Interconnected Rural Customers and 112% for Newfoundland Power (Amended 2013 GRA, Volume 1, page 4.9, Table 4.2). In the Amended 2013 GRA, Hydro proposes an alternative allocation methodology on the basis of revenue requirement (Amended 2013 GRA, Volume I, page 4.7, lines 12 to 16). Under Hydro's proposed allocation methodology, the proposed rate increase as applied for in the Amended GRA would be 2.1% for Labrador Interconnected Rural Customers and 2.8% for Newfoundland Power's customers (Amended 2013 GRA, Volume I, page 4.7, lines 18 to 21), and the revenue to cost ratios would be 13% for both customer classes (Amended 2013 GRA, Volume II, Exhibit 13, Schedule 1.2, pages 2 of 6 and 6 of 6).

Hydro justifies its review of the allocation methodology as follows (Amended 2013 GRA, Volume I, page 4.8, lines 5 to 9):

> *This is the first GRA since the Existing Methodology was approved in 1993 in which the full impact of the Rural Deficit allocation will be reflected in the rates of customers on the Labrador Interconnected System. Therefore, Hydro believes it is appropriate at this time to review the fairness of the Rural Deficit allocation methodology.*

The Consumer Advocate submits that a revenue to cost ratio of 142% for Labrador Interconnected customers, in and of itself, justifies a review of the fairness of the Rural Deficit allocation methodology.

Although rates for Labrador Interconnected customers start at a low level, almost 30%[8] of the proposed rate under the current allocation methodology would be attributable to the rural rate subsidy, a cost over which Labrador Interconnected customers have no control. The average annual contribution per Labrador Interconnected customer under the current allocation methodology is $653.15, about three times the average annual contribution per Newfoundland Power customer of $216.64 (Amended 2013 GRA, Volume I, page 4.8, Table 4.1). As Hydro states on page 5 of 8 in CA-NLH-166 (Revision 3, Mar 24-15), "The current methodology results in materially higher customer billing impacts for Labrador Interconnected Customers primarily because they have higher electricity usage as a result of living in an area of the Province where the climate is materially colder".

Hydro states on page 6 of 8 in CA-NLH-166 (Revision 3, Mar 24-15) "Hydro believes that the current methodology does not provide a reasonable sharing of the rural deficit between Labrador Interconnected Customers and Newfoundland Power Customers". The Consumer Advocate agrees, and notes that all experts participating in the Amended 2013 GRA with the

[8] Based on the portion of the revenue to cost ratio attributable to the rural deficit (0.42) divided by the overall revenue to cost ratio (1.42) (Amended 2013 GRA, Volume 1, page 4.9, Table 4.2).

exception of Mr. Brockman, Newfoundland Power's expert witness, also agree with this conclusion. The experts in agreement with the proposed allocation methodology include Dr. Wilson, the Board's expert witness, Mr. Doug Bowman, the Consumer Advocate's expert witness, Mr. Greneman, Hydro's expert witness, Mr. Raphals, the Innu Nation's expert witness, and Dr. Feehan, the expert witness for the Towns of Labrador City, Wabush, Happy Valley-Goose Bay and North West River.

Several cost recovery methodologies were proposed by the interveners at the 1993 review. All methodologies proposed at the review are arbitrary, including the currently-approved methodology. The bottom line is that this comes down to a fairness issue. Even Mr. Brockman agrees, as he states (September 29, 2015 Transcript, page 88, lines 21 to 23) "*This is a fairness issue, a fairness of allocating something that isn't really a cost in the sense that we normally think of a cost.*" The Board is now left to decide which methodology is the most fair. The Consumer Advocate points out that the Board's witness, Dr. Wilson, and the Consumer Advocate's witness, Mr. Doug Bowman, are independent.[9] Unlike Mr. Brockman, Mr. Doug Bowman represents all customers in the Province including both Labrador Interconnected and Newfoundland Power customers, while Dr. Wilson is neutral. Mr. Brockman, on the other hand, represents only Newfoundland Power's customers.

The Consumer Advocate recommends that the Board accept the allocation methodology proposed by Hydro in the Amended 2013 GRA. Based on the principles of fairness and minimization of the impact on the price signal, allocation of the deficit on the basis of revenue requirement is preferred over the current allocation methodology.

The Consumer Advocate's preferred methodology for payment of the Rural Rate Deficit would be for the Board to direct a portion of Hydro's return toward payment of the rural subsidy. However, given Government's directive which gives Hydro the right to earn a ROE equal to Newfoundland Power's, the jurisdiction of the Board to order the same may arguably be limited. Nevertheless, the rural deficit has become a significant burden. It results in unreasonable and discriminatory rates for the subsidizing customers (Report of C. Douglas Bowman, p. 33, lines 11-12).

[9] Hydro is likewise independent.

The operating deficit for supply to rural areas in Quebec and British Columbia is 1%, and for Manitoba and Ontario is about 0.1% of revenue from electricity sales. [Bowman Report, p. 31, lines 17-23] The operating deficit in Newfoundland and Labrador based on rates proposed in the Amended 2013 GRA is 9.7% of revenue from electricity sales.[10] This Government initiative has become far out of hand, and now presents the Board with a dilemma in that it is being forced to approve rates that clearly cannot be judged to be reasonable and non-discriminatory.

The Consumer Advocate urges the Board to exercise its power to recommend legislation pursuant to Section 83 of the Public Utilities Act, recommending that the legislature make such amendments to the Electrical Power Control Act as are necessary to ensure that Newfoundland Power customers and Labrador interconnected customers shall not be required to subsidize the cost of power provided to rural customers in the Province.

Furthermore, the Board in Order No. P.U. 7 (2002-2003) stated at p. 126-127:

> *2. Future Options*
>
> *The Board refers to its statutory obligations in implementing rates that are in accordance with the provincial power policy. Section 3.3 (a) (i) of the EPCA stated "the rates to be charged. . . should be reasonable and not unjustly discriminatory". Depending on the level of subsidy paid by one customer to support equitable rates for another customer, rates may be judged unreasonable and discriminatory to the subsidizing customer. The alternative, commensurate with reducing this subsidy, would be to change rate design to shift additional costs to rural customers. This reallocation, it could be argued, may not provide reasonable or non-discriminatory rates to rural customers. Under these circumstances, the only effective means of implementing the provincial power policy is to transfer some or all of the rural deficit to NLH or its shareholder, Government. The question of who should share in this continuing liability, either rural customers, other customers, NLH and/or Government, may become a central issue for the board in future. The Board notes that a number of witnesses supported social policies being reflected as a cost to Government with the proposed options varying from adjusting shareholder*

[10] Based on a rural deficit of $64.07 million (Amended GRA, Volume II, Exhibit 13, Schedule 1.2.1, page 2 of 2) and revenue from sales of $660.0 million (GRA Application Volume I, Finance Schedule 1, page 1 of 11).

return to recovering this cost through appropriate taxation. The Board is not inclined to adjust NLH's regulated 3% ROE in this Application and is of the view that taxation is a prerogative of Government beyond the control of this Board. The Board feels strongly, however, that discussions involving NLH and Government around future funding options for the rural deficit should constitute part of the evidentiary record. (emphasis added)

In 2002, the Board was not inclined to adjust Hydro's 3% ROE. Presently, pursuant to Government directive, the setting of Hydro's ROE has been prescribed. While Government has prescribed the ROE the issue still remains whether the Board in cognizance of its duty to approve rates that are reasonable and non-discriminatory may yet still direct a portion of the prescribed return on equity towards the rural deficit. Accordingly, the Consumer Advocate would also request that the Board state a case to the Court of Appeal for the Court's opinion as to whether or not the Board has the necessary jurisdiction, for rate setting purposes, to direct a portion of the prescribed return to the rural deficit.

G.2. Informing Customers about Rural Deficit Subsidy on Electricity Bills

The Consumer Advocate submits that customers who pay for and customers who receive the benefit of the subsidy have a right to know of the existence and the amount of the subsidy on their bills.

Presently, the existence and amount of the subsidy is not disclosed on customers' bills. It should be made explicit. While it would be new to show this subsidy information on customers' bills, it is already happening in relation to the "Lab Coast Electricity Rebate" which is spelled out on customers' bills, for instance. [Reference: IN-NLH-004, Attachment 4, p. 1 of 8] Also, until recently rebates on the provincial portion of the Harmonized Sales Tax were shown on customers' bills throughout the province. [Reference: Ibid, p. 1 of 8] In both cases, the information was made available to customers on their bills. Dr. Feehan testified:

I see no reason not to inform people of the amount that they're receiving in a subsidy and just like people who are paying the subsidy should really see it on their bills as well.

[Reference: Transcript, October 5, 2015, p. 72, lines 9-14]

Customers receiving the information on their electricity bills about the "Lab Coast Electricity Rebate" they are receiving are told its amount and these customers can thereby understand what their bill would have been but for the subsidy. The fact that the rural deficit subsidy is being paid by other ratepayers instead of Government should have no bearing upon its disclosure on bills.

Likewise, those who are paying the subsidy in their monthly electricity bills should understand what their bill would have been but for the subsidy built into their electricity bills. If the amount were small it would be one matter, but the rural deficit adds about 13% to the bills of Newfoundland Power and Hydro's Labrador Interconnected customers based on the proposed allocation methodology.

[Reference: Amended 2013 GRA, Volume II, Exhibit 13, Schedule 1.2]

The Consumer Advocate can think of no valid reason not to inform customers of this non-cause based charge on their monthly bills, and therefore submits that the Board order Hydro to show rural rate subsidy amounts, paid or received, on customer bills.

H. COST OF SERVICE ISSUES

H.1 Specifically-Assigned O&M Costs

Mr. Dean, a witness for Vale, recommends (page 10, lines 18 to 27 of report entitled *Expert's Report on Newfoundland and Labrador Hydro's Amended 2013 General Rate Application*, dated June 4, 2015):

> *To summarize, I recommend that the Board adopt this procedure in order to restate the original plant in service costs to 2015 dollars and then use the restated cost to allocate the specifically assigned expense. While it may not be as precise as individually restating the cost of each asset in current or constant year dollars, it would however go a long way to eliminate the inequity in the current methodology employed by Hydro. As mentioned above, Hydro has specifically allocated $436, 715 of OM&A expense to Vale. Taking into account the ten-fold escalation in construction costs, as this procedure does,*

the appropriate OM&A charge to Vale is $87,742. The current methodology is inequitable and overcharges Vale almost $350,000 each and every year.

The Consumer Advocate submits that this is a blatant and unsubstantiated attempt by Vale to transfer cost from itself onto other customers. The Consumer Advocate bases this statement on the following:

- Vale knew full well how specifically-assigned costs are calculated in this province and signed a contract indicating its agreement to pay these costs. On August 19, 2011, Hydro's Senior Legal Counsel wrote Vale's Senior Contracts Administrator, Mr. Darryl Drover and set out how operating and maintenance costs were calculated pursuant to the Board's approved cost of service methodology (Undertaking No. 47, Attachment 1). Now Vale is trying to back out of its agreement. Vale is a major power consumer – it understands, or at least should understand, how power supply agreements are structured. It is unreasonable to assume that Vale is a naïve customer which did not know what it was signing. There is no evidence on the record that Vale was misled by Hydro.

- Hydro states in relation to the current methodology for determining specifically-assigned O&M costs (V-NLH-083 (Rev 1, Jun 23-15, page 1 of 6, lines 17 to 18) "*Hydro's existing methodology is generally consistent with industry practice in cost of service allocation*". Not a single witness submitted evidence indicating that Hydro's current methodology for calculating specifically-assigned O&M is inconsistent with practice elsewhere.

- Not a single witness was able to identify another jurisdiction that uses the methodology proposed by Mr. Dean including Hydro's expert witness, Mr. Grenenan. With respect to Mr. Greneman's review of methodologies used elsewhere to develop specifically-assigned Industrial Customer O&M costs, the Consumer Advocate asked Mr. Fagan "*And certainly [Mr. Grenenan] was not able to find an instance where Mr. Dean's methodology has been adopted in another jurisdiction for Industrial Customers?*" Mr. Fagan responded "*No, he wasn't*" (see October 6, 2015 Transcript, page 68, lines 5 to 11).

- Mr. Dean himself was unable to find a single jurisdiction that uses his proposed methodology for determining specifically-assigned O&M. With respect to using indexing for specifically-assigned O&M, Mr. O'Brien asked (Transcript, pages 73 and 74, lines 20 to 25 and lines 1 to 4, respectively) "*Okay. And in terms of with respect to how you would deal with specifically assigned charges and O&M, have you seen it used, indexing used in that fashion before?*" Mr. Dean responded "*No, as I said, I really was not able to find anything that says they do or they don't. I could not find anything, very little out there, unless you are in the jurisdiction itself, very little out there.*"

- It appears that Mr. Dean did not look that hard. Neither did Hydro for that matter. When the Consumer Advocate asked Mr. Fagan (October 6, 2015 Transcript, page 73, lines 14 to 21) "*Has Hydro called Vale up in Sudbury to see how they do it up there? Mr. Dean, he's been retained by Vale. He told us he didn't call them and find that out. Do you guys know that?*" Mr. Fagan responded "*No*". While Mr. Dean may not know the importance of regulatory precedence, Hydro and Mr. Greneman certainly should, yet have been unable to provide such precedence.

- It is not clear that newer facilities have lower O&M costs as suggested by Mr. Dean. For example, environmental issues such as vegetation management, wind and ice conditions, etc., are independent of the age of facilities. Mr. O'Reilly asked "*And would you also agree that new transmission lines are probably more reliable than old transmission lines?*" Mr. Goulding responded "*In general, there are more aspects than just the age of the line. You know, another determining factor might be the environment that it operates in*" (October 22, 2015 Transcript, page 9, lines 10 to 18). Mr. Dean himself states (October 1, 2015 Transcript, page 86, lines 13 to 18) "*Also included in the OMA, about 50 percent of the OMA charge is nothing to do with the assets feeding Hydro, it has to do with the general stuff, the control centre, the Hydro centre here, the telecommunications, stuff of a general nature*". Is Mr. Dean suggesting that because these costs are "general" they are not legitimate? Of course they are legitimate - they are part of the cost of operating and maintaining the system, including the costs to operate and maintain specifically-assigned assets. The Consumer Advocate is not aware of any previous GRAs where the Board found that general costs are not legitimate costs to be recovered by utilities.

- Hydro itself indicates that new facilities tend to be less reliable than middle-aged facilities, citing the bathtub curve shown on Chart 1.4 (page 1.11) of the Amended 2013 GRA. The bathtub curve recognizes that assets have a high failure rate early in their lifetimes, followed by a period of low failure rates in the interim years of their lifetime, and followed again by higher failure rates later in their lifetimes when the effects of old age come into play. The bathtub curve is accepted in the industry, and as the Chart itself indicates, is reproduced from the *National Institute of Standards and Technology, U.S. Department of Commerce*. The bathtub curve suggests that if anything, Vale should probably be paying a higher specifically-assigned O&M cost than under the current methodology. Vale itself provides an excellent example of the bathtub curve effect. As Mr. Goulding testified, one of the supply transformers at Vale, although new, has been out of service since around February of last winter (October 21, 2015 Transcript, page 87, lines 6 to 11).

- The methodology proposed by Mr. Dean transfers a significant amount of money away from Vale and on to other customers. Mr. Dean calculated an amount of $87,742 for Vale's specifically-assigned O&M. This compares to $436,715 calculated under the current methodology, meaning almost $350,000 would be transferred to other customers (page 10, lines 18 to 27 of report entitled *Expert's Report on Newfoundland and Labrador Hydro's Amended 2013 General Rate Application*, dated June 4, 2015). Hydro calculates a figure of roughly $150,000, about 2/3 greater than Mr. Dean's figure (October 1, 2015 Transcript, pages 83 and 84).

- It makes no sense to alter cost of service aspects now before the cost of service study is completed in 2016. It is anticipated that many aspects will be altered as a result of this cost of service study. For example, as the Board's expert witness Dr. Wilson says, a portion of transmission network costs should be allocated to energy, as opposed to allocation of 100% of transmission costs to peak as is currently done (see June 1, 2015 report entitled *Updated Report to The Newfoundland and Labrador Board of Commissioners of Public Utilities on Cost Allocation and Rate Design Issues in the Newfoundland and Labrador Hydro ("Hydro") November 10, 2014 Amended General Rate Application*, by J.W. Wilson & Associates, Inc., pages 11 and 12. This would have the effect of transferring less of the revenue requirement to Newfoundland Power customers and more of the revenue requirement to the Island Industrial Customers.

In summary, no evidence has been filed to suggest that Hydro's current methodology for calculating specifically assigned O&M costs is out of line with what is done in other jurisdictions. In fact, Hydro's research indicates it is in line with what other jurisdictions are doing. No evidence has been filed to suggest Mr. Dean's methodology is in line with regulatory practice elsewhere. In fact, nobody was able to provide a single example of its use elsewhere, and neither Mr. Dean nor Hydro even bothered to find out what practice is used at other Vale facilities in Canada. Further, no evidence has been filed to suggest the current methodology is unfair. In fact, Mr. Dean himself indicates that half of the charges relate to general expenses which the Board has approved as legitimate expenses in every previous GRA in the Province. Hydro's witnesses have also indicated that failure rates can be quite high in the early years of an asset's life, and notes that environmental factors also come into play regardless of an asset's age. The methodology proposed by Mr. Dean transfers a significant amount of money away from his client and on to other customers without a shred of evidence suggesting that Vale is being unfairly treated.

On this basis, the Consumer Advocate recommends that the Board reject the alternative methodology proposed by Mr. Dean and continue with the current methodology proposed in the Amended 2013 GRA. If the Board believes this issue warrants further study, it should be included in the scope of work for the cost of service study to be performed in 2016.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 23rd day of December, 2015.

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