O'DEA EARLE

February 18, 2015

Ms. G. Cheryl Blundon
Board of Commissioners of Public Utilities
120 Torbay Road, P.O. Box 12040
St. John's, NL A1A 5B2

Dear Ms. Blundon:

Re: Newfoundland and Labrador Hydro ("Hydro") 2015 Interim Rates Application

In its Amended 2013 General Rate Application filed with the Board on November 10, 2014 (the "*Amended 2013 GRA*"), Hydro requested that the proposed customer rates be approved on an interim basis in advance of completing the GRA in order to reduce the amount of 2015 costs deferred for future recovery from customers. Hydro also proposed revised RSP rules effective January 1, 2015 to permit the continued phase-in of Island Industrial Customer (IIC) rates consistent with OC2013-089, as amended. In correspondence from the Board dated December 24, 2014, Hydro was directed to file a comprehensive interim rates application for rates to be charged March 1, 2015. In response to the Board directive, on January 28, 2015 Hydro submitted an Application to the Board (the "*2015 Interim Rates Application*") requesting interim rates effective March 1, 2015 (see 2015 Interim Rates Application Evidence – Background). This is Hydro's third application for interim rates since filing its 2013 GRA.

In the 2015 Interim Rates Application, Hydro makes application to the Board for an interim order approving (see 2015 Interim Rates Application Para. 23):

(i) The schedule of rates, tolls and charges set out in Schedule 1 to be effective March 1, 2015 until superseded by a final order of the Board relating to the Amended 2013 GRA;
(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 Newfoundland Power scheduled for July 1, 2015 as set out in Schedule 1 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.

To summarize, Hydro is requesting:

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1. An interim increase in rates because it states it is in need of an immediate improvement in its financial position; and
2. Implementation of a rate phase-in plan to bring Industrial Customer rates up to the full cost of supply as contemplated in OC2013-089, as amended.

Hydro proposes that the Board conduct a full review of its costs at the Amended 2013 GRA, and to adjust rates and refund money to customers if it determines that the interim rates have collected excess revenues.

The Consumer Advocate's position with respect to Hydro's 2015 Interim Rates Application is set out below.

A. ***Qualifying the Need for Interim Rates***

In the Interim Rates Evidence dated November 2013 (Section 3, pages 4 to 6), Hydro documents historical use of interim rates in this Province. Hydro quotes the Board in Order No. P.U. 41(2006) as follows (page 4, lines 17 to 20):

> *WHEREAS section 75 of the Act provides that the Board may make an interim order unilaterally and without public hearing or notice, approving with or without modification a schedule of rates, tolls and charges submitted by a public utility upon the terms and conditions that it may decide; and ...*

The Board goes on to state in the same Order (page 4, lines 21 to 24 of Hydro's November 2013 Interim Rates Evidence):

> *WHEREAS if, after a full review of Hydro's Revised Application, it is determined that excess revenue has been earned by Hydro as a result of the Interim Order the Board may order, pursuant to Section 75(3) of the Act, that customers of Hydro receive a refund; and*

Therefore, the Board has jurisdiction to approve interim rates, and if the review of the Amended 2013 General Rate Application determines that the interim rates have resulted in Hydro earning excess revenues, to refund the excess revenues to customers. Interim rates applications are common practice in other jurisdictions (see Amended 2013 GRA, page 4.20, footnote 30).

Hydro has now filed three different interim rates applications since the 2013 GRA[1] involving considerable time, resources and focus of the Board and the parties. The multiple interim rates applications demonstrate the lack of consensus among the parties and Hydro on what is required in the way of evidence and supporting documentation to afford a proper review of an interim rates application. The Consumer Advocate proposes that the Board apply the interim rates test used by the Alberta Utilities Commission. The Alberta interim rates test identified below includes two parts. The first part of the test relates to quantum and need for the rate increase and the second part of the test relates to the general public interest.

[1] The Board's February 4, 2015 email directed the Parties to preface requests for information with the letters TIR for "third interim rate application".

Part One

i. Is the identified revenue deficiency probable and material?

ii. Can all or some portion of any contentious items be excluded from the amount collected?

iii. Is the increase required to preserve the financial integrity of the applicant or to avoid financial hardship to the applicant?

iv. Can the applicant continue safe utility operations without the interim adjustment?

Part Two

i. Do the interim rates promote rate stability and ease rate shock?

ii. Do the interim adjustments help maintain intergenerational equity?

iii. Can interim rate increases be avoided through the use of carrying costs?

iv. Are the interim rate increases required to provide appropriate price signals to customers?

v. Is it appropriate to apply the interim rider on an across-the-board basis?

Decisions involving interim rates filings of two transmission and distribution utilities, ENMAX and ATCO, where the Alberta Utilities Commission utilized its two-part interim rates test are summarized below.[2]

In the ENMAX interim rates application, the utility requested: 1) approval of interim rates that would collect 60% of its forecast revenue shortfall, and 2) that the interim rates increase be applied equally across the board to all customer classes in order to maintain the currently approved rate structure. In making its decision, the Commission applied the above-stated two-part test for interim rates, and found that collection of 60% of the utility's revenue deficiency would be sufficient to account for potentially contentious elements of the utility's revenue requirement calculation, noting that the proposed rate increases were requested on an interim basis and would be trued up once the final 2015 rates were approved. The Commission also noted that an equal across-the-board increase to all rate classes was a simple and cost effective method for applying the increase.

In the ATCO interim rates application, the utility requested recovery of 77% of its distribution revenue requirement and 86% of its transmission revenue requirement. For the purposes of the interim rates calculation, ATCO excluded two cost items that it considered potentially contentious.

[2] Alberta Utilities Commission Decisions include "*ENMAX Power Corporation; 2015 Interim Distribution and Transmission Tariff Application*" dated November 12, 2014 (http://www.auc.ab.ca/applications/decisions/Decisions/2014/2014-311.pdf), and "*ATCO Electric Ltd.; 2009 Interim Distribution Tariff and Transmission Facility Owner's Tariff*" dated December 19, 2008 (http://www.auc.ab.ca/applications/decisions/Decisions/2008/2008-134.pdf).

In rendering its decision, the Alberta Utilities Commission applied the above stated two-part test for interim rates, but found that ATCO had provided limited information with respect to the test to support its interim rates request. The Commission found that some form of interim rates relief was justified, but was concerned that the final approved rates could be based on an amount that was less than the interim rate increase proposed by the utility. The Commission found that to provide gradualism and a transitional rate level, an intermediate position between current rates and proposed final rates was preferable. The Commission noted that past practice for interim rates orders had generally resulted in decisions maintaining existing rates or granting 50% of the proposed revenue requirement increase. Based on these circumstances, the Commission approved 50% of the proposed revenue increase for the utility's transmission component and 25% of the proposed revenue requirement increase for the utility's distribution component effective January 1, 2009.

We note that Newfoundland Power's 2009 application for interim rates effective January 1, 2010 would not have passed the two-part interim rates test. As stated in Hydro's November 2013 Interim Rates Evidence (page 5, lines 16 to 18), "*The application was filed on the basis of the uncertainty of the timing of the issuance of the Board's final Order and the potential impacts on NP's opportunity to earn a just and reasonable return*". The potential impact on a utility's opportunity to earn a just and reasonable return is not enough to pass the two-part interim rates test. In the absence of clear direction on filing requirements, Newfoundland Power did not show that additional revenue was needed: 1) because its revenue deficiency was material, and needed to preserve its financial integrity, 2) to avoid financial hardship, or 3) to continue safe operations.

B. Does Hydro's Application Meet the Two-part Interim Rates Test?

In reply to TIR-CA-NLH-1, Hydro provides a defence of its 2015 Interim Rates Application on the basis of the two-part interim rates test. Hydro indicates that in its opinion its 2015 Interim Rates Application meets this test.

With regard to quantum and need for the interim rates, Hydro states that its revenue deficiency is probable and material as continuation of 2007 base rates would result in a net loss in 2015 of $34.6 million (TIR-CA-NLH-1, page 3 of 12, lines 7 to 9). If interim rates are made effective March 1, Hydro will recover 70% of the forecast net income deficiency for 2015 (TIR-CA-NLH-1, page 3 of 12, lines 18 to 20), therefore in effect, some portion, and perhaps all, of the contentious cost items in the Amended 2013 GRA have been removed from the proposed amount to be collected under interim rates. Delays in implementation of interim rates beyond March 1 would further worsen Hydro's financial position. For example, if interim rates were implemented effective April 1, the forecast net income for 2015 would be reduced to $5.2 million, or 60% recovery of the forecast net income deficiency (TIR-CA-NLH-1, page 4 of 12, lines 19 to 22, and page 5 of 12, lines 1 to 2). Although Hydro could continue to provide safe operations without interim rates, it would be forced to take actions to minimize financial losses and cut costs (TIR-CA-NLH-1, page 7 of 12, lines 10 to 14). Hydro states that Board approval of interim rates is necessary to "*preserve Hydro's financial integrity and to avoid potential long term hardship to both Hydro and ratepayers through increased long-term borrowing costs*" (TIR-CA-NLH-1, page 7 of 12, lines 2 to 5). In the ENMAX case cited earlier, the Alberta Utilities Commission noted that such revenue deficiencies reduce cash flow, which in turn requires increased short-term borrowing, and might also impact long-term borrowing (Para. 30).

It is clear that given these circumstances, Hydro requires an interim rate increase and its application passes Part 1 of the interim rates test. Hydro also shows that with respect to Part 2 of the interim rates test, its proposed interim rates will promote rate stability, ease rate shock, help to maintain inter-generational equity, and improve price signals to consumers. The Consumer Advocate submits that Hydro's 2015 Interim Rates Application meets the requirements set out in the two-part interim rates test. The key consideration in the assessment of this Application is the impact on the electricity consumers in the Province. The Consumer Advocate does not see how electricity consumers can possibly benefit from Hydro's continuing financial deterioration.

C. *Should Hydro's 2015 Interim Rates Application be Approved as Proposed?*

The Consumer Advocate has reviewed Hydro's 2015 Interim Rates Application from the perspective of: 1) the amount of revenue requested in light of Hydro's financial position, 2) the impacts on customers in terms of rate smoothing, and 3) legal requirements under OC2013-089, as amended.

Regulatory boards that allow an interim rate increase often cap the amount at a percentage of the additional revenue needed to provide the utility a reasonable rate of return. In the ENMAX and ATCO cases cited above, the Alberta Utilities Commission limited both utilities to 60% or less of the utility's required increase in revenues. Such limits are imposed for several reasons, such as: 1) to acknowledge that the utility is at least partly responsible for needing the interim rates; i.e., because it filed its rate case too late; 2) to reduce the possibility that a rate reduction will be necessary when final rates are set; i.e., because the regulatory commission removes costs that have not met the prudency test, or because the regulatory commission allows a lower rate of return than requested by the utility; 3) to enable rate smoothing and reduce rate impacts on customers; and 4) to alleviate intergenerational equity concerns.

Hydro is in effect requesting 78.5% of its revenue deficiency for 2015[3] because the rates would become effective on March 1, 2015 rather than January 1, 2015 (see TIR-CA-NLH-2). Because the proposed rate increase would be implemented effective March 1, 2015, the Board is left to decide at the GRA how much of the $13.7 million of Hydro's 2015 revenue shortfall should be recoverable in final rates. Of course, if the Board found that more than $13.7 million should be removed from the revenue requirement, it could reduce rates and refund excess revenues to customers. However, $13.7 million covers off considerable uncertainty in Hydro's costs. For example, if the Board were to disallow recovery of 100% of the 2015 costs that are subject to its prudency review, the final allowed increase in Hydro revenues would still exceed by $5.6 million the amount resulting from proposed interim rates if implemented March 1, 2015 (see TIR-CA-NLH-3).[4] There are other applications relating to Hydro costs under Board review as well, such as Hydro's 2014 revenue

[3] Calculated as follows: ($570,261,000 – $520,329,000) / ($583,917,000 – $520,329,000) = 0.785, or 78.5%.

[4] In TIR-NP-NLH-3, Newfoundland Power requests the amount of amortization included in the 2015 test year adjusted revenue requirement related to capital projects that are subject to further review by the Board. Hydro's response indicates that $4.4 million in amortization costs and $8.7 million relating to return on rate base, for a total of $13.1 million, is included in the 2015 revenue requirement for these projects. It is understood that the difference between this response and the response to TIR-CA-NLH-3 (Part 4) relates to return on rate base which was frozen at the 6.82% level in TIR-NP-NLH-3 to be consistent with the revenue requirement calculation included in the Amended 2013 GRA. In either case, the revenues from proposed 2015 interim rates effective March 1, 2015 would be less than the 2015 revenue requirement even if all 2015 costs subject to the Board's prudency review were disallowed (by $0.5 million for the case considered in TIR-NP-NLH-3).

deficiency (see November 28, 2014 letter to Board entitled *Newfoundland and Labrador Hydro's 2013 Amended General Rate Application – 2014 Cost Recovery Application*) and the 2014 increased capacity-related supply costs on the Island Interconnected System (see October 8, 2014 letter to the Board entitled *An Application by Newfoundland and Labrador Hydro for the approval of the deferral and recovery of expenses associated with the increased capacity-related supply costs on the Island Interconnected System in 2014*). Therefore, there are ample opportunities for the Board to claw back any excess revenues that might accumulate to Hydro under the 2015 Interim Rates Application; i.e., rate riders established to recover these costs might be reduced, or eliminated altogether, as the Board sees fit.

With regard to rate shock, Table 5 (page 16) of the 2015 Interim Rates Application Evidence shows that rate increases are not only manageable, but in most cases, customer classes will see rate decreases owing to a steep drop in the oil price forecast.[5] A notable exception is the IIC class. Hydro states in the 2015 Interim Rates Application Evidence (page 1, lines 20 to 21), "*The Island IC Group presented the position that the impacts of the rate proposals reflected in the Amended Application constitute "rate shock""*.

Hydro has addressed this issue in its evidence (Section 2), and developed a phase-in plan for IIC rates that it believes to be consistent with OC2013-089, as amended. Table 2 (page 9) of the 2015 Interim Rates Evidence presents two alternative rate phase-in proposals for the IICs. The Consumer Advocate submits that both approaches violate OC2013-089, as amended, which requires that the IIC rate phase-in occur over a three-year period beginning September 1, 2013. The next steps in the IIC rate phase-in should therefore occur on September 1, 2014 and September 1, 2015, with IIC rates brought up to the full cost of supply on September 1, 2016. We note that when Step 1 of the IIC rate phase-in was approved in Order P.U. 26(2013) the subsequent steps were not approved at the same time (with adjustments for costs ultimately approved by the Board in the GRA). It is the Consumer Advocate's submission that OC2013-089, as amended, establishes a legal requirement that the next step of the IIC rate phase-in be implemented retroactively to September 1, 2014, with subsequent steps approved for implementation on September 1, 2015 and September 1, 2016, and that the IIC RSP operate in accordance with the approved methodology effective January 1, 2014.

Further, OC2013-089, as amended, is clear that the IIC rate phase-in is to be funded from the January 1, 2007 to August 31, 2013 accumulated Load Variation component of the Rate Stabilization Plan that was credited to the IIC Rate Stabilization Plan effective August 31, 2013 (the IIC RSP Surplus Fund). Hydro has proposed to offset part of the IIC rate increase by transferring $2.1 million from the balance of the load variation component of the RSP that has built up since September 1, 2013 (see 2015 Interim Rates Application Evidence, pages 4 and 5) . Hydro makes this proposal even though the Board has yet to rule on the methodology for disposition of this balance (page 5 of 2015 Interim Rates Application Evidence, lines 6 to 13). The Consumer Advocate submits that it is inappropriate to transfer $2.1 million from this account to fund the IIC rate phase-in when the Board has not yet ruled that these funds are owing to the IICs; neither is use of these funds for this purpose consistent with OC2013-089, as amended. The IIC rate phase-in scenario without the $2.1 million transfer is addressed in TIR-IC-NLH-4, scenario (c). Tables 2 and 3 (page 2 of 3) show the resulting impact on IIC rates and the IIC RSP Surplus Fund balance.

The argument that the IIC rate phase-in results in rate shock is not valid, given:

[5] The IICs, the Island and Labrador Isolated Government Departments, and Labrador Interconnected customers would see rate increases while all other classes would see rate decreases (see TIR-CA-NLH-5).

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1) Under OC2013-089, as amended, it is a legal requirement that IIC rates be raised to the full cost of supply over a three year period (2015 Interim Rates Application Evidence, page 2, lines 21 to 22). As stated in the 2015 Interim Rates Application Evidence (page 1, lines 15 to 18), the interim rates are needed "*to permit the continued phase-in of the Island Industrial Customer (IC) rates and to ensure the forecast fuel costs reflected in the proposed interim rates were consistent with the forecast fuel costs used in the operation of the RSP*";
2) The IICs did not have a rate increase from 2008 through August 2013. As stated in the Second Interim Rates Application Evidence dated May 2014 (page 8, lines 22 to 24): "*The IC rates do not currently include a fuel rider and, as a result, their rates do not recover the increased cost of Holyrood fuel since the 2007 Test Year*". In 2007, the average Holyrood fuel purchase price was $56.86 per barrel. This compares to an average Holyrood fuel purchase price in 2012 of $115.26 (see 2013 GRA, page 2.47, lines 4 to 5), representing an increase of 103%. Conversely, Newfoundland Power customers have been subjected to annual rate adjustments to reflect increased fuel costs since the 2007 test year;
3) The IICs received a subsidy of $37.6 million granted through OC2013-089, as amended (based on a comparison of revenues that should have been collected from the IICs during the period 2008 through 2012 had the load variation component of the RSP been allocated on the basis of load ratio share as proposed by Hydro in the 2006, 2013 and the Amended 2013 GRAs – see RSP-CA-NLH-12)[6]. This subsidy is more than double the average annual revenue Hydro received from the entire IIC class during the period from 2008 to 2012 (see CA-NLH-183 of 2013 GRA);
4) The dramatic reduction in the recent oil price forecast has mitigated a significant portion of the required IIC rate increase. As stated by Hydro in the 2015 Interim Rates Evidence (page 7, lines 18 to 20): "*For the purpose of establishing interim rates, an adjusted revenue requirement for NP and the Island IC was determined to reflect the reduced No. 6 fuel cost forecast for 2015*". According to the Amended GRA (Table 1 on page 1.6R), the required IIC rate increase based on the 2013 Test Year was 73.1%. The required rate increase for the IICs was reduced to 39.2% in Hydro's Amended 2013 GRA, and to 18.1% in the 2015 Interim Rates Application owing to the updated Holyrood fuel cost (see TIR-PUB-NLH-6).
5) Teck Resources will cease to take power and no longer be a customer in June 2015 (see page 2.61 of Amended 2013 GRA, lines 15 to 17);
6) CBPP has received a considerable rate reduction in its bills owing to capacity assistance agreements, including $6.1 million in the first quarter of 2014 (see Table 1, page 2 of Hydro Application for Deferral and Recovery of 2014 Capacity-Related Supply Costs Evidence dated October 2014) and $1.7 million annually beginning in 2015 (see October 28, 2014 cover letter to *Application of Newfoundland and Labrador Hydro for approval of Agreement with Corner Brook Pulp and Paper Limited for Capacity Assistance*);
7) Vale will receive a rate reduction owing to its new capacity assistance agreement. It is understood that Vale will initially provide 10.8 MW of capacity assistance, increasing to 15.8 MW as Vale's load ramps up to full capacity. The payment is $28/kW, so the total annual payment will be $442,400 once the capacity assistance increases to 15.8 MW (see December 1, 2014 *Capacity Assistance Agreement between Hydro and Vale*);
8) Vale only began taking power in December 2012, and is not expected to reach full production levels until the end of 2016 (see page 2.60, lines 19 to 22 of Amended 2013 GRA); and

[6] The Board approved the transfer of RSP funds to the IICs consistent with OC2013-089, as amended, but the IIC rate phase-in has fallen behind the schedule required in OC2013-089, as amended. Step 2 of the rate phase-in should have been implemented on September 1, 2014. The purpose of the funds transfer was to pay for the phase-in of IIC rates.

9) Praxair only began taking power in October 2013 and is expected to ramp up operations through the end of 2014 (see page 2.61, lines 1 to 3 of Amended 2013 GRA).

D. Pass-through of Interim Rates to Newfoundland Power Customers

It is important that the Board's Order relating to Hydro's 2015 Interim Rates Application be quickly passed through to Newfoundland Power customers since it will result in a rate reduction. In the response to TIR-CA-NLH-8, Hydro indicates that Newfoundland Power has in the past been able to quickly file applications with the Board for increased rates to its customers when it has had advanced notice.

The Consumer Advocate supports Hydro's proposal that there be no RSP rate adjustment for Newfoundland Power customers in July 2015. As stated by Hydro (2015 Interim Rates Application Evidence, page 14, lines 7 to 10): "*Implementation of revised rates on March 1, 2015 reflect both the disposition of the balance in the RSP segregated load variation component and the updated fuel forecast avoids the requirement for a July 1, 2015 rate change*".

E. Recommendations

The Consumer Advocate recommends that the Board:

1) Approve Hydro's 2015 Interim Rates Application as proposed subject to adjustment following a full review of Hydro's costs at the Amended 2013 GRA (with implementation of rate adjustments in a manner similar to the method proposed in TIR-CA-NLH-6)[7]. The Consumer Advocate urges the Board to direct Newfoundland Power to implement these interim rates promptly so that its customers receive the rate reduction in a timely manner. Further, there should be no RSP rate adjustment for Newfoundland Power customers in July 2015;
2) Approve Hydro's proposed phase-in plan (the entire phase-in plan, not just the first step) for IIC rates subject to modifications stemming from the amended 2013 GRA, but implement the first step retroactively to September 1, 2014, the second step on September 1, 2015 and the third and final step on September 1, 2016 to be consistent with OC2013-089, as amended. Further, the proposal to offset part of the IIC rate increase by transferring $2.1 million from the balance of the load variation component of the RSP should not be allowed. The Board has not yet ruled on the methodology for disposition of this balance.

Please feel free to contact the undersigned if you have any questions.

[7] The Board has gone back to adjust interim rates in the past as documented in the response to TIR-CA-NLH-7.

Yours very truly,

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