

1 Q. (Re: 2015 Interim Rates Application) The Alberta Utilities Commission has used a
2 test to evaluate an interim rates application in "*ENMAX Power Corporation; 2015*
3 *Interim Distribution and Transmission Tariff Application* " dated November 12, 2014
4 (see <http://www.auc.ab.ca/applications/decisions/Decisions/2014/2014-311.pdf>).
5 The test is identified below and includes two parts. The first part of the test relates
6 to quantum and need for the rate increase and the second part of the test relates
7 to the general public interest. Does Hydro's 2015 Interim Rates Application meet
8 this test? Please elaborate the response, as applicable:
9

10 Part One

- 11 i. Is the identified revenue deficiency probable and material?
12 ii. Can all or some portion of any contentious items be excluded from the
13 amount collected?
14 iii. Is the increase required to preserve the financial integrity of the applicant or
15 to avoid financial hardship to the applicant?
16 iv. Can the applicant continue safe utility operations without the interim
17 adjustment?
18

19 Part Two

- 20 i. Do the interim rates promote rate stability and ease rate shock?
21 ii. Do the interim adjustments help maintain intergenerational equity?
22 iii. Can interim rate increases be avoided through the use of carrying costs?
23 iv. Are the interim rate increases required to provide appropriate price signals
24 to customers?
25 v. Is it appropriate to apply the interim rider on an across-the- board basis?
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27

1 A. As noted above, the Alberta Utilities Commission (AUC) has established a two-part
2 test applicable to interim rate applications. It is the opinion of Hydro that its interim
3 rate application dated January 28, 2015 meets the requirements of this test.

4
5 The first part of the test relates to quantum and need, and includes the following
6 considerations:

- 7 i. Is the identified revenue deficiency probable and material?
- 8 ii. Can all or some portion of any contentious items be excluded from the
9 amount collected?
- 10 iii. Is the increase required to preserve the financial integrity of the applicant or
11 to avoid financial hardship to the applicant?
- 12 iv. Can the applicant continue safe utility operations without the interim
13 adjustment?

14
15 The second part of the test relates to the public interest and includes the following
16 considerations:

- 17 i. Will the interim rates promote rate stability and ease rate shock?
- 18 ii. Will the interim adjustments help to maintain intergenerational equity?
- 19 iii. Can the interim rate increases be avoided through the use of carrying costs?
- 20 iv. Are the interim rate increases required to provide appropriate price signals
21 to customers?
- 22 v. Is it appropriate to apply the interim rider on an across the board basis?

Part I: Quantum and Need

(i) Is the identified revenue deficiency probable and material?

Yes.

As noted in Hydro's Amended Application, the continuation of 2007 base rates in 2015 would result in a net loss for Hydro of \$34.6 million, and a return on rate base of 3.33%.¹ This loss would undoubtedly be material to Hydro and would result in a return on rate base materially lower than that approved in 2007 and proposed for 2015.²

Hydro's proposed interim rates would recover 2015 forecast test year costs if implemented on January 1, 2015 and provide the opportunity to earn a 2015 net income of \$33.2 million. The difference in forecast 2015 net income between proposed rates and existing rates is \$67.8 million. Delayed implementation to March 1, 2015, as reflected in the 2015 Interim Rates Application, will result in a forecast 2015 net income deficiency of approximately \$20 million.³ Therefore, approval of the proposed interim rates will permit Hydro the opportunity to recover approximately 70% of the forecast 2015 net income deficiency.⁴ However, rate implementation on March 1, 2015 is currently uncertain given the current application review in progress.

¹ See Finance evidence, Schedule II, Page 1 of 1, Lines 34 and 43 of Hydro's Amended Application.

² Hydro's 2007 rate of return on rate base of 7.44% was approved by the Board in P.U. 8(2007).

³ The net income deficiency is based upon the difference between revenue from existing and proposed base rates for 2015.

⁴ \$20 million net income deficiency represents approximately 30% of the \$67.8 million forecast net income deficiency for 2015 under existing rates.

1 Approval of the proposed interim rates to become effective April 1, 2015 will permit
2 Hydro to recover slightly less than 60% of the 2015 forecast net income deficiency.⁵
3 The hearing on Hydro's Amended Application is not scheduled to start until
4 September 2015 and final rates are not likely to be implemented at the earliest
5 until December 1, 2015. In this scenario, Hydro's net income deficiency would be
6 approximately \$61 million.⁶

7
8 Hydro submits that delayed implementation of proposed rates for 2015
9 demonstrates that the identified net income deficiency is both probable and
10 material.

11
12 (ii) Can all or some portion of any contentious items be excluded from the amount
13 collected?

14
15 Exclusion of any costs reflected in the proposed rates will further increase the
16 forecast 2015 net income deficiency proposed to be deferred for future recovery
17 from customers.⁷

18
19 Approval of the proposed interim rates effective March 1, 2015 provides the
20 opportunity to recover only 70% of the forecast net income deficiency for 2015 and
21 a further delay in implementation on April 1, 2015 reduces the recovery percentage
22 of the 2015 net income deficiency to slightly less than 60%. A 60% recovery of the

⁵ \$28 million net income deficiency represents approximately 41% of the \$67.8 million forecast net income deficiency for 2015 under existing rates.

⁶ The actual 2015 net income shortfall will be finalized upon the Board's determination of the final 2015 Test Year revenue requirement and customer rates.

⁷ In the Amended Application dated November 10, 2014, Hydro proposed a deferral account to provide recovery of the 2015 net income deficiency that results from delayed rate implementation.

1 forecast net income deficiency provides a forecast net income for 2015 of
2 approximately \$5.2 million.⁸

3
4 Given the 2015 forecast net income if proposed interim rates are approved
5 effective either March 1, 2015 (\$13.2 million) or April 1, 2015 (\$5.2 million), Hydro
6 does not believe it is appropriate to make further adjustments to reduce 2015 Test
7 Year revenue requirement for the purpose of establishing interim rates. Delayed
8 implementation also further exacerbates intergenerational equity concerns by
9 increasing the amount of historical costs to be recovered from customers in future
10 years.

11
12 If upon final testing of 2015 costs, the Board determines that 2015 cost adjustments
13 are required, then these amounts would be applied to reduce the 2015 net income
14 deficiency to be recovered through customer rates in future years. Hydro's
15 proposed approach ensures (i) customers do not pay rates in 2015 that exceed the
16 cost of providing service in 2015, and (ii) the amount of 2015 costs to be recovered
17 from customers in future years is minimized.

18
19 (iii) Is the increase required to preserve the financial integrity of the applicant or to
20 avoid financial hardship to the applicant?

21
22 Yes.

23
24 The 2013 GRA filed in July 2013 proposed new rates to become effective January 1,
25 2014. There has been no change in base rates yet approved for any customers with
26 the exception of the Labrador transmission rate approved on an interim basis

⁸ \$5.2 million = \$33.2 million forecast net income if rates were in effect for the full year less the \$28 million net income impact if proposed rates are not implemented until April 1.

1 effective January 1, 2015. The Board has approved a \$45.9 million deferral account
2 to provide the opportunity to recover the 2014 net income deficiency in the future,
3 subject to the Board's prudency review. Delayed approval of new interim rates for
4 2015 is creating another material net income deficiency for 2015. The cumulative
5 effect of delayed rate implementation from January 1, 2014 to March 1, 2015 is an
6 under-recovery from customers of approximately \$66 million in costs (excluding No.
7 6 fuel, which is recovered through the RSP).

8
9 The impact of a continued denial of the Board to permit cost recovery on Hydro's
10 creditworthiness needs to be considered over the longer-term. Because the
11 Province has unconditionally guaranteed Hydro's existing long-term debt, there is a
12 direct linkage between Hydro's creditworthiness, which is influenced by Hydro's
13 ability to achieve financial targets consistent with an investment-grade utility, and
14 the credit rating of the Province. To the extent that credit rating agencies continue
15 to view Hydro to be self-supporting, then the Province's credit rating is not likely to
16 be affected. A poor financial position for Hydro over the long-term could adversely
17 impact the Province's credit rating and thereby, increase the borrowing costs of the
18 Province, and hence Hydro's own borrowing costs.

19
20 The Government directive on Hydro's return on equity being set to equal that
21 approved for Newfoundland Power along with the \$100 million equity contribution
22 in 2009 would imply an expectation that Hydro should maintain a strong stand-
23 alone financial position and performance. If Hydro's Interim Rates Application is not
24 approved, Hydro could incur a \$34.6 million net loss for 2015 unless the Board
25 approves a deferral account to provide for recovery of the 2015 net income
26 deficiency resulting from delayed rate implementation. Hydro's 2015 financial
27 forecast under existing rates is inconsistent with the notion of a self-supporting
28 entity.

1 The approval of the proposed interim increase in base rates will reduce financial
2 uncertainty for 2015. Board approval of new customer rates to recover 2015
3 revenue requirement is necessary to preserve Hydro's financial integrity and to
4 avoid potential long term hardship to both Hydro and ratepayers through increased
5 long-term borrowing costs.

6
7 (iv) Can the applicant continue safe utility operations without the interim
8 adjustment?

9
10 Yes. However, if the 2015 Interim Rates Application is not approved and Hydro is
11 not provided certainty of recovering the 2015 net income deficiency, then Hydro
12 must plan to minimize its financial losses in 2015. Absent other information, Hydro's
13 2015 financial forecast without interim rates signals a fiduciary obligation to cut
14 costs.

15
16 While Hydro is always seeking ways to minimize costs, it does not think it would be
17 prudent, practical or safe to reduce costs to the magnitude of the net income
18 deficiency.

19
20 **Part II: Public Interest Factors**

21
22 (i) Will the interim rates promote rate stability and ease rate shock?

23
24 Yes.

25
26 The proposed interim rates would avoid confusion for retail customers. The 2015
27 Interim Rate Application includes a proposal to reflect the material reduction in
28 2015 fuel costs which would normally be implemented on July 1, 2015 at the same

time as implementing new customer base rates to provide increased income to Hydro for 2015. This proposal should be less confusing for customers than implementing two rate changes over a very short time period.⁹

The Industrial Customer (IC) Group indicated that the proposed interim rates reflected in the Amended Application constituted rate shock. The phase-in approach of Island IC rates provided in the 2015 Interim Rates Application appears to address the IC Group concerns with respect to rate shock.

In addition, delayed implementation of Hydro's 2015 base rates would further increase amounts that Hydro will propose for deferred recovery from customers.¹⁰ Not only could this add to any potential rate increase relating to Hydro's 2015 net income deficiency, it further compounds the issue of intergenerational equity, which will be discussed in Part II(ii).

(ii) Will the interim adjustments help to maintain intergenerational equity?

Yes.

Approval of the 2015 Interim Rates Application will help maintain intergenerational equity. The 2015 Interim Rates Application proposes to use the IC RSP Surplus balance and the 2014 year-end credit balance in the RSP load variation component

⁹ If the 2015 Interim Rates Application is not approved, customer rates will decrease in July and subsequently increase to reflect the GRA final rates order.

¹⁰ On December 24, 2014, the Board issued order number P.U. 58(2014), approving the deferral of \$45.9 million with respect to Hydro's 2014 revenue requirement.

1 to provide recovery of the \$6.8 million year-end RSP balance owing from Island IC.

2 The proposed approach is consistent with maintaining intergenerational equity.¹¹

3
4 If the 2015 Interim Rates Application is not approved, there is a substantial risk that
5 customers' rates for 2015 will not reflect the costs associated with the service
6 provided in that period. In this circumstance, 2007 base rates will be in place for
7 much and potentially all of 2015. Rates charged to customers in 2014, and now
8 potentially 2015, will not accurately reflect the costs associated with the service
9 provided in that period. Denying Hydro's 2015 Interim Rates Application will further
10 increase the 2015 net income deficiency and place an increased cost burden on
11 future customers to fund recovery of costs incurred in previous years.

12
13 As noted in evidence filed by Newfoundland Power, in their 2011 Sale of Joint Use
14 Support Structures application¹², *"As time passes, the makeup and usage of a*
15 *customer group changes. Therefore, the longer the period that costs are deferred,*
16 *the more serious the breach of the intergenerational equity principle... cost*
17 *deficiencies should be recovered over as short a period as is reasonable, so the*
18 *customer group that eventually pays for the costs is similar to the one benefiting*
19 *from the costs."* Hydro submits this concept is particularly relevant with respect to
20 2015 interim rates. The greater the delay with respect to Hydro's 2015 base rate
21 implementation, interim or otherwise, the greater the concern with
22 intergenerational equity.

¹¹ See page 6 to the Evidence of the 2015 Interim Rates Application.

¹² Newfoundland Power, Sale of Joint Use Support Structures, Consent #2, the Report of J.T. Browne Consulting, Appendix 3, Page 4 of 4.

1 (iii) Can interim rate increases be avoided through the use of carrying costs?

2
3 This is not a reasonable approach in the current circumstances. Carrying costs do
4 nothing to address the underlying problem, namely the existence of a significant
5 net income deficiency that must be recovered from customers because customer
6 base rates do not recover the cost to provide service.

7
8 As stated earlier, Hydro filed its GRA in July 2013 for new base rates to become
9 effective January 1, 2014. Further delay in implementing new customer rates on an
10 interim basis will only increase the cost recovery burden to be imposed on future
11 customers upon final rates being established.

12
13 (iv) Are the interim rate increases required to provide appropriate price signals to
14 customers?

15
16 Yes.

17
18 Hydro's forecasted price of No. 6 fuel used for generation at the Holyrood Thermal
19 Generation Station has decreased materially for 2015. Blending Hydro's base rate
20 increase with savings on No. 6 Fuel will reduce the number of required rate changes
21 in 2015 and potential rate confusion for customers.

22
23 (v) Is it appropriate to apply the Distribution interim rate increase on an across the
24 board basis?

25
26 Rate changes to customers of Newfoundland Power will be determined in
27 accordance with Board-approved rate design for Newfoundland Power customers.

28

1 The proposed interim rate increase to Labrador Interconnected customers is
2 proposed on an across the board basis, with the exception of the proposed rates for
3 Street and Area lighting.

4
5 Conclusion

6
7 Hydro submits that the 2015 Interim Rates Application meets the two-part test
8 originally established by the AUC for consideration of interim rate adjustments.
9 Hydro has shown that the net income deficiency for 2015 is both probable and
10 material.

11
12 Approval of the proposed interim rates will provide an approximate 70% recovery
13 of the 2015 forecast net income deficiency if implemented on March 1, 2015 and a
14 recovery of slightly below 60% if implemented April 1, 2015. A 60% recovery of the
15 2015 forecast net income deficiency provides a forecast net income for 2015 of
16 approximately \$5.2 million.

17
18 Hydro does not believe it is appropriate to make further adjustments to reduce
19 2015 Test Year revenue requirement for the purpose of establishing interim rates. If
20 upon final testing of 2015 costs, the Board determines that 2015 cost adjustments
21 are required, then these amounts would be applied to reduce the 2015 net income
22 deficiency to be recovered through customer rates in future years.

23
24 The proposed interim rates will add rate stability for 2015, enable the phase-in of
25 Island IC rates with materially lower customer impacts and help mitigate
26 intergenerational equity concerns caused by delayed rate implementation. Delayed
27 implementation of Hydro's 2015 base rates will further increase net income

1 deficiency proposed for recovery from customers upon establishment of final
2 customer rates.

3

4 Approval of Hydro's 2015 Interim Rates Application provides a reasonable balance
5 of the interests of both the utility and its customers.