

HAND DELIVERED

December 10<sup>th</sup>, 2014

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

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

Ladies & Gentlemen:

**Re: Newfoundland and Labrador Hydro's 2013 General Rate Application – Hydro's  
2014 Cost Recovery Application dated November 28, 2014 (the "Application")**

**A. Introductory**

The Board's letter of December 3<sup>rd</sup>, 2014 requested submissions on the Application. This letter provides Newfoundland Power's submissions on the Application.

**B. Background**

The Application is the latest in a series of applications made by Newfoundland and Labrador Hydro ("Hydro") seeking interim relief in respect of a general rate proceeding which was originally filed on July 30<sup>th</sup>, 2013 (the "original rate application").

Hydro's current rates were established based upon a rate application filed in 2006. There have been significant changes in Hydro's revenues and costs since that time. The filing of the original rate application provided an opportunity to address these changes. The course of proceedings which commenced with the original rate application has been extended with numerous changes in Hydro's financial outlook.

The original rate application sought an increase in Hydro's revenue requirements for 2013 of \$137 million, or 31.8%.<sup>1</sup> The original rate application proposed that rates for Newfoundland Power's customers be decreased.

---

<sup>1</sup> See Table 3, 2013 Amended GRA Filing: Reconciliation to Original GRA Filing.

Two requests for interim relief on the original rate application were considered by the Board; the second sought relief in the form of an interim transfer of \$29.4 million from Hydro's rate stabilization plan in 2014. Both of these requests were denied.<sup>2</sup>

No hearing was held on the original rate application. On June 6<sup>th</sup>, 2014, approximately one month prior to commencement of the hearing into the original rate application, Hydro gave notice that it intended to amend the original rate application.

On October 8<sup>th</sup>, 2014, Hydro filed an application for approval of the deferral and recovery of expenses associated with increased capacity-related supply costs on the Island Interconnected system of \$9.7 million which were incurred in the first quarter of 2014 (the "2014 capacity cost application"). The Board's decision on the 2014 capacity cost application is currently outstanding.

On November 10<sup>th</sup>, 2014, Hydro filed an amended rate application (the "amended rate application"). The amended rate application seeks an increase in Hydro's revenue requirements for 2015 of \$231.4 million, or 53.7%.<sup>3</sup> This application proposes that rates for Newfoundland Power's customers be increased.

On November 28<sup>th</sup>, 2014, Hydro filed the Application. It seeks deferral and recovery of a 2014 revenue deficiency forecast at \$45.9 million so that Hydro will have the opportunity to earn a reasonable return for 2014.

### **C. Principal Issues**

#### ***Hydro's Return on Equity***

The amended rate application indicates that without relief Hydro's return on equity ("ROE") would be -4.76% in 2014. In Hydro's 2007 general rate application, the Board effectively allowed a ROE of 4.47% for ratemaking purposes. From 2007 through 2013, Hydro's earned ROEs ranged from 0.06% to 6.59%. These ROEs appear to have been sufficient to maintain Hydro's financial integrity.

In OC2009-063, the provincial government authorized a ratemaking ROE for Hydro equivalent to that allowed for Newfoundland Power "...commencing with the first General Rate Application by Newfoundland and Labrador Hydro after January 1, 2009...". Newfoundland Power's current ROE is 8.8%.<sup>4</sup>

The \$45.9 million in cost deferral and recovery sought in the Application is based upon a forecast 2014 ROE for Hydro of 8.8%.

---

<sup>2</sup> See Order Nos. P.U. 13 and 39 (2014).

<sup>3</sup> See Table 2, 2013 Amended GRA Filing: Reconciliation to Original GRA Filing.

<sup>4</sup> See Amended Rate Application: Company Evidence, page 3.17-3.18.



### ***Hydro's Forecast Costs***

The amended rate application seeks recovery of substantial increases in Hydro's costs in addition to the increase in the cost of equity. For example, 2014 operations and maintenance costs are indicated to be 35% higher than in 2007.<sup>5</sup> These cost increases include costs associated with the Board's ongoing *Investigation into the Supply Issues and Power Outages on the Island Interconnected System*.<sup>6</sup> In addition, Hydro's 2014 energy supply costs are forecast to be higher based on the lowest Holyrood fuel conversion factor since 2007.<sup>7</sup>

The \$45.9 million in cost deferral and recovery sought in the Application is based upon full recovery of Hydro's forecast 2014 costs.<sup>8</sup>

### ***Regulatory Practice***

The Application seeks deferred recovery of substantial cost increases and an increased return from customers in advance of full testing of the cost increases. In Order No. P.U. 39 (2014) which dealt with an earlier Hydro application for interim relief in 2014, the Board observed:

*"Under the existing regulatory framework the determination of a just and reasonable return on rate base is undertaken in the context of a general rate application where all costs are fully tested to ensure that only those costs that are required for the provision of service are included in rates to customers."*

*"The Board notes that the approval of interim relief in advance of the conclusion of a general rate application is an extraordinary measure which must be fully justified in the circumstances."*<sup>9</sup>

The Board has historically permitted cost deferrals to address specific cost items that are both (i) reasonably quantified and justified and (ii) clearly distinguishable from the costs reflected in a utility's rates. Examples of such deferrals range from the cost effects of concluding amortizations which were previously tested to agreed changes in utility ROE.<sup>10</sup> Deferral accounts have also been used to account for variations in unpredictable costs. A prominent example of this is Hydro's rate stabilization account which adjusts for variations in the cost and amount of fuel for Holyrood. These uses of cost deferrals are consistent with generally accepted sound public utility practice.

<sup>5</sup> See Table 3, 2013 Amended GRA Filing: Reconciliation to Original GRA Filing.

<sup>6</sup> See Amended Rate Application: Company Evidence, page 2.39-2.40.

<sup>7</sup> See Amended Rate Application: Company Evidence, Regulated Activities, Schedule V, page 1 of 1.

<sup>8</sup> It includes costs associated with projects not yet approved by the Board for inclusion in rate base (see Amended Rate Application: Company Evidence, page 3.19, footnote 14); it does not include the costs addressed in the 2014 capacity cost application.

<sup>9</sup> See Order No. P.U. 39 (2014), page 10, lines 3-6 and page 11, lines 14-16.

<sup>10</sup> See Order Nos. P.U. 40 (2005) and P.U. 17 (2012). In both cases, the deferrals approved for future recovery were quantified and justified by reference to the utility's most recently tested costs.

The deferral and recovery of the \$45.9 million in 2014 costs as proposed in the Application is not consistent with regulatory practice.

#### **D. Submission on Disposition**

##### ***The Application as Filed***

With this Application, Hydro is seeking full recovery of its 2014 costs as forecast in the amended rate application. Given the amended rate application was filed on November 10<sup>th</sup>, 2014, such recovery would effectively amount to a guarantee of Hydro's 2014 rate of return. This is, in Newfoundland Power's view, inconsistent with Section 80 of the *Public Utilities Act* as interpreted by the Newfoundland and Labrador Court of Appeal.<sup>11</sup>

The amended rate application contains substantial increases in Hydro's costs. These cost increases have not been tested. Given the magnitude of some of these increases, it cannot be assumed that the Board will determine all of these increases to be "...reasonable and prudent and properly chargeable to operating account..." as required by Section 80(3) of the *Public Utilities Act*. In addition, the assumption of an 8.8% ROE for 2014 where the Board is not approving new rates for Hydro does not, in Newfoundland Power's view, conform to OC2009-063.

The Application proposes that the Board make an interim order approving a transfer of a 2014 revenue deficiency of \$45.9 million from Hydro's income statement to a 2014 revenue deficiency deferral account and also proposes certain options for recovery. Hydro appears to propose that the Board test the 2014 costs in 2015 prior to approving recovery.<sup>12</sup> Following approval of the Application, it is unclear to Newfoundland Power what jurisdiction, if any, the Board would retain to reduce recovery of the amount deferred. Section 75 of the *Public Utilities Act* specifically provides for interim orders governing rates. No equivalent provision exists permitting subsequent adjustment of *interim* orders with respect to deferral accounts. Accordingly, there exists a risk that an interim order in the Application could, in effect, be a final order.

For these reasons, Newfoundland Power submits the Board should deny the Application as filed.

##### ***A Possible Alternative***

Newfoundland Power recognizes that the combination of circumstances presented in the Application might be considered by the Board to be extraordinary. These might include (i) the background and timing of the Application, (ii) the practical need to rebalance Hydro's costs and rates as soon as reasonably possible, and (iii) the maintenance of Hydro's financial integrity. Together, these factors and others might lead the Board to conclude a degree of relief may be warranted or necessary in the public interest.

---

<sup>11</sup> See Newfoundland (Board of Commissioners of Public Utilities), Re (1998), 164 Nfld and P.E.I. R. 60, paragraph 31.

<sup>12</sup> See Amended Rate Application: Company Evidence, page 3.9, lines 18-27.





Extraordinary circumstances may make it reasonable for the Board to consider deferral of *some amount* of Hydro's 2014 costs for *possible* future recovery. This consideration of future recovery of those costs could be made in 2015 when the Board considers the amended rate application.

Any amount considered for any such deferral should, however, be much less than the \$45.9 million proposed in the Application. Deferral of the \$45.9 million is not justified given the substantial untested cost increases included in Hydro's 2014 forecast. In addition, deferral of \$45.9 million would risk the deferral becoming an incentive for further extension of an already extended proceeding.

An approach along these lines would clearly be a departure from regulatory practice relating to cost deferrals. For this reason, in Newfoundland Power's view, it could only be justified by the Board finding that extraordinary circumstances exist.

Such an approach might, however, enable Hydro to reduce the costs it would otherwise recognize in 2014 while providing an assurance that all costs ultimately required to be borne by customers are reasonable. In extraordinary circumstances, it might be the most reasonable available balance of the competing objectives of the utility and consumers.

**E. Concluding**

We trust the foregoing is helpful to the Board.

If you have any questions, please contact the undersigned at the direct telephone number noted below.

Yours very truly,



Gerard M. Hayes  
Senior Counsel

c. Geoffrey Young  
Newfoundland and Labrador Hydro

Paul Coxworthy  
Stewart McKelvey

Thomas Johnson  
O'Dea Earle Law Offices

Thomas O'Reilly, QC  
Vale Newfoundland and Labrador Limited



Ed Hearn, QC  
Miller & Hearn

Yvonne Jones, MP  
Labrador

Senwung Luk  
Olthuis, Kleer, Townshend LLP

Tom Sheldon  
Nunatsiavut Government

Robert Pilgrim  
Serco Canada Inc., 5 Wing Goose Bay

