

1      **Q.    What would Newfoundland Power propose as an effective means to provide**  
2      **appropriate interim relief to Hydro given the expectation there will be no final**  
3      **order before 2015?**

5      A.    Newfoundland Power is not in a position to propose an effective means to provide  
6      appropriate interim relief to Newfoundland and Labrador Hydro.

8      Newfoundland Power observes that, from a practical perspective, ensuring that a utility  
9      has a reasonable opportunity to earn a just and reasonable return each year is a  
10     responsibility of that utility's management. In Newfoundland Power's view, only the  
11     utility's management has a sufficient understanding of the financial outlook of the utility  
12     to discern the most effective means of ensuring the utility has a reasonable opportunity to  
13     earn a just and reasonable return each year.

15     Regulatory practice will affect the assessment of options available to a utility to address a  
16     forecast lack of opportunity to earn the just and reasonable return allowed under Section  
17     80 of the *Public Utilities Act*. Features of regulatory practice before the Board which  
18     would, in Newfoundland Power's view, be relevant to such an assessment include:

20     1. *Rate-making is Prospective*: In the Newfoundland and Labrador Court of Appeal's  
21     majority opinion in a stated case presented by the Public Utilities Board in 1996, it  
22     was indicated that:

24         "The process of rate setting is generally prospective by nature...In developing  
25         the utility's requirements, the Board focuses on a "test year" as the basis for  
26         its estimates and adjustments. Traditionally, in North America the test year  
27         was chosen as the latest 12 month period for which complete data were  
28         available. More recently, due largely to inflation, boards adopted a forward-  
29         looking test year which in effect amounts to a forecast of what expenses and  
30         costs, and hence revenue requirements, will be. This has been the practice of  
31         the Board and is supported by the [*Public Utilities Act*] and the [*Electrical  
32         Power Control Act*].” (Stated Case, para. 77)

34     2. *Regulatory Lag*: There is an interval of time between when an application seeking  
35     regulatory relief is filed with the Board and the point at which the Board can be  
36     reasonably expected to render a decision on the application. This interval is largely  
37     attributable to the requirement for the Board to satisfy itself via the development of  
38     a record and, where necessary, the conduct of a public hearing as to the merits of  
39     granting the relief sought. While an applicant utility cannot control the extent of  
40     regulatory lag which will be present on a particular application, similar applications  
41     tend to provide some guidance that is helpful in management assessment of when  
42     the relief sought in an application might be granted. For example, the Board

typically takes 7 to 9 months to render an order on a Newfoundland Power general rate application.<sup>1</sup>

3. *Rates are Typically Set on Tested Costs:* The current regulatory practice is that the Board establishes customer rates based upon “tested” costs. Tested costs are costs that have been examined by the Board and found appropriate and reasonable for the purposes of establishing customer rates. While only tested costs are used by the Board to establish customer rates, all costs are not necessarily tested at the same time. For example, from 1999 through 2011 an automatic adjustment formula (the “AAF”) was approved by the Board to adjust Newfoundland Power’s customer rates annually to reflect market changes in the Company’s cost of equity. The AAF typically used a combination of (i) costs tested in the Company’s last general rate application, and (ii) the most recent estimate of the Company’s cost of equity as generated by the AAF to determine customer rates for the succeeding year.<sup>2</sup>

Section 75 of the *Public Utilities Act* permits the Board to make an interim order changing customer rates prior to finally judging the costs to be appropriate and reasonable for ratemaking purposes. When the Board has exercised this authority it has relied upon tested costs to the extent possible.<sup>3</sup>

4. *Cost/Revenue Deferrals are Effectively Tested Before Approval:* The current regulatory practice is that the Board assesses and determines the appropriateness of cost deferrals in advance of approving them. This can occur as part of general rate

<sup>1</sup> See Order Nos. P.U. 19 (2003), P.U. 32 (2007), P.U. 46 (2009) and P.U. 13 (2013).

<sup>2</sup> Occasionally, the Board will approve modifications to test year costs when the Board is satisfied the modification is appropriate. For example, in Order No. P.U. 36 (2010), the Board approved a rate increase effective January 1<sup>st</sup>, 2011, resulting from Order No. P.U. 31 (2010), approving the adoption of the accrual method of accounting for other post-employment benefits costs ("OPEBs costs"). The customer rates approved by the Board were based on a combination of (i) 2010 tested costs (the most recent approved test year) and (ii) the difference between 2010 tested OPEBs costs (on a cash basis), and 2011 OPEBs costs (on an accrual basis) together with transitional adjustments.

<sup>3</sup> In Order No. P.U. 21 (1998-99), the Board set interim 1998 customer rates for Newfoundland Power following the Board's investigation into the Company's cost of capital. The order established interim rates based on a combination of (i) 1997 tested costs (Newfoundland Power's most recent approved test year) and (ii) a cost of common equity of 9.25% as ordered in Order No. P.U. 16 (1998-99).

1 applications or in standalone deferred recovery applications.<sup>4</sup> The Board has not  
2 yet approved a cost or revenue deferral on anything other than a final basis.<sup>5</sup>

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4 In Newfoundland Power's view, to assess "...an effective means to provide appropriate  
5 interim relief..." in any circumstances, requires both an understanding of (i) the  
6 particular utility outlook which gives rise to the need for relief and (ii) the framework  
7 and practice which governs regulatory oversight of that utility, including the items  
8 enumerated in this response.

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<sup>4</sup> See, for example, Order No. P.U. 13 (2013), which determined Newfoundland Power's 2013/2014 General Rate Application. Amongst other things, in this order, the Board approved a Conservation and Demand Management Cost Deferral Account. See also, Order No. P.U. 40 (2005), which determined Newfoundland Power's 2006 Accounting Policy Application. Amongst other things, in this order, the Board approved deferral of depreciation true-up of approximately \$5.8 million (see the response to Request for information SIR-NLH-NP-002). It also approved recognition of approximately \$3.1 million to offset increased income tax expense arising from a CRA tax settlement after determining that (i) the CRA tax settlement benefitted consumers and (ii) the proposed recognition of revenue was the least cost means of addressing the tax impacts associated with the settlement (see the response to Request for information SIR-NLH-NP-003).

<sup>5</sup> While there is a provision in the Public Utilities Act for interim orders governing rates, there is no provision which governs interim orders approving transfers from deferral accounts (see the responses to Requests for Information SIR-NLH-NP-006 and SIR-NLH-NP-007).