

1 Q. Please provide any regulatory precedent for the transfer of a balance to be
2 recognized as revenue on an interim basis.

3
4

5 A. Hydro is not aware of any exact matching of the proposed transfer to revenue as
6 proposed in the application. However, the Board has approved RSP transfers to
7 offset customer costs on an interim basis in a previous Hydro order which, in
8 principle, achieves the same result as Hydro is seeking. The Board has also
9 approved revenue recognition and cost deferral by Newfoundland Power to offset
10 increased costs between test years, which again, can be considered a precedent in
11 considering Hydro's Second Interim Rates Application. Additional details on these
12 Board approvals are provided below.

13

14 ***RSP Transfers***

15 In P.U. 46(2006), the Board approved, on an interim basis prior to the conclusion of
16 the 2006 GRA, that Hydro shall set up a reserve account to maintain the December
17 31, 2006 Rate Stabilization Plan Hydraulic Variation balance. This balance is net of
18 the normal 25% December 31, 2006 allocation, with normal Rate Stabilization Plan
19 financing charges applied, until the balance in the account is disposed of later by
20 final Order of the Board.

21

22 In Order No. P.U. 8(2007), the Board approved that Hydro distribute the balance of
23 the reserve account, established in Order No. P.U. 46(2006), in accordance with the
24 provisions of the special adjustment to the RSP Hydraulic Production Variation
25 balance approved by the Board. The special adjustment approved the use of
26 approximately \$20 million of the credit balance in the RSP Hydraulic Production

Variation component be utilized to pay down the RSP Historical Plan Balance owing from customers.¹

While the precedent provided above did not specifically approve the transfer of a balance from the RSP as revenue, Order No. P.U. 46(2006) did approve on an interim basis the setting aside of an RSP credit balance to offset costs to ultimately be recovered from customers.

NP's 2005 Accounting Policy Application

In Order No. P.U. 40(2005) (the "Revenue Recognition Order"), the Board approved a change in Newfoundland Power's revenue recognition accounting policy (i.e., from a billing basis to an accrual basis). The Revenue Recognition Order included approval for Newfoundland Power to recognize as revenue, for regulatory purposes, \$3,086,000 in 2006 to offset income tax effects arising from a CRA tax settlement.

The Board stated, "The increased income taxes payable by NP for 2006 are directly related to the recognition of the unbilled revenue for tax purposes and NP is entitled to recover this cost."²

The revenue recognition for NP was approved in the Revenue Recognition Order on a final basis, even though the additional income tax costs were not tested in aggregate with other costs in a GRA process.

¹ The effect of November 23, 2006 Agreement on Revenue Requirement was to reduce the RSP rate charged to NP by Hydro, and hence reduce NP's rates to its customers. This impact was reflected in Hydro's Revised Application and in the interim rates approved by the Board in Order Nos. P. U. 41(2006) and P. U. 42(2006).

² See page 14, lines 21 to 23 of Order No. P.U. 40(2005).

1 In the same application, Newfoundland Power also requested revenue recognition
2 of \$5,793,000 to offset increased depreciation expense between test years due to
3 the conclusion of a test year true-up adjustment. While the Board did not approve
4 the proposed revenue recognition, the Board did approve a deferral account to
5 avoid a negative financial impact on NP from recognition of the increased
6 depreciation expense in 2006.

7
8 ***Relevance to Current Application***

9 The regulatory precedents provided above demonstrate the authority of the Board
10 to permit the use of deferral accounts to balance the interests of customers and the
11 utility.

12
13 In the 2005 Newfoundland Power Revenue Recognition Order, the Board approved
14 both revenue recognition and deferred cost recovery on a final basis to provide
15 Newfoundland Power the opportunity to earn a reasonable return. The Board's
16 approval did not require a full testing of Newfoundland Power costs but appears to
17 have been based upon the test of prudence of the additional costs to be incurred by
18 Newfoundland Power between test years.

19
20 In the Second Interim Rates Application (the "Application"), Hydro is proposing
21 revenue recognition on an interim basis for 2014 until the Board is provided the
22 opportunity to fully test costs for 2014 following the filing of the amended
23 application in the fall of 2014. This approval would provide Hydro the opportunity
24 to earn a reasonable return in 2014 while at the same time providing no
25 disadvantages to customers. Only the tested revenue requirement for 2014 will be
26 recovered from customers through rates.

1 Similar to Newfoundland Power's circumstances in filing its 2005 Revenue
2 Recognition Application, Hydro also has material increases in costs not reflected in
3 existing customer rates. For example, the increased revenue requirement due to
4 the increased return on equity ("ROE") requirement in compliance with the
5 Government directive is approximately \$21 million.³ Hydro is also required to
6 recognize and record asset retirement obligations (AROs) in compliance with Order
7 No. P.U. 29(2012). The expense impact of AROs is an increase in depreciation costs
8 of \$2.3 million and accretion costs of \$0.8 million.⁴ Employee future benefits have
9 increased by approximately \$3.5 million compared to the 2007 Test Year, mainly
10 due to the decrease in the discount rate.

11
12 The combined effect of the Government directive on ROE, additional costs in AROs
13 in compliance with a Board order and employee future benefits is approximately
14 \$27.5 million. This comprises more than 90% of the revenue recognition proposed
15 on an interim basis for 2014. Hydro believes interim approval to recognize revenue
16 in 2014 to offset these and other prudent costs is consistent with the requirement
17 of legislation to provide Hydro the opportunity to meet the fair return standard.

³ See Hydro's response to PUB-NLH-056, Attachment 1, filed in the 2013 GRA. This amount will be higher for 2014 with the addition of new assets to rate base for 2014.

⁴ See page 3.32 of GRA Evidence and Hydro's response to NP-NLH-091.