Q. 2013-2014 General Rate Application, Company Evidence

Explain in detail the operating costs incurred in 2010 and 2011 and forecast for 2012 that have arisen solely due to severe weather, including the amount of such costs and their impact on the overall operating costs, net income and regulated return on equity in the year they were incurred.

A. ***A. Cost Dynamics:***

Severe weather events present a hazard to the Company's return because of the cost of response.[1] In the year a severe weather event occurs, response costs tend to increase the Company's total costs. These increased costs, in turn, tend to decrease net income and the regulated return on equity. But the impact cannot be practically isolated in the manner suggested by this question due to a number of cost dynamics.[2]

Firstly, restoration work required following a severe weather event takes priority over virtually all other work performed by Newfoundland Power. This can result in a portion of work planned for a year being deferred into a subsequent year. Often this is the simple result of resource limitations both within the Company and outside of it (i.e., contractors). To the extent deferral of planned work occurs, it can mitigate, but typically will not eliminate, the general tendency of a severe weather event to reduce the Company's return.[3]

[1] In the period 2010 to present, Newfoundland Power has, in its view, experienced 3 severe weather events: the March 2010 ice storm, Hurricane Igor in September 2010 and Tropical Storm Leslie in September 2012. The last severe weather event prior to 2010 was an ice storm which occurred in December 2007 and resulted in operating costs of approximately $230,000 and capital costs of approximately $1.1 million. All severe weather events as defined by the Canadian Electricity Association Service Continuity Committee for *reliability reporting purposes* (see response to Request for Information CA-NP-131) are not considered to have a material impact on the Company's operating and capital costs or its business risk.

[2] The impracticability of cost isolation is also a result of management accounting practices. The Company does not track costs in a way that permits it to segregate costs that arise "…*solely* due to severe weather…" as this question requests. Response to severe weather events typically results in cost impacts resulting from (i) round-the-clock operations and more extensive use of contractors and other resources and (ii) redirecting the efforts of existing staff. The former costs are largely incremental while the latter are not typically fully incremental. Capital costs resulting from severe weather are also only estimates. This is because some of the impacts of severe weather events may not manifest themselves for extended periods. For example, following the Hurricane Igor restoration in September 2010, the Company experienced an increased incidence of Service repair and replacement in the storm-affected areas through at least the first quarter of 2011. These repairs and replacement Services (or a portion of them) were likely related to Hurricane Igor but treated as routine maintenance. Given these considerations the Company can only *estimate* cost impacts of major storm events.

[3] Deferrals, in fact, occurred in 2010 and were reported to the Board in response to a request for information on the Company's actual 2010 capital expenditures where it was indicated that "…storm related work related to the March ice storm and Hurricane Igor required Newfoundland Power to adjust the amount of work to be completed under the 2010 *Rebuild Distribution Lines* project by reducing complete line rebuilds and focusing on more selective replacement of high priority items."

Secondly, in a year in which a severe weather event occurs, management will, following restoration of service, reassess its financial position and its options. It will then take any reasonable steps open to it to manage operations in a way that offers the best opportunity for the Company to earn its return in that year. To the extent management reasonably can take steps to earn its return, it will.

A third dynamic is the multi-year financial impact of additional capital expenditures. Capital expenditures required as a result of severe weather events typically have no relation to revenue growth. In 2010, the Company incurred approximately $6 million of such capital expenditures which will not be included in the ratemaking process until this Application. The additional financing cost of these expenditures from 2010 through to the 2013/2014 test period represent a continuing impact on the Company's net income and regulated return on equity.[4] Accordingly, the impacts of severe weather events on Newfoundland Power's net income and regulated return on equity are typically not restricted to the year in which the weather event occurred.

B. Estimated Costs:

Table 1 shows the *estimated* operating and capital costs incurred in 2010 through 2012 forecast arising from severe weather events.

Table 1
Severe Weather Events
Estimated Costs
($000s)

	2010	**2011**	**2012F**
Operating	2,400	-	1,000
Capital	6,100	200[5]	1,200
Total	**8,500**	**200**	**2,200**

[4] This approximately $6 million of additional expenditures was not *substantially* offset by capital cost reductions in 2010. The Company's amended 2010 general rate application forecast 2010 capital expenditure of approximately $64.7 million, which was included in current customer rates. Additional Board approvals related to severe weather events (Order Nos. P.U. 17 (2010) and P.U. 35 (2010)) increased the Company's approved capital budget by approximately $6.1 million to $70.8 million. Ultimately, actual 2010 capital expenditures, which were also influenced by increased customer connections, were approximately $73 million.

[5] The 2011 capital costs of $200,000 represent the insurance deductible on the cost of reinstatement of the Company's Port Union and Lawn hydroelectric plants following Hurricane Igor in 2010. The expenditures were approved by the Board in Order No. P.U. 11 (2011).

C Concluding:

The segregation of the Newfoundland Power costs that arise *solely* due to severe weather events is impractical. Nevertheless, the operating and capital costs associated with response to such events clearly present a risk to the Company's ability to earn its allowed return.

Please refer to the response to Request for Information PUB-NP-005 for more information on how the cost impacts of severe weather events are a prominent feature of Newfoundland Power's business risk profile.