

**NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES**

AN ORDER OF THE BOARD

NO. P.U. 36(2015)

IN THE MATTER OF the *Electrical Power Control Act, 1994*, SNL 1994, Chapter E-5.1 (the "*EPCA*") and the *Public Utilities Act*, RSNL 1990, Chapter P-47 (the "*Act*"), as amended, and regulations thereunder; and

IN THE MATTER OF an amended general rate application filed by Newfoundland and Labrador Hydro on November 10, 2014; and

IN THE MATTER OF an amended application filed by Newfoundland and Labrador Hydro for approval, among other things, to establish a deferral account to reduce Hydro's forecast net income deficiency for 2015.

The Application

On November 12, 2015 Hydro filed an application amending its July 10, 2015 application for a 2015 cost deferral account to reduce its 2015 net income deficiency (the "Application"). The Application seeks an Order of the Board approving:

- i) A cost deferral in the amount of \$60.5 million to reduce Hydro's forecast 2015 net income deficiency;
- ii) The proposed account definition for the proposed cost deferral;
- iii) The deferral of Hydro's 2015 general rate application costs with recovery to be determined in a future order of the Board; and
- iv) The general rate application settlement agreement dated August 14, 2015, on an interim basis.

The Application was circulated to Newfoundland Power Inc. ("Newfoundland Power"), the Consumer Advocate, a group of three Island Industrial customers: Corner Brook Pulp and Paper Limited, North Atlantic Refining Limited and Teck Resources Limited (the "Industrial Customer Group"), Vale Newfoundland and Labrador Limited ("Vale"), the Innu Nation, the Towns of Labrador City, Wabush, Happy Valley-Goose Bay and North West River (the "Towns of Labrador"), Nunatsiavut Government and Yvonne Jones, MP Labrador.

On November 30, 2015 Newfoundland Power, the Consumer Advocate, the Industrial Customer Group and Vale filed submissions. Hydro filed a submission on December 2, 2015.

Background

On July 30, 2013 Hydro filed a general rate application proposing a 2013 test year and customer rate changes.

On November 18, 2013 Hydro filed an application seeking interim rate relief in advance of the conclusion of the general rate application. In Order No. P.U. 40(2013) the Board deferred consideration of Hydro's proposals for interim rate changes stating that there was insufficient time to implement rate changes for January 1, 2014 and that rate changes should not be made pending resolution of the issues and concerns associated with the application. The Board approved an amendment to the Rate Stabilization Plan ("RSP") rules to suspend the January 1, 2014 RSP adjustment for Island Industrial customers.

On February 11, 2014 Hydro filed an amended application for interim relief, requesting new rates for Island Industrial customers, to be effective January 1, 2014, and a deferral mechanism to recover any revenue shortfall between interim and final rates. In Order No. P.U. 13(2014) the Board dismissed Hydro's application finding that Hydro had not filed an application with supporting evidence that set out a comprehensive, unambiguous set of proposals.

On May 12, 2014 Hydro filed a further application for interim relief requesting approval, on an interim basis, to recognize \$29.4 million to be transferred from the RSP as revenue and to change Island Industrial customer rates as of January 1, 2014.

On June 6, 2014 Hydro advised that it would be filing an amended general rate application in the fall of 2014. As a result the general rate application hearing which was scheduled to begin on July 9, 2014 did not proceed. Hydro did not amend its third application for interim relief which had been filed prior to the announcement of an amended general rate application. In Order No. P.U. 39(2014) the Board denied the application stating that Hydro had not demonstrated that it was appropriate to set aside the proposed revenue shortfall in a deferral account and that the proposal for interim rates for Island Industrial customers could not be assessed until Hydro filed its amended general rate application.

On November 10, 2014 Hydro filed an amended general rate application requesting, among other things, an order of the Board approving interim rates for its customers for 2015.

On November 28, 2014 Hydro filed an application for approval of the deferral and recovery of \$45.9 million associated with a forecast revenue deficiency. In Order No. P.U. 58(2014) the Board approved the creation of a deferral account in relation to Hydro's proposed 2014 revenue requirement and the segregation of \$45.9 million into the account but did not approve recovery.

On December 24, 2014 the Board directed Hydro to file a separate application setting out proposals for interim rates for Newfoundland Power and Island Industrial customers to be effective March 1, 2015.

On January 28, 2015 Hydro filed an application seeking interim approval of rates for its customers to be effective March 1, 2015. In Order No. P.U. 14(2015) the Board denied the application but found that Hydro had justified an interim increase in rates. The Board directed Hydro to file revised rates

and RSP rules to reflect the findings of the Board, including an interim base rate increase of 8.0% for Newfoundland Power to be effective July 1, 2015.

On May 27, 2015 Hydro filed a compliance application proposing revised rates and requesting approval of a 2015 revenue deficiency deferral account of \$20 million on the basis that the interim rates approved effective July 1, 2015 would not provide the opportunity for Hydro to earn a fair return in 2015. On June 3, 2015 the Board advised Hydro that the application was not in compliance with Order No. P.U. 14(2015) and directed Hydro to amend and re-file the application. The Board also advised Hydro that a separate application in respect of Hydro's deferral account proposal would be required. Hydro filed a revised compliance application on June 5, 2015 and in Order Nos. P.U. 17(2015) and P.U. 21(2015) the Board approved, on an interim basis, revised rates for Hydro's customers, effective July 1, 2015.

On July 10, 2015 Hydro filed an application requesting, among other things, a cost deferral in the amount of \$20 million. In the application Hydro stated that it was forecasting a 2015 net income deficiency of \$41.8 million and a net loss of \$8.6 million and that cost recovery in the amount of \$20 million would provide Hydro the opportunity to recover 70% of the forecast net income deficiency. A minor revision to the application was filed on July 23, 2015.

Application Proposals

The Application states that the proposed 2015 deferral is to address the 2015 financial impacts of the delayed conclusion of the general rate application beyond year end. Hydro submits that rates implemented effective July 1, 2015, on their own, do not provide a reasonable opportunity to earn a fair return in 2015.

In the Application Hydro has updated its forecast of the 2015 net income deficiency. Hydro explains that the increase in the 2015 net income deficiency is primarily related to three factors:

- i) customer bills for the first six months of 2015 were based on 2007 test year base rates resulting in a loss of \$36.8 million;
- ii) higher interest expense associated with the operation of the RSP relative to the 2007 test year which accounts for \$7.6 million of the deficiency; and
- iii) additional supply costs, in the amount of \$12.7 million, for which Hydro had proposed new recovery mechanisms in the amended general rate application.

Hydro proposes to defer these costs and also costs associated with the August 14, 2015 Settlement Agreement in the amount of \$2.2 million and 2015 general rate application costs in the amount of \$1.2 million.

Hydro explains that it amended the Application to seek 100% recovery as it no longer anticipates a general rate application order before the end of 2015. Hydro states that without approval of the Application it forecasts a net loss of \$30.8 million in 2015 and a return on rate base of 3.56%. Hydro explains that approval of 100% provides a forecast return on rate base of 6.62%, which is at the bottom of the proposed range of rate of return on rate base, and that approval of a recovery percentage below 100% would not provide Hydro with the opportunity to earn a reasonable return on rate base in 2015.

1 Hydro explains that approval of the 2015 test year will result in a recalculation of the RSP balances
2 for 2015 and reversal of the 2015 RSP interest expense which will provide savings in 2016. Due to
3 the materiality of the impact on its 2015 financial results Hydro proposes to record the additional
4 interest expense in a deferral account for 2015.

5
6 Hydro states that supply costs in 2015 are now forecast to be materially higher than the 2015 test
7 year forecast. Hydro states that there is also a material increase in Holyrood fuel costs associated
8 with the delay in implementation of the 2015 test year Holyrood fuel conversion rate. Hydro notes
9 that the amended general rate application proposes the implementation of three new deferral accounts
10 to address variances in actual from test year - the Isolated Systems Supply Cost Variance Deferral
11 Account, the Energy Supply Cost Variance Deferral Account and the Holyrood Conversion Rate
12 Deferral Account. Hydro provides evidence in relation to the reasons for the forecast variances from
13 test year and notes that the energy supply cost variance amount reflects the proposed cost variance
14 threshold of \$0.5 million. Hydro states that it proposes deferral of the additional supply costs in 2015
15 due to the materiality of the impact on 2015 financial results. Hydro submits that these costs are
16 appropriate for deferral as the costs are not controllable by Hydro and that they were proposed for
17 recovery in the general rate application.

18
19 Hydro states that interim approval of the Settlement Agreement would:

- 20 i) provide for greater certainty regarding year-end financial reporting and agreed upon
21 deliverable dates;
22 ii) reduce the net income deficiency in relation to asset retirement obligation costs;
23 iii) provide more accurate financial reporting in relation to employee future benefits; and
24 iv) be consistent with the past practice of the Board for conservation and demand management
25 costs for the years 2009 to 2014.

26
27 Hydro states that, without an order to defer its external general rate application hearing costs, it will
28 have to expense these costs in 2015. Hydro requests that, to permit more accurate financial reporting,
29 these costs be deferred with recovery to be determined in a future order of the Board. Hydro notes
30 that it proposes in the general rate application that these costs be deferred and recovered over a three-
31 year period.

32
33 Hydro explains that \$11.8 million of the proposed \$60.5 million deferral amount will be disposed of
34 by updating the RSP for the 2015 test year (the RSP interest adjustment and the Holyrood fuel
35 conversion rate change). The recovery approach for the remaining \$48.7 million would be subject to
36 a future order of the Board upon finalization of the actual 2015 net income deficiency.

37
38 Hydro submits that the proposals in the Application address the forecast 2015 net income deficiency
39 in a reasonable manner which does not disadvantage customers and further, that the proposed
40 deferral account is consistent with past practice of the Board. The Application submits that the actual
41 2015 net income deficiency will be finalized upon conclusion of the general rate application and the
42 approved net income deficiency can be set aside in a deferral account for future recovery.

Submissions

Newfoundland Power submits that the relief requested in the Application should not be granted and states:

The relief requested in the Application is not consistent with the utility entitlement to a fair return as provided under Section 80 of the Public Utilities Act (the "Act") as that entitlement has been consistently defined by the Court of Appeal and the Board. In addition, neither the Application nor the evidence filed in support of it addresses the concerns raised by the Board in Order No. P.U. 58(2014), relating to regulatory practice and the responsibility for the consequences of utility management decision making.

Newfoundland Power notes that the amount of the proposed deferral has tripled from \$20 million to \$60.5 million in the four months since the filing of the application in July of 2015. Newfoundland Power states that the dramatic increase is the result of Hydro management decisions and/or economic uncertainty and for this reason Hydro, and not customers, should bear the consequences of financial management of the utility.

Newfoundland Power states that Hydro has provided no evidence indicating how recovery of past net income deficiencies in future years is consistent with generally accepted sound public utility practice. Newfoundland Power submits that the Application does not address the reasonableness of the impact on customers of the possible liability of over \$100 million relating to past net income deficiencies and questions how deferred recovery of a net income deficiency from a prior year would not be "...a retroactive adjustment of the actions of management."

Newfoundland Power submits that the regulatory lag associated with Hydro's general rate application does not justify approval of the relief sought noting that management decisions of Hydro made a substantial contribution to the extended regulatory lag. Newfoundland Power notes that restructuring of management and operations contributed significantly to the length and complexity of the general rate application. Further Newfoundland Power notes that a month before the hearing was scheduled to begin in 2014 Hydro provided notice that it was planning to amend the application later in the fall. Newfoundland Power states that the amended application filed five months later was substantially different which contributed significantly to the length and complexity of the general rate application.

Newfoundland Power submits that Hydro's actual return on equity since 2007 has not impaired its creditworthiness noting that earned return on equity ranged from 0.06% to 6.59%. Newfoundland Power submits that this is because Hydro's creditworthiness and financial integrity is directly dependent upon the creditworthiness of the province which guarantees Hydro's debt. Newfoundland Power submits that there is no near-term financial urgency from a creditworthiness perspective associated with the Application.

Newfoundland Power submits that:

The relief requested in the Application is inconsistent with regulatory practice because it (i) is not prospective, (ii) practically provides Hydro with relief from the effects of its own management decision making, and (iii) not required to maintain Hydro's continued financial integrity.

1 Nevertheless Newfoundland Power acknowledges that the Application indicates a forecast net loss
 2 for Hydro of \$30.8 million in 2015 and that, while the Board may conclude that the utility should
 3 bear the burden of this loss, it must be mindful of Hydro's creditworthiness. Newfoundland Power
 4 states:

5
 6 *On the one hand, the Board is practically being asked to use a deferral account to relieve Hydro*
 7 *from the consequences to its bottom line of its own managerial decision making and transfer*
 8 *those consequences to customers. This is a clear departure from regulatory practice relating to*
 9 *a utility's entitlement to a fair return and cost deferrals. On the other hand, the Board must*
 10 *practically be mindful of the consequences of its orders on the financial integrity of Hydro.*
 11 *Long-term utility creditworthiness is in the customers' best interest.*
 12

13 Newfoundland Power submits that if the Board feels compelled to grant any relief, the deferral of
 14 \$20 million representing Hydro's July 2015 estimate of appropriate regulatory relief is a "generous
 15 regulatory response to the circumstances." Newfoundland Power submits that the amount proposed
 16 in the July 2015 application has a greater prospective quality than the more recent estimate of \$60.5
 17 million and also that this would, to a greater degree, expose Hydro to the effects of its own
 18 management decision making and economic conditions. Newfoundland Power states that this
 19 approach is more consistent with the Board's regulative and corrective role and it cannot be
 20 considered to be arbitrary because it is based on the financial evidence of Hydro. Newfoundland
 21 Power states:

22
 23 *Permitting deferral for future consideration of \$20 million, as opposed to \$60.5 million, is also*
 24 *a more balanced regulatory response. It would (i) ameliorate any possible short-term risks to*
 25 *Hydro's creditworthiness which might exist in the current circumstances and (ii) reduce the*
 26 *amount of customers' possible future liability to fund Hydro's forecast 2015 net income*
 27 *deficiency.*
 28

29 The Consumer Advocate recommends that the Board reject the Application but states that he would
 30 not object to a cost deferral amount of \$20.2 million as requested by Hydro in its July 2015 interim
 31 rate application. The Consumer Advocate states that he would normally not object to a cost deferral
 32 account but notes several considerations, including:

- 33
 34 i) The Board granted interim rate increases effective July 1, 2015;
 35 ii) The interim rate increase for Newfoundland Power effective July 1, 2015 was 8% as
 36 compared to the approximate 4.8% decrease proposed in the general rate application and
 37 the 4.1% rate increase proposed in the amended general rate application;
 38 iii) The amount proposed to be deferred is triple the amount requested in July 2015;
 39 iv) The Application proposes 100% recovery of the 2015 revenue deficiency;
 40 v) Hydro provided testimony in the general rate application hearing that Hydro has proposed
 41 deferral accounts for collection of an additional \$116 from customers, including the \$60.5
 42 million proposed in the Application; and
 43 vi) Hydro has not determined the impact on customers of the proposed deferral of \$116
 44 million.

1 The Consumer Advocate states:

2
3 *In the Consumer Advocate's submission, the interim rate increase granted by the Board*
4 *effective July 1, 2015 fairly addresses Hydro's financial situation in 2015. Although effective*
5 *only from mid-year, the rate increase granted for Newfoundland Power, far and away Hydro's*
6 *largest customer, is almost double what Hydro proposes in the Amended 2013 GRA. We also*
7 *point out that this Amended Application requests a cost deferral amount that is triple that*
8 *requested only four months ago, and represents roughly half of the \$116 million being*
9 *requested by Hydro for recovery in cost deferral accounts in the Amended 2013 GRA. Hydro*
10 *has not indicated what impact these cost deferral accounts will have on customers, but it can be*
11 *safely assumed that it will be significant. Such large variations in costs lend little confidence in*
12 *Hydro's forecasting ability.*

13
14 Vale notes that the creation of a \$60.5 million deferral account is more than three times the revenue
15 deficiency forecast in July 2015. Vale also questions whether the requested relief achieves the goals
16 of Hydro as the creation of the deferral account provides no certainty that the Board will ultimately
17 accept that the amount requested accurately reflects Hydro's recoverable revenue shortfall.

18
19 Nevertheless Vale does not object to the creation of the deferral account but states that its agreement
20 is not an endorsement of the accuracy of the proposed revenue deficiency amount. Vale questions
21 whether the deferral account should include the full amount requested by Hydro and is concerned
22 that Hydro has significantly overstated its recoverable 2015 revenue deficiency noting several
23 concerns including the proposed rate of return of 8.8% and the inclusion of costs associated with the
24 proposed supply cost deferral account and the Holyrood conversion factor which have not yet been
25 approved by the Board. In addition, Vale questions the inclusion of \$1.2 million for general rate
26 application costs based on the fact that the length and complexity of the proceeding was contributed
27 to by Hydro's choice not to file a general rate application for seven years and to amend the general
28 rate application on the eve of the start of the hearing in July 2014. Vale also questions the inclusion
29 of amounts which Liberty Consulting found were imprudently incurred. Vale states:

30
31 *The importance of carefully scrutinizing Hydro's recoverable deficiency is magnified by the fact*
32 *that the recovery of past revenue shortfalls through deferral accounts to be repaid by future*
33 *customers creates the potential for intergenerational inequity.*

34
35 Vale states that it has no comment on Hydro's proposed interim approval of the Settlement
36 Agreement.

37
38 The Industrial Customer Group states that if the Application is approved the Board's Order should
39 fully reflect the interim nature of the proposals. The Industrial Customer Group submits that the
40 Application appears to presume that the supply cost recovery mechanisms sought in the general rate
41 application will be approved as proposed. The Industrial Customer Group notes that the operation of
42 these mechanisms and the RSP were the subject of evidence and undertakings, some of which remain
43 outstanding and it can reasonably be anticipated these recovery mechanisms will be the subject of
44 final submissions in the general rate application. The Industrial Customer Group states:

45
46 *In short, Hydro's actual 2015 net income deficiency is undetermined, and many of the premises*
47 *on which Hydro is proposing to calculate and recover that deficiency remain contentious and in*
48 *issue in the amended GRA.*

1 The Industrial Customer Group states that it reserves the right to make submissions on the
2 disposition of the deferral account.

3
4 In its reply submission Hydro explains that the Application does not propose deferral of any
5 increased costs forecast in 2015 relative to the 2015 Test Year and clarifies that to the extent that
6 costs other than supply costs have increased from the 2015 Test year, they have not been included in
7 the proposed deferral. Hydro also submits that because the Application is based on the forecast 2015
8 Test Year costs, it is not correct to suggest that approval of the Application transfers the risks of 2015
9 management decisions and economic uncertainties already encountered to Hydro's customers.

10
11 Hydro submits that, based on the 2015 forecast using actuals to the end of August, a cost deferral of
12 \$60.5 million is required to provide Hydro the opportunity to achieve a rate of return on rate base at
13 the bottom of the proposed range. Hydro submits that:

14
15 *Approval of the Amended 2015 Cost Deferral Application will balance the interest of the utility*
16 *and the customer, in that it (i) provides Hydro the opportunity to earn a reasonable return in*
17 *2015 and (ii) does not impact customer rates as customer rates will only be modified to provide*
18 *recovery of tested costs for 2015 on conclusion of the GRA.*

19
20 Hydro explains that the cost deferral application filed in July 2015 did not address the net income
21 impact of the proposed 70% recovery of the 2015 net income deficiency, the material increase in
22 supply costs or the higher than forecast RSP interest because Hydro assumed the general rate
23 application would conclude in 2015.

24
25 In relation to the supply costs deferral accounts, Hydro believes it is appropriate and consistent with
26 utility practice in Canada that it is provided the opportunity to recover supply costs that are prudently
27 incurred in the provision of reliable service. Hydro explains that, for reasons beyond its control, its
28 supply cost mix can vary from forecast with material financial impact. Hydro believes it is
29 appropriate that these costs be deferred until the Board has decided on the appropriate treatment of
30 the enhanced reliability and fuel efficiency costs.

31
32 In relation to Newfoundland Power's suggestion that if the Board does approve a deferral the amount
33 of the deferral should be \$20 million, Hydro explains that this would result in a net loss of \$10.8
34 million, a return on equity of -2.84% and a rate of return on rate base of 4.72%. Hydro submits that
35 this is not a reasonable level of return.

36
37 In relation to the suggestion of the Consumer Advocate that the interim rate increase on July 1, 2015
38 fairly addresses Hydro's financial situation in 2015, Hydro notes it forecasts a net loss of \$30.8
39 million in 2015 even with the additional revenue. Hydro submits that the \$20 million deferral
40 recommended by the Consumer Advocate is not a reasonable level of recovery for 2015.

41
42 Hydro notes that neither Vale nor the Industrial Customer Group oppose the creation of the deferral
43 account.

Board Findings

It is accepted regulatory practice for a utility to request and be granted interim relief in advance of the conclusion of a general rate application and the implementation of final rates. Since the initial filing of the general rate application in 2013 the Board has granted interim relief in Order No. P.U. 58(2014), which approved a \$45.9 million deferral for 2014, and in Order Nos. P.U. 14(2015), P.U. 17(2015) and P.U. 21(2015), which approved interim increases in rates for Hydro's customers effective July 1, 2015. In granting interim relief, either in the form of interim rates and/or deferral of costs, the Board must be satisfied that such relief is demonstrated to be necessary in the circumstances and in accordance with sound utility regulatory practice. Approval of such relief is not, and should not be viewed to be, routine and each request must be considered in the context and circumstances under which it is requested. The question before the Board in this Application then is whether interim relief is warranted and, if so, what should be the level of that relief.

The Board shares the concerns expressed by Newfoundland Power as to whether Hydro's proposal for a 2015 cost deferral is in accordance with sound public utility practice. As the Board has stated in the past, and as set out by the Court of Appeal, the setting of a rate of return is, to the extent practicable, to be done prospectively. There is no entitlement to a rate of return but rather the management of the utility must manage its business effectively to earn the return which is approved in a general rate application process. This same concern was identified by the Board in Order No. P.U. 58(2014) relating to the proposed 2014 revenue deficiency deferral of \$45.9 million. In its decision on that application, which was filed late in the year and just two weeks after Hydro filed its amended general rate application, the Board referenced the issues of timing and lack of opportunity to review the supporting evidence and possible impacts and considerations. The Board allowed the deferral in those circumstances but reserved any decision on recovery of all or part of the deferred amount. The general rate application has now progressed to the point where the hearing has been completed, the majority of undertakings and other evidence has been filed, and final submissions from the parties are pending. The question of whether the proposed 2015 deferral is in accordance with sound public utility practice can now be considered more fully in the context of the full evidentiary record.

Hydro frames the deferral relief requested in this Application in the context of a forecast 2015 net income deficiency, while in the 2014 application Hydro requested deferral and recovery of a forecast revenue deficiency. The Board sees no distinction between these but notes that, in this Application, Hydro is requesting deferral of 100% of its forecast revenue shortfall for 2015. If the 2015 deferral is approved as requested Hydro will have the opportunity, as it did in 2014, to reduce, in its regulated financial statements for 2015, a portion of its operating expenses with no assurance of future recovery of those costs. As noted by Newfoundland Power, this brings into question whether deferred recovery of a net income deficiency from a prior year could be considered a retroactive adjustment of the actions of management. In this regard the Board agrees with Newfoundland Power that a net income deficiency is not a cost but rather is the net financial result of a year of utility operation. The Board's concern in the ongoing general rate application is to test Hydro's 2014 and 2015 costs and then determine the revenue requirement to be recovered from customers in rates to cover those costs. Any consideration of deferral and future recovery from customers of costs for 2015 pending conclusion of the general rate application must be with reference to the 2015 test year costs as put forward by Hydro in its general rate application, as this will be the basis on which final rates for 2015 will be determined.

1 The Board has already granted Hydro interim rate relief for 2015. In considering that request the
 2 Board found that, based on the evidence, Hydro's financial position has deteriorated since 2007 and
 3 particularly since the filing of the 2013 general application, due to increased costs. The Board was
 4 satisfied that interim rate relief was warranted in advance of the conclusion of the general rate
 5 application. As a result the Board ordered interim base rate increases to be effective July 1, 2015 of
 6 8.0% for Newfoundland Power and 10% for Island Industrial customers, an increase of 50% of the
 7 proposed increase in the base rates for Government diesel customers, and specific rate adjustments
 8 and transfers for the Industrial Customers' RSP. These interim increases are significant and resulted
 9 in an additional \$26 million in forecast revenue for 2015¹. In this Application Hydro submits that the
 10 implementation of the 2015 interim rates order, on its own, does not provide a reasonable
 11 opportunity for Hydro to earn a fair return in 2015 and that the deferral account is also necessary to
 12 reduce Hydro's forecast net income deficiency.

13
 14 The Board's first consideration then is whether a deferral of some or all of the 2015 costs that may
 15 not be recovered in existing interim rates should be allowed. The Board notes that the reason put
 16 forth by Hydro for this Application is the delay in the conclusion of the general rate application and
 17 the associated impact on Hydro's forecast 2015 net income. However, as set out in Order No. P.U.
 18 58(2014), the protracted timeline associated with the general rate application is primarily due to
 19 Hydro's own decisions and actions. The Board also agrees with Newfoundland Power that the
 20 evidence does not demonstrate that approval is required to maintain Hydro's financial integrity. The
 21 evidence shows that Hydro's returns over the 2007 to 2013 period were low but there is no evidence
 22 that these returns impaired its creditworthiness or financial integrity in any way. It appears that the
 23 guarantee provided by Government supports Hydro's financial position even where Hydro
 24 experienced low returns, and that there is no near-term financial urgency from a creditworthiness
 25 perspective associated with the Application. Hydro has also not argued that the continued safe and
 26 reliable operation of the utility is contingent on approval of the Application.

27
 28 Nevertheless the Board accepts that the evidence in the general rate application, including extensive
 29 written and oral testimony from Hydro's operational and financial management, demonstrates that
 30 there has been an increase in costs to provide service since 2007 when base rates were last
 31 established. Hydro initially filed the general rate application in 2013 seeking approval of an
 32 increased revenue requirement reflective of these cost increases. While the Board believes that Hydro
 33 failed to pursue the general rate application with due dispatch, the general rate application is before
 34 the Board and the evidence does support an increase in the revenue requirement. Given that the
 35 general rate application is nearly concluded and the evidence establishes that there has been an
 36 increase in costs, the Board accepts that approval of a cost deferral in 2015 is appropriate in the
 37 circumstances to offset the impact of the cost of providing service in 2015, even with the interim rate
 38 relief approved as of July 1, 2015.

39
 40 Having established that a cost deferral for 2015 is appropriate the Board must now turn its mind to
 41 the amount of the deferral that should be approved in this circumstance. Hydro explains that the
 42 proposed \$60.5 million reflects the cost recovery that would have been provided had the Board
 43 approved the 2015 test year forecast costs, in addition to the cost deferrals proposed in the general
 44 rate application, effective January 1, 2015. The Board notes Hydro's position that approval of a
 45 recovery less than 100% of this amount would not provide Hydro with the opportunity to earn a
 46 reasonable return on rate base in 2015. However, the determination of what constitutes a reasonable

¹ Schedule 3: Amended 2015 Cost Deferral Application, November 12, 2015, Evidence - page 5, Table 1.

1 return for Hydro in 2015 will be established by the Board in the general rate application. Hydro will
 2 be allowed to recover from customers all necessary and reasonable costs as determined by the Board
 3 for the 2015 test year, including a reasonable return on rate base. This will be done at the conclusion
 4 of the general rate application after the Board has considered the full evidentiary record, including
 5 the submissions from the parties, and issued its final order.

6
 7 The Board notes that both Newfoundland Power and the Consumer Advocate suggest that, if the
 8 Board finds that a 2015 cost deferral should be approved, then \$20 million would be an appropriate
 9 amount to allow on the basis that this is the amount requested in its initial July 2015 cost deferral
 10 application. However, the Board did not make any determination at the time of the July 2015
 11 application as to whether this was an appropriate amount to be deferred for 2015. In the context of
 12 the amended cost deferral application, the Board will look to the evidence before it at this time to
 13 determine the amount, if any, of 2015 costs that will be allowed for deferral.

14
 15 In establishing the amount of any 2015 test year costs to be recovered in the future from customers
 16 the Board must use its best judgment to determine an appropriate deferral amount in advance of its
 17 final determinations on the general rate application. The Board notes that Hydro's forecast net
 18 income deficiency of \$60.5 million requested to be deferred is calculated based on its forecast actual
 19 revenue and expenses for 2015, and a forecast net loss of \$30.8 million. The Board does not accept
 20 this basis for a proposed deferral amount but rather looks to the proposed 2015 test year costs which
 21 are before the Board and being tested as part of the general rate application process. This distinction
 22 between a net income deficiency and a cost deferral was raised by Newfoundland Power in its
 23 submission. The Board agrees with Newfoundland Power that to do otherwise is not consistent with
 24 the prospective nature of ratemaking and substantially eliminates the risk to Hydro arising from its
 25 management decision making and economic uncertainty. The Board's role is to provide, through the
 26 setting of rates based on tested forecast costs, the opportunity for a utility to earn an appropriate
 27 return. Hydro's actual net income in any given year will depend on how it manages the operations of
 28 the utility during that year.

29
 30 With regard to the 2015 test year costs the Board notes that, in its 2015 Interim Rates Application,
 31 Hydro updated its 2015 revenue requirement to reflect a lower fuel forecast as it was considered to
 32 be material. This adjustment reduced the 2015 revenue requirement by approximately \$73 million.
 33 Hydro provides its restated 2015 revenue requirement with the re-forecasted No. 6 fuel cost to be
 34 \$583.9 million.² Under existing interim rates Hydro forecasts its 2015 total revenue from energy
 35 sales at \$546.3 million.³ The Board also notes that Hydro further adjusted its 2015 test year revenue
 36 requirement downward by \$5.0 million to account for impact on the 2015 average rate base of 2014
 37 forecast asset additions that were not in service for 2014.⁴ With no other adjustments for 2015 and
 38 assuming the Board approves the 2015 test year costs as proposed with the re-forecasted fuel costs,
 39 the Board estimates the 2015 revenue shortfall to be \$32.6 million.

40
 41 The Board notes that regulatory precedent in relation to interim rate applications generally provides
 42 for less than 100% recovery of the proposed revenue shortfall. Utilities are frequently granted
 43 between 50% and 70% of such a shortfall. The Board also notes that several expense categories

² TIR-CA-NLH-002.

³ Evidence to Revised Compliance Application, Appendix 1, page 1. This total revenue includes \$26 million additional 2015 revenue from the interim rate increases approved for July 1, 2015 in Order No. P.U. 14(2015).

⁴ The calculation of this amount is set out in TIR-NP-NLH-011.

1 included in the 2015 test year costs and certain test year assumptions were the subject of significant
2 cross-examination of Hydro's witnesses by the intervenors and Board counsel during the hearing,
3 and that final submissions on the proposed 2015 test year revenue requirement are still pending. The
4 Board's findings with respect to the prudence review may also affect the 2015 allowed expenses.
5 During the general rate application proceeding a number of questions were also raised in relation to
6 Hydro's proposed supply cost deferral accounts, particularly with respect to the shifting of risks from
7 Hydro to consumers, the interaction with the RSP, and the impacts on Hydro's incentive to operate
8 efficiently. Any decisions of the Board with respect these contentious items or other disallowances
9 may also reduce the allowed 2015 revenue requirement.

10
11 The Board also shares the concern expressed by several parties in relation to the impact on customers
12 of the deferral of \$55.9 million from 2014 already approved and the \$60.5 million now proposed to
13 be deferred for 2015. Approval of the 2015 deferral as proposed by Hydro would result in
14 approximately \$116 million to be recovered from customers starting in 2016. Hydro did not provide
15 evidence of the potential impact on customers of the approval of such large deferrals or how Hydro
16 will address recovery of the deferred amounts. The Board is also concerned about the possible
17 financial impact on Hydro if a material portion of the deferred amounts is not allowed and Hydro has
18 to record these expenses in 2016. The Board must take these factors into account when determining
19 the amount of any 2015 cost deferral.

20
21 In the absence of a final determination by the Board of the allowed revenue requirement for 2015 and
22 considering the need to balance Hydro's financial integrity with the impact on future customers of
23 significant cost deferrals, the Board is satisfied that Hydro should be allowed to defer 60% of the
24 estimated \$32.6 million test year revenue shortfall for 2015, or an amount of \$19.6 million. As
25 indicated by the Board in Order No. P.U. 58(2014) with respect to the 2014 revenue deficiency
26 deferral, there is no certainty at this time of recovery of all or part of this deferral as a final
27 determination on allowed costs for both 2014 and 2015 has not been made by the Board.

28
29 The Board is not satisfied that it is appropriate at this stage of the proceeding to approve the
30 proposed deferral of amounts in relation to the 2015 supply costs. The proposed amount associated
31 with this deferral is given by Hydro to be \$12.7 million, which reflects the supply costs that Hydro
32 would recover if its general rate application proposals for the three deferral accounts: i) isolated
33 systems supply cost variance; ii) the energy supply cost variance; and, iii) the Holyrood conversion
34 factor, are approved. The Board views these proposed accounts as a significant change in approach
35 and the proposals are contentious.

36
37 With respect to Hydro's request to record an additional \$7.6 million in RSP interest expense in a
38 deferral account for 2015 the Board is satisfied that this proposal should be approved. The 2015
39 increase in RSP interest expense of \$7.6 million is the result of the use of 2007 test year RSP inputs
40 rather than the 2015 test year RSP inputs. The Board agrees that this amount is material and that it
41 would not have been captured in the 2015 test year under the normal operation of the RSP had a final
42 order on the general rate application been issued before the end of 2015. When the Board's final
43 order is issued the RSP balances for 2015 will be recalculated based on the approved RSP inputs
44 from the 2015 test year cost of service. This will result in a reversal of the increased 2015 interest
45 expense to provide an interest expense savings in 2016.

46
47 The Application also requests interim approval of the Settlement Agreement, dated August 14, 2015,
48 which sets out the deferral of \$2.2 million in relation to employee future benefits, asset retirement

obligations, and conservation and demand management costs. The Settlement Agreement addresses a number of issues and the Board is concerned that the impact of the interim approval of the agreement in its entirety is not clear. Based on the Settlement Agreement the Board will, however, accept the proposals and associated 2015 financial impact related to the accounting treatment of employee future benefits, asset retirement obligations, and conservation and demand management costs⁵. Hydro identifies the total 2015 deferral associated with these proposals to be \$2.2 million⁶ and this amount will be allowed. The Board does not believe it is appropriate or necessary to approve the Settlement Agreement on an interim basis at this time.

The Board notes that the Application also requests approval to defer Hydro's 2015 general rate application costs, which are forecast to be \$1.2 million. Hydro states that deferral of the general rate application costs would permit more accurate financial reporting in 2015 and 2016. The Board notes that, in the Settlement Agreement, the parties have agreed that costs related to the general rate application be recovered in customer rates over a three-year period, commencing with the date that new rates become effective, with the amount of such costs to be determined by the Board. Vale questions whether all of the \$1.2 million associated with general rate application costs should be recoverable from ratepayers as the length and complexity of the general rate application was contributed to by Hydro's choice to not file an application for seven years and to amend the general rate application on the eve of the hearing scheduled in July of 2014. The Board agrees that there may be a question whether all of the 2015 general rate application costs should be recovered by Hydro. Given that the 2015 general rate application costs may be contentious and that a final determination on the total costs to be recovered in customer rates will be subject to final determination by the Board, the Board is satisfied that an amount of \$800,000 for Hydro's 2015 general rate application costs is a reasonable amount to include as part of a 2015 deferral.

Conclusion

The Board accepts that \$19.6 million is, in the circumstances, a reasonable amount to defer in 2015 in relation to the delay in the implementation of rates. In addition to this amount the Board will approve the deferral of \$2.2 million in relation to accounting treatment of employee future benefits, asset retirement obligations, and 2015 conservation and demand management costs, as set out in the Settlement Agreement. The Board will also approve the deferral of \$7.6 million in 2015 RSP interest expense. The Board will approve the deferral of \$800,000 related to Hydro's 2015 hearing costs, instead of the \$1.2 million proposed by Hydro. The Board will not approve the inclusion the amount proposed in relation to the supply cost variances of \$12.7 million. The total 2015 deferral to be approved is \$30.2 million. The amortization or recovery of any or all of the deferred amounts will be determined at the conclusion of the general rate application.

Costs

Vale requests an award of costs given that it had a significant interest in the Application and its interests are discreet from the interests of the Industrial Customer Group. Vale further states that the Application was made necessary by the complexity and delays in the general rate application process as a result of the fact that Hydro elected to allow seven years between general rate applications and

⁵ As set out in Items 8, 9 and 17 of the Settlement Agreement dated August 14, 2015.

⁶ Schedule 3, Appendix A, page 1 of 2, lines 33-36.

1 therefore submits that the costs of the Application should be borne by Hydro and should not form a
2 part of Hydro's rate base.

3
4 The Board finds that Vale has a genuine interest in the outcome of the Application and that it
5 participated in an efficient and meaningful manner and contributed to the Board's understanding of
6 the issues. Therefore the Board will make an award of costs to Vale upon the filing of a detailed
7 claim for the consideration of the Board within 30 days of this Order.

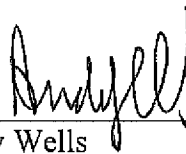
8
9 No other intervenor has filed a claim for costs in this Application. The Board will grant leave for
10 intervenors to apply for an award of costs, setting out a detailed claim for costs, within 30 days of
11 this Order.

12
13 The Board makes no order at this time in relation to the recovery of the amounts of paid by Hydro in
14 relation to the award of costs in this Application or whether the amounts should be included in rate
15 base.

16
17
18 **IT IS THEREFORE ORDERED THAT:**

- 19
20 1. The Board accepts the Settlement Agreement proposals in relation to the 2015 accounting
21 treatment for: i) actuarial gains and losses in Employee Future Benefits; ii) depreciation and
22 accretion expenses associated with Asset Retirement Obligations; and, iii) annual customer
23 energy conservation program costs.
- 24
25 2. The creation of a deferral account in relation to Newfoundland and Labrador Hydro's
26 proposed 2015 revenue requirement, as set out in Schedule A, is approved.
- 27
28 3. That segregation of \$30.2 million, as of December 31, 2015, in the deferral account is
29 approved with a final determination on recovery of this amount to be determined by the
30 Board in a future order.
- 31
32 4. Vale is entitled to an award of costs in an amount to be determined by the Board upon the
33 filing of a detailed cost submission within 30 days of the date of this Order.
- 34
35 5. Leave is granted to the other intervenors to apply for an award of costs, setting out a detailed
36 cost submission, within 30 days of this Order.
- 37
38 6. Newfoundland and Labrador Hydro shall pay the expenses of the Board arising from this
39 Application.

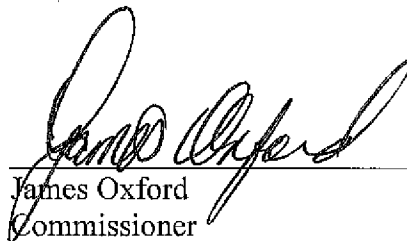
DATED at St. John's, Newfoundland and Labrador, this 22nd day of December 2015.



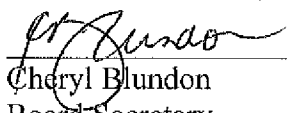
Andy Wells
Chair & Chief Executive Officer



Darlene Whalen, P.Eng.
Vice-Chair



James Oxford
Commissioner



Cheryl Blundon
Board Secretary

2015 Cost Deferral Account

This account shall be charged with the following amounts for 2015:

Revenue Variance	\$19.6 million
RSP Interest Expense	\$ 7.6 million
Settlement Agreement Accounting Proposals	\$ 2.2 million
GRA Cost Deferral	<u>\$ 0.8 million</u>
Total	\$30.2 million