

HAND DELIVERED

November 30, 2015

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 ("Hydro") 2013 General Rate Application –  
Hydro's Amended 2015 Cost Deferral Application dated November 12, 2015 (the  
"Application")**

**A. Introductory**

The Board's e-mail of November 20, 2015 requested submissions on the Application by Monday, November 30, 2015.

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 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. For these reasons, Newfoundland Power submits that the Board should not grant the relief requested in the Application.

The evidence filed in support of the Application indicates Hydro is forecasting a net loss of \$30.8 million in 2015. This evidence may present something of a dilemma to the Board. The Board may conclude that the utility and not its customers should bear the burden of this forecast loss. However, the Board must be mindful of the consequences of its orders on Hydro's creditworthiness. This submission also suggests a potential alternative disposition available to the Board on the Application.

## B. Application Background

### *General*

The Application is the latest in a series of applications made by Hydro seeking interim relief in respect of a general rate proceeding which was originally filed on July 30, 2013 (the “original rate application”). Two of these applications were denied because the relief requested was not consistent with regulatory practice.<sup>1</sup>

On November 28, 2014, Hydro filed an application seeking deferral and recovery of a 2014 forecast net income deficiency of \$45.9 million so that Hydro would have the opportunity to earn a reasonable return for 2014. In Order No. P.U. 58 (2014), the Board, amongst other things, approved Hydro’s segregation of \$45.9 million in a deferral account but did not approve the recovery of this amount either in part or in full.<sup>2</sup> It was clear that a primary influence on the Board’s decision was Hydro’s late filing of the application.<sup>3</sup>

Following receipt of Order No. P.U. 58 (2014), Hydro determined it was reasonable to record the \$45.9 million as a regulatory asset in 2014.<sup>4</sup> Any Board determination in a 2016 final order on the original rate application that part, or all, of the \$45.9 million 2014 forecast net income deficiency should not be recovered from customers will be recognized by Hydro in 2016.<sup>5</sup>

On July 10, 2015, Hydro filed a 2015 Cost Deferral Application seeking recovery of \$20 million to “...reduce Hydro’s forecast 2015 net income deficiency.”<sup>6</sup> Hydro’s forecast 2015 net income deficiency had been reduced by a series of orders which provided Hydro with interim rate relief effective July 1, 2015.<sup>7</sup>

On July 23, 2015, the 2015 Cost Deferral Application was revised to indicate Hydro’s desire to have “The actual 2015 net income deficiency...finalized upon conclusion of the GRA at which time the approved net income deficiency that has resulted from delayed implementation of customer rates for 2015 can be set aside in a deferral account for future recovery.”<sup>8</sup>

On November 12, 2015, Hydro filed the Application which amended the 2015 Cost Deferral Application. The Application sought “...approval of a cost deferral of \$60.5 million to reduce

<sup>1</sup> See Order Nos. P.U. 13 and 39 (2014).

<sup>2</sup> See Order No. P.U. 58 (2014), page 9, lines 28-29.

<sup>3</sup> See Order No. P.U. 58 (2014), page 8, lines 34-40.

<sup>4</sup> See Transcript, November 19, 2015, page 78, line 20 to page 79, line 10.

<sup>5</sup> See Transcript, November 19, 2015, page 42, line 25 to page 45, line 2.

<sup>6</sup> See paragraph 12 of *Hydro’s 2015 Cost Deferral Application*, filed July 10, 2015.

<sup>7</sup> See Order Nos. P.U. 19 and 21 (2015).

<sup>8</sup> See paragraph 15 of *Hydro’s 2015 Cost Deferral Application - Amended*, filed July 23, 2015.





Hydro's forecast 2015 net income deficiency.”<sup>9</sup> This \$60.5 million represents almost 2 times Hydro's 2015 test year forecast net income of \$32.6 million.<sup>10</sup>

It appears possible that, depending upon the terms of the Board's final order on the original rate application, Hydro might file a further cost deferral application for 2016.<sup>11</sup>

Hydro envisages recovering any approved 2014 and 2015 net income deficiencies from customers, including the customers of Newfoundland Power, in the future.<sup>12</sup> Hydro expects to accomplish this by accessing customer credit balances in Hydro's rate stabilization plan or by increasing the rates paid by customers in the province.<sup>13</sup> Hydro has provided no evidence, expert or otherwise, indicating how the recovery of past net income deficiencies in future years, as proposed in the Application, is consistent with generally accepted sound public utility practice.<sup>14</sup>

### ***The Application in Context***

In Order No. P.U. 58 (2014), the Board effectively permitted Hydro to defer a 2014 forecast net income deficiency of \$45.9 million for future consideration. It will be 2016 by the time the Board ultimately determines what part, if any, of this \$45.9 million 2014 forecast net income deficiency will have to be recovered from Hydro's customers, including the customers of Newfoundland Power.

The Application seeks deferral of a 2015 forecast net income deficiency of \$60.5 million for future consideration. This serves to increase the possible liability in 2016 and beyond of Hydro's customers, including the customers of Newfoundland Power, to over \$100 million on account of Hydro's *past* net income deficiencies. Depending upon the amount, if any, the Board determines is recoverable from customers, recovery can be expected to take a significant number of years. Neither the Application nor the evidence filed in support of it addresses the reasonableness of these potential customer consequences.

The Board's decision to grant deferral in Order No. P.U. 58(2014) was influenced by the lateness of Hydro's filing of the 2014 application. The Board also made it clear in the order that (i) the deferral was a departure from regulatory practice, and (ii) a utility bore the risks of its own management decision making.

Hydro filed the Application on November 12, 2015; 10½ months after the Board issued Order No. P.U. 58 (2014). Neither the Application nor the evidence filed in support of it addresses (i)

<sup>9</sup> See paragraph 13 of *Hydro's 2015 Cost Deferral Application - Amended*, filed November 12, 2015.

<sup>10</sup> See Schedule 3, Appendix A, page 1 of 2, *Hydro's 2015 Cost Deferral Application - Amended*, filed November 12, 2015.

<sup>11</sup> See Transcript, November 19, 2015, page 63, line 6 to page 64, line 18.

<sup>12</sup> See Transcript, November 19, 2015, page 45, lines 3-11.

<sup>13</sup> See Transcript, November 19, 2015, page 40, line 2 to page 41, line 6.

<sup>14</sup> Section 4 of the *Electrical Power Control Act*, 1994 requires the Board to apply “...tests which are consistent with generally accepted sound public utility practice” in carrying out its duties under the *Public Utilities Act*.

regulatory practice, vis a vis deferral of *net income deficiencies*, or (ii) the consequences of management decision making which were raised in Order No. P.U. 58 (2014).

These shortcomings in the Application matter. The operation of deferral accounts in public utility regulation to deal with the effects of uncertain or volatile *costs* is well understood.<sup>15</sup> How deferral of a *net income deficiency* would work is by no means clear. A net income deficiency is not a cost. It is the net financial result of a year of utility operation. In particular, it is difficult to understand how deferred recovery of a net income deficiency from a prior year would not be "...a retroactive adjustment of the actions of management."<sup>16</sup>

The proposals contained in the Application, as well as its timing, are the result of Hydro management decisions. There is nothing that either the Board or Hydro's customers could practically have done to ensure more timely consideration of Hydro's 2015 return. For this reason, Hydro, and not Hydro's customers, should bear the consequences of financial management of the utility.

### C. Why the Relief Requested in the Application Should be Denied

#### *The Regulatory Principles*

A utility's entitlement to a reasonable return is found in Section 80 of the *Public Utilities Act*. This entitlement has been considered by the Board on numerous occasions. In Order No. P.U. 39 (2014), the Board observed:

"The Board agrees that Hydro is entitled to earn annually a just and reasonable return on its rate base, as provided for in section 80 of the *Act*, but notes that Hydro is not guaranteed to earn the established return. The rate of return is, where practicable, established by the Board on a prospective basis and Hydro must manage its business, working within the existing regulatory framework, so as to minimize the risks and maximize its opportunity for a just and reasonable return. The Newfoundland and Labrador Court of Appeal addressed this issue in Newfoundland (Board of Commissioners of Public Utilities), Re (1998), 164 Nfld and P.E.I. R.60, stating at paragraph 31:

*[31] This leads to another point. because the setting of the rate of return is based on projections one cannot be sure that the rate of return will be achieved in practice. Although the utility is "entitled" by s. 80 of the Act to have the Board determine a just and reasonable rate of return based on appropriate predictive techniques and methodologies, it is not "entitled", in the sense of being guaranteed, to that rate of return". The utility therefore takes the risk that its chosen management techniques and the future economic climate may not yield its expected success. Although some of the activities of the utility are*

<sup>15</sup> See *Newfoundland and Labrador Hydro vs. Newfoundland and Labrador (Board of Commissioners of Public Utilities)*, 2012 NLCA 38, at paragraph 63.

<sup>16</sup> Re Newfoundland (Board of Commissioners of Public Utilities), 164 Nfld and P.E.I. R.60, paragraph 32.





*regulated within the framework of the statutory objectives, the utility nevertheless remains subject to business risks and effects of management decisions. To that extent, the financial risks associated with the operation of the utility, just as in the case of any private business, are to be born by the investors in the enterprise, not the customer of the service.*

As indicated by the Court of Appeal in paragraph 32 ‘...the powers of the Board must be regulative and corrective, but not managerial, and they do not therefore contemplate a retroactive adjustment of the actions of management.’<sup>17</sup>

The regulatory principle that the effects of management decision making are to be born by the utility and not its customers has been stated repeatedly by the Board in orders on Hydro applications for interim relief, including Order No. P.U. 58 (2014).<sup>18</sup>

#### ***Why the Board Should Deny the Requested Relief***

Hydro’s practice of seeking deferred consideration and future recovery of past net income deficiencies is contrary to both the Board’s and the Court of Appeal’s articulation of a utility’s entitlement under Section 80 of the Act. While timing considerations may have justified the Board’s approval in Order No. P.U. 58 (2014), no such considerations exist with the Application.<sup>19</sup>

Hydro has chosen to file the amended Application to defer consideration and recovery of a 2015 net income deficiency in November 2015. By November, the year is substantially complete. Seeking to establish an appropriate return in such a timeframe is not consistent with having a just and reasonable 2015 rate of return for Hydro determined on predictive techniques and methodologies.

Deferring a net income deficiency for future consideration and recovery substantially eliminates the risk to Hydro arising from its management decision making and economic uncertainty. It appears that Hydro is proposing that it should be permitted deferred recovery of all 2015 test year costs which the Board may ultimately approve, together with an ROE of 8.8%. The deferred recovery is to be considered in a compliance application following the Board’s 2016 order.<sup>20</sup> This effectively amounts to (i) determination of Hydro’s 2015 return in 2016 and (ii) a guarantee of an ROE of 8.8%. Neither of these results is consistent with the prospective nature of ratemaking in this province.

<sup>17</sup> Order No. P.U. 39 (2014), page 9, line 24 to page 10, line 3.

<sup>18</sup> Order No. P.U. 58 (2014), page 9, lines 1-15.

<sup>19</sup> Hydro’s original application seeking recovery of a 2015 forecast revenue deficiency was filed on July 10, 2015. It was 4 months later, during the course of public hearing into the original rate application, that Hydro filed the Application on November 12, 2015.

<sup>20</sup> See Transcript, November 19, 2015, page 40, lines 2-18 and page 60, lines 7-22.

In July 2015, Hydro sought a \$20 million deferral to reduce its forecast 2015 net income deficiency. By the filing of the amended Application 4 months later in November 2015, Hydro's proposed deferral to reduce the forecast 2015 net income deficiency had *tripled* to \$60.5 million.

The dramatic increase in the recovery sought in relation to Hydro's forecast 2015 net income deficiency is the result of Hydro management decisions and/or economic uncertainty.<sup>21</sup> The Application, if approved, will transfer the risks of 2015 management decisions already made and economic uncertainties already encountered from Hydro to its customers.

Because the relief sought in the Application is inconsistent with the utility entitlement to a fair return as provided by Section 80 of the Act (as interpreted by the Court of Appeal and the Board), the relief sought should be denied.

#### **D. Regulatory Policy Analysis of a Possible Alternative**

##### ***The Essential Regulatory Issue***

The Application indicates that Hydro is forecasting a net loss of \$30.8 million for 2015.<sup>22</sup> The essential regulatory issue this forecast raises is whether the utility or its customers should bear the burden of this loss.

In Newfoundland Power's submission, this Application confronts the Board with a dilemma. On the one hand, the Board is practically being asked to use a deferral account to relieve Hydro from the consequences to its bottom line of its own managerial decision making and transfer those consequences to customers. This is a clear departure from regulatory practice relating to a utility's entitlement to a fair return and cost deferrals.<sup>23</sup> On the other hand, the Board must practically be mindful of the consequences of its orders on the financial integrity of Hydro.<sup>24</sup> Long-term utility creditworthiness is in the customers' best interest.

---

<sup>21</sup> The tripling in the size of the relief requested for the forecast 2015 net income deficiency from \$20 million in July 2015 to \$60.5 million in November 2015 is not the only indicator of the impact of Hydro's management decisions and economic uncertainty on the forecast 2015 net income. At page 4 of the response to Request for Information TIR-CA-NLH-001 filed February 9, 2015 in support of Hydro's *Third Interim Rate Application*, Hydro indicated that if rates were not implemented until December 1, 2015, Hydro would have a net income deficiency of approximately \$61 million. Interim rates were approved effective July 1, 2015 and Hydro's forecast 2015 net income deficiency is approximately \$61 million. The response to Request for Information TIR-CA-NLH-001 is provided at pdf page 233/1006 of materials filed in support of the Application.

<sup>22</sup> See Schedule 3, Appendix A, page 1 of 2, *Hydro's 2015 Cost Deferral Application - Amended*, filed November 12, 2015.

<sup>23</sup> In the Application, Hydro seeks deferral of a forecast 2015 *net income deficiency*. A net income deficiency essentially represents the overall net financial result of a year's operations. This is different from a *cost* deferral. In regulatory practice, a cost deferral typically concerns a *specific* cost not contemplated at the time of establishing the utility's rates. In Order No. P.U. 56 (2014), the Board approved deferral of \$9.65 million in additional capacity related supply costs incurred by Hydro in the first quarter of 2014.

<sup>24</sup> The power policy of the province clearly indicates that the maintenance of utilities' creditworthiness is a matter of importance. See, for example, Section 3(a)(iii) of the *Electrical Power Control Act, 1994*.



### ***The Relevant Evidence***

#### ***Regulatory Lag***

Hydro's proposals in the Application appear to be based upon the length of time, or regulatory lag, associated with the original rate application.<sup>25</sup> In Newfoundland Power's submission, this does not justify approval of the relief sought in the Application.

The original rate application was filed 28 months ago on July 30, 2013. A final order on the original rate application, as amended, is not expected until sometime in 2016. This degree of regulatory lag is much longer than typical.<sup>26</sup> However, a substantial contribution to the extended regulatory lag associated with the original rate application is clearly the result of management decisions of Hydro.

Since Hydro's last general rate application, significant restructuring of the management and operations has occurred. The extent and impact of these organizational changes were known to Hydro at the time of filing the original rate application. That the changes would be the subject of regulatory assessment was foreseeable. In fact, review of the consequences of this restructuring on costs and service has contributed significantly to the length and complexity of the original rate application.

The longer regulatory lag associated with the original rate application was also a reflection of Hydro's conduct of the application itself. In June 2014, approximately one month prior to commencement of the scheduled hearing into the original rate application, Hydro gave notice that it intended to amend the application. Five months later, Hydro filed an amended application with significant differences, including substantially increased costs. Review of the many differences in the amended application have also contributed significantly to the length and complexity associated with the original rate application.

#### ***Hydro's Financial Integrity***

In Hydro's 2007 general rate application, the Board effectively allowed a return on equity ("ROE") of 4.47% for ratemaking purposes. From 2007 through 2013, Hydro's earned ROEs ranged from 0.06% to 6.59%.<sup>27</sup> Hydro's ROEs would have been lower in some years had the debt guarantee fee due to the province not been waived or reduced.<sup>28</sup>

---

<sup>25</sup> See Schedule 3, page 4, *Hydro's 2015 Cost Deferral Application - Amended*, filed November 12, 2015. See also Transcript, November 19, 2015, page 34, line 7 to page 36, line 24.

<sup>26</sup> Hydro's longest previous general rate application took approximately 12 months from initial filing to final order. That application was Hydro's first under the *Public Utilities Act* and included numerous revisions and extensive hearings. See Order No. P.U. 7(2002-2003).

<sup>27</sup> *Hydro's 2013 General Rate Application (November 2014 amendment)*, *Company Evidence, Finance*, pages 3.17-3.18.

<sup>28</sup> See the response to Request for Information NP-NLH-307 (Revision 1, Apr 24-15), Attachment 1, page 10 of 11 which indicates no debt guarantee fee was paid by Hydro for the years 2008, 2009 and 2010.

Hydro's actual ROEs since 2007 have not impaired Hydro's creditworthiness or financial integrity in any way. This is because Hydro's creditworthiness and financial integrity is directly dependent upon the creditworthiness of the province which guarantees Hydro's debt.<sup>29</sup>

Hydro's evidence is that there is no near-term financial urgency from a creditworthiness perspective associated with the Board's decision on the Application. The evidence appears to be that, absent regulatory relief, Hydro will simply suffer a financial loss in 2015.<sup>30</sup>

### ***Potential Alternative Relief***

#### ***General***

In Order No. P.U. 58 (2014), the Board found that, absent a review of Hydro's 2014 revenue requirement, there was no reasonable basis upon which to reduce the proposed deferral of a 2014 forecast net income deficiency of \$45.9 million. The Board also found that utilities remain subject to business risks and effects of management decisions.<sup>31</sup>

At least 1 potential alternative to Hydro's proposed deferral of a 2015 forecast net income deficiency of \$60.5 million exists on the current record before the Board. This alternative provides a more balanced regulatory response to the circumstances presented to the Board on the Application than Hydro's proposal. Because this alternative is based upon financial evidence of Hydro, it cannot be considered arbitrary.

#### ***A \$20 Million Deferral***

On July 10, 2015, Hydro filed the original 2015 Cost Deferral Application seeking in the amount of \$20 million. This filing, which exceeded 850 pages in length, can be taken as *Hydro's best estimate* in July 2015 of what was appropriate to address Hydro's forecast 2015 net income deficiency.

If the Board were to choose to permit deferral for future consideration of any amount on account of Hydro's forecast 2015 net income deficiency, deferral in the amount of \$20 million would be superior, from a regulatory policy perspective, to the proposed \$60.5 million. Firstly, deferral of Hydro's July 2015 estimate of its requirements has a greater *prospective* quality than Hydro's November 2015 estimate. This is more consistent with the prospective nature of a utility's entitlement to a reasonable return. Secondly, deferral of Hydro's July 2015 estimate of its requirements exposes Hydro, in a greater degree, to the effects of its own management decision making and economic conditions. This is more consistent with the Board's regulative and corrective, as opposed to managerial, role.

---

<sup>29</sup> See, for example, *Hydro's 2013 General Rate Application (November 2014 amendment)*, *Company Evidence, Finance*, pages 3.35 to 3.36.

<sup>30</sup> See Transcript, November 16, 2015, page 179, line 13 to page 182, line 6 and November 19, 2015, page 48, line 21 to page 56, line 9.

<sup>31</sup> Order No. P.U. 58 (2014), page 8, line 41 to page 9, line 15.





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

Before Hydro could be permitted recovery of any part of the \$20 million, it should be required to satisfy the Board through evidence that recovery is consistent with sound public utility practice.

#### **E. Submission on Disposition**

The Board should deny the relief requested in the Application.

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.

In considering the Application and, in particular, Hydro's failure to address the clear concerns of the Board in Order No. P.U. 58 (2014), the following comments made in the recent decision of the Supreme Court of Canada in *Ontario (Energy Board) v. Ontario Power Generation Inc.* seem apposite:

"I have noted above that it is essential for a utility to earn its cost of capital in the long run. The Board's disallowance may have adversely impacted OPG's ability to earn its cost of capital in the short run. Nevertheless, the disallowance was intended "to send a clear signal that OPG must take responsibility for improving its performance". (Board Decision, at p. 86). Such a signal may, in the short run, provide the necessary impetus for OPG to bring its compensation cost in line with what, in the Board's opinion, consumers should justly expect to pay for an efficiently provided service. Sending such a signal is consistent with the Board's market proxy role and its objectives under s. 1 of the *Ontario Energy Board Act*, 1998."<sup>32</sup>

If the Board feels compelled by the circumstances to grant *any* relief on the Application, a superior alternative to that proposed in the Application can be supported by the record before the Board.

The Board could permit deferral, but not recovery, of \$20 million on account of Hydro's 2015 forecast net income deficiency. This represents Hydro's July 2015 estimate of what was appropriate regulatory relief. Before Hydro could be permitted recovery of any part of the \$20

---

<sup>32</sup> *Ontario (Energy Board) v. Ontario Power Generation Inc.*, 2015 SCC 44, at paragraph 120.

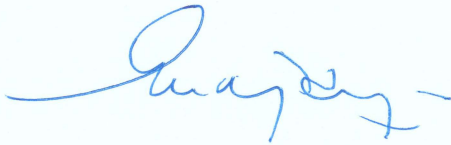
million, it would be required to demonstrate recovery was consistent with sound public utility practice. This alternative is a generous regulatory response to the circumstances.

**F. Concluding**

We trust the foregoing is clear and helpful to the Board.

If you have any questions, please contact the Company.

Yours very truly,



Gerard M. Hayes  
Senior Counsel

c. Geoffrey Young  
Newfoundland and Labrador Hydro

Paul Coxworthy  
Stewart McKelvey

Dennis Browne, QC  
Browne Fitzgerald Morgan & Avis

Senwung Luk  
Olthuis, Kleer, Townshend LLP

Thomas Johnson, QC  
O'Dea Earle Law Offices

Thomas O'Reilly, QC  
Vale Newfoundland and Labrador Limited

Yvonne Jones, MP  
Labrador

Tom Sheldon  
Nunatsiavut Government

