

November 24, 2014

The Board of Commissioners of Public Utilities
Prince Charles Building
120 Torbay Road, P.O. Box 21040
St. John's, Newfoundland & Labrador
A1A 5B2

Attention: Ms. Cheryl Blundon
Director Corporate Services & Board Secretary

Dear Ms. Blundon:

Re: Newfoundland and Labrador Hydro (Hydro) - Application for approval of the deferral and recovery of expenses associated with the increased capacity-related supply costs on the Island Interconnected System in 2014

On October 8, 2014, Hydro filed an Application seeking an Order approving the deferral and recovery of \$9,650,000 in additional 2014 Capacity-Related Supply Costs that were incurred in the first quarter of 2014. Please accept the following submission as Hydro's Reply to the submissions of Newfoundland Power, the Consumer Advocate, and the Industrial Customers with regard to the Application.

1.0 Application Background and RFI Process

In its Application, Hydro identified the material increases in Capacity-Related Supply Costs that were required to deal with capacity constraints on the Island Interconnected System and provide reasonably safe and adequate and just and reasonable service to its customers. The Application noted that the Board's past regulatory treatment of Major Extraordinary Repairs is similar to the current situation, since the additional Capacity-Related Supply Costs incurred were non-capital expenses that were extraordinary in nature and not otherwise identified and included in Hydro's existing rates. Hydro also noted that the unrecovered costs in question greatly exceed the threshold amount of \$500,000, and there would be a significant shock to Hydro's earnings if they were to be recognized in 2014 and not approved for recovery on a deferred basis.

The Consumer Advocate and Newfoundland Power submitted a total of 29 Requests for Information (RFIs) as part of the review process for the Application. Hydro filed its responses to the RFIs on November 12, 2014. These responses provided further detailed information regarding the nature of the capacity constraints that Hydro experienced and the specific times and dates when the costs were incurred. The RFI responses also addressed the regulatory justification that would allow the Board to approve the deferral and recovery of these costs.

2.0 Intervenor Submissions

In their submissions on this matter, neither the Consumer Advocate nor Newfoundland Power take issue with the fact that Hydro incurred \$9,650,000 in additional Capacity-Related Supply Costs in the first quarter of 2014 that were not otherwise provided for in Hydro's existing rates. The intervenors have also not challenged the Board's jurisdiction and authority to grant the Order that Hydro has requested.

The main issue raised by both the Consumer Advocate and Newfoundland Power in their submissions appears to be one of timing. The Consumer Advocate takes issue with Hydro's claim that all the Capacity-Related Supply Costs were prudently incurred, and submits that this determination cannot be made prior to the issuance of the Board's Final report on its Investigation and Hearing into Supply Issues and Power Outages on the Island Interconnected System (the Investigation). Similarly, Newfoundland Power submits that the circumstances which gave rise to Hydro's need to incur the additional Capacity-Related Supply Costs are relevant to the question of whether the additional capacity costs were extraordinary and unexpected, and notes that the Investigation into these issues is not complete.

The Consumer Advocate recommends that the Board deny the Application pending the outcome of the Investigation, while Newfoundland Power submits that the deferred recovery as proposed should be denied because the evidence does not prove that deferred recovery is "...appropriate and necessary in the circumstances."

In their submission, the Industrial Customers state that they do not have any comment on the Application.

3.0 Hydro's Position

As Hydro noted in response to NP-NLH-001, Hydro submits that the Application (and its subsequent RFI responses) provide the Board with the relevant information regarding the unanticipated Capacity-Related Supply Costs that Hydro prudently incurred which the Board requires to make its determination in this matter. From a timing perspective, it is critical for Hydro to have a determination from the Board on this matter prior to year-end so that these costs can be removed from Hydro's 2014 expenses and be placed on Hydro's balance sheet as a deferred asset.

At the same time, Hydro acknowledges that the Investigation into the events that occurred in the first quarter of 2014 is ongoing, and that Phase 1 of the Investigation is now expected to conclude in the first quarter of 2015. In light of the submissions of the Consumer Advocate and Newfoundland Power, Hydro submits that it would be appropriate for the Board to approve the creation of a deferral account in the amount of \$9,650,000 prior to the end of 2014, and set aside the issue of recovery of this amount from ratepayers until Phase 1 of the Investigation is complete. This approach would provide Hydro with confirmation regarding the approved deferral of the additional

Capacity-Related Supply Costs prior to year-end, but would also allow the Board to make its decision regarding the recovery of these costs after the completion of the ongoing Investigation related to the circumstances in which the costs were incurred. This approach would also be consistent with the Board's Order No. P.U. 29(2014) relating to Hydro's 2014 Capital Budget Supplemental Application – Sunnyside Replacement Equipment and Order No. P.U. 32(2014) relating to Hydro's 2014 Capital Budget Supplemental Application – Western Avalon Terminal Station Transformer T5 tap changer.

With respect to the Investigation itself, Hydro would like to take the opportunity provided by this Reply to respond to some of the comments raised by Newfoundland Power regarding the Board's findings in its Interim Report. Hydro states in its Application (and continues to submit) that the additional Capacity-Related Supply Costs were extraordinary and unexpected and prudently incurred. Newfoundland Power claims in its submission that this seems inconsistent with the findings to date of the Board in the Investigation. Hydro does not agree.

Neither Liberty's Interim Report (dated April 24, 2014) nor the Board's Interim Report (dated May 15, 2014) specifically concluded that Hydro's actions during the first quarter of 2014 were imprudent. Hydro recognizes that Liberty and the Board have raised certain items regarding Hydro's asset management decisions leading into the first quarter of 2014, and Hydro has been working diligently to actively address any issues raised on a go-forward basis. However, as Hydro noted in response to NP-NLH-016, and as the Board found in its Interim Report, at page (ii), it is not possible to determine whether the failures or outages of his past winter could have been avoided had different decisions been made by Hydro. Hydro agrees that **with the benefit of hindsight**, it is possible to identify mitigation actions that **may** have avoided **some** of the costs, **if approved by the Board in advance and in place at the time**. However, as Hydro noted in response to NP-NLH-002, based on past experience and the knowledge of the equipment entering into the winter of 2013/2014, Hydro could not have been reasonably expected to have all the mitigating measures in place to prevent the generation shortfalls that were experienced.

Hydro believes the Investigation has served a useful purpose in identifying causes of the capacity constraints that were incurred and mitigation measures which should be put in place going forward, and looks forward to continuing to work with all stakeholders as part of that process.

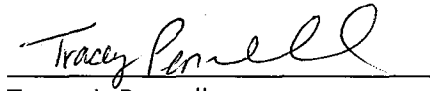
4.0 Relief Sought

In summary, Hydro requests that the Board recognize the additional Capacity-Related Supply Costs of \$9,650,000 as an extraordinary expense, and approve the creation of a deferral account for costs in that amount prior to the end of 2014. Hydro further requests that the Board set aside the issue of cost recovery and order that it be addressed in a subsequent process following the conclusion of Phase I of the Investigation.

Please contact the undersigned should you have any questions.

All of which is respectfully submitted.

NEWFOUNDLAND AND LABRADOR HYDRO



Tracey L. Pennell
Legal Counsel

cc: Gerard Hayes – Newfoundland Power
Paul Coxworthy – Stewart McKelvey Stirling Scales
Sheryl Nisenbaum – Praxair Canada Inc.

Thomas Johnson – Consumer Advocate
Tom O'Reilly, QC – Cox & Palmer