

HAND DELIVERED

November 18, 2014

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 - 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 (the "Application")

A. The Application

On October 8th, 2014, Newfoundland and Labrador Hydro ("Hydro") filed the Application for approval of the deferral and recovery of expenses associated with the increased capacity-related supply costs on the Island Interconnected system in the first quarter of 2014 (the "additional capacity costs").

The Application seeks an order of the Board approving the deferral and recovery of \$9,650,000 in additional capacity costs incurred by Hydro. It is Hydro's evidence that the \$9,650,000 in additional capacity costs were incurred "to minimize the impact of system capacity constraints in the first quarter of 2014 on service to customers." The Application asserts that such costs were "prudently incurred" and "extraordinary and unexpected". Should the Board approve the Application, the majority of the additional capacity costs will be borne by Newfoundland Power's customers.

During 2014, the Board has been conducting an investigation into supply issues and power outages on the Island Interconnected System (the "Investigation"). The focus of the Investigation is the circumstances which gave rise to Hydro's need to incur the additional capacity costs.

This letter provides Newfoundland Power's submission on the Application.



B. Regulatory Practice

The Board has in the past approved deferred recovery by Hydro of expenses related to major extraordinary repairs where they meet the minimum threshold of \$500,000 and would cause a rate shock or a shock in Hydro's earnings that is considered unreasonably high. The Board most recently considered the principles upon which it would approve such recovery in Order No. P.U. 4 (2014).

In Order No. P.U. 4 (2014), the Board considered a Hydro application for approval to treat 2013 costs associated with repairs to the fuel oil system at Holyrood as an extraordinary expense. The Board was satisfied that the \$1.06 million cost was non-capital in nature and was an unplanned operating expense. Nevertheless, the Board denied the Application. In its order, the Board found:

Allowing for the recovery of unanticipated expenses outside of a test year is an extraordinary measure that the Board will order only when it is satisfied that it is *appropriate and necessary in the circumstances.*¹ (Emphasis added)

C. Board Findings in the Investigation

Hydro asserts in the Application that the identified additional capacity costs were extraordinary and unexpected and were prudently incurred. This seems inconsistent with the findings to date of the Board in the Investigation.

In the Board's Interim Report in the Investigation (the "Interim Report"), the Board concluded that the following caused or contributed to the January system events which gave rise to the additional capacity costs:

- *Hydro's deferral of scheduled preventive maintenance and testing of key transmission system equipment, including the 2013 scheduled and recommended testing and maintenance on the transformer and circuit breaker at Sunnyside, which failed.*
- *Hydro's failure to properly execute repairs and maintenance.*
- *Hydro's failure to ensure the availability of qualified resources and vendor support.*
- *Hydro's failure to procure critical spare parts for its generation assets.*
- *Hydro's decisions on timing of generation asset repairs, notably the Hardwoods and Stephenville gas turbines.*²

In its response to Request for Information NP-NLH-016, Hydro indicates that it is speculative to question the impact each of these causes identified by the Board had on the need to incur the additional capacity costs. Hydro states that such a question presupposes that certain actions taken by Hydro could have prevented the outages.

¹ See Order No. P.U. 4 (2014), page 5.

² See page i of the Board's Interim Report, *Investigation and Hearing into Supply Issues and Power Outages on the Island Interconnected System*, May 14th, 2014.

Hydro's responses to the various Requests for Information on the Application appear to imply that the electrical system conditions which gave rise to the additional capacity costs could not reasonably have been avoided.³ This is not consistent with a number of the Board's findings in the Interim Report. For example, the Board determined that, if certain preventive maintenance and testing deferred by Hydro "had been carried out as planned and recommended, the system [disturbances] and subsequent outages may have been avoided." In addition, the Board indicated it was satisfied that "Hydro's asset management decisions contributed to the nature, extent and duration of the outages."⁴ The Board concluded in the Interim Report that "these events are not outside the range of outcomes for which a utility should plan".⁵

D. Newfoundland Power's Submission

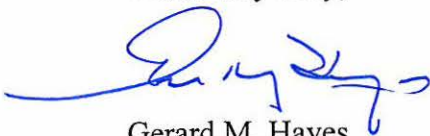
The Interim Report contains conclusions and observations already made by the Board about the circumstances which gave rise to Hydro's need to incur the additional capacity costs. These circumstances, including the relationship of acts and omissions of Hydro to the events of January – March, 2014, are relevant to the question of whether the additional capacity costs were extraordinary and unexpected.

But, the Investigation is not complete. This fact was recognized by the Board in Order No. P.U. 29 (2014) which dealt with Hydro's application for approval of supplementary capital expenditures associated with the Sunnyside substation. In that Order, the Board approved the proposed capital expenditures but chose to defer determination of how the expenditures would be treated from a regulatory perspective because the Investigation was not complete.

The evidence in support of the Application simply proves Hydro incurred the additional capacity costs and that these costs contribute to Hydro's forecast failure to earn a just and reasonable return in 2014. The evidence does not prove that deferred recovery of the additional capacity costs are "...appropriate and necessary in the circumstances." as required by current regulatory practice. For this reason, the deferred recovery as proposed in the Application should be denied.

Newfoundland Power submits that Hydro has not established on the record of the Application, that the circumstances surrounding its incurring the additional capacity costs are such as to justify the relief requested.

Yours very truly,



Gerard M. Hayes
Senior Counsel

³ See also the responses to Requests for Information NP-NLH-017 and 018.

⁴ See the Interim Report, page 26, lines 23 – 30.

⁵ See the Interim Report, page 25, lines 37 – 39.



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