NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

AN ORDER OF THE BOARD

NO. P.U. 14(2017)

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, as amended (the "*Act*"), and regulations thereunder; and

IN THE MATTER OF a general rate application filed by Newfoundland and Labrador Hydro on July 30, 2013; 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 Order No. P.U. 49(2016); and

IN THE MATTER OF an application filed by Newfoundland and Labrador Hydro on January 27, 2017 with revised proposals related to the general rate application to reflect Order No. P.U. 49(2016).

The Application

On January 27, 2017 Hydro filed an application requesting approval of new rates and other proposals based on the findings and determinations of the Board in Order No. P.U. 49(2016) arising from Hydro's most recent general rate application (the "Compliance Application").

The Compliance Application was circulated to: Newfoundland Power Inc. ("Newfoundland Power"); the Consumer Advocate, Dennis Browne, Q.C.; a group of Island Industrial customers: Corner Brook Pulp and Paper Limited ("CBPPL") and NARL Refining Limited Partnership ("NARL") (the "Industrial Customer Group"); Teck Resources Limited; 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.

The Board engaged its financial consultant, Grant Thornton, to review the Compliance Application. On March 15, 2017 Grant Thornton filed a report, *Board of Commissioners of Public Utilities Financial Consultants Report Newfoundland and Labrador Hydro Compliance Application* (the "Grant Thornton Report").

Requests for information related to the Compliance Application and the Grant Thornton Report were filed and answered by March 30, 2017. Submissions were filed with the Board on or before April 17, 2017.

Grant Thornton Report

The scope of Grant Thornton's review included the 2013 average rate base, the 2014, 2015, 2016 and 2017 revenue deficiencies and proposed recovery, the 2015 test year revenue requirement, average rate base and rate of return on rate base for rate setting, the RSP, the proposed deferral accounts and the excess earnings definition. Grant Thornton verified Hydro's proposed Schedule of Rates, Rules and Regulations incorporated the changes approved in Order No. P.U. 49(2016) as well as the calculation of the proposed rates in relation to the forecast revenue requirement. The Grant Thornton Report identified several issues for the consideration of the Board:

- Labrador Interconnected system customers were excluded from the revenue deficiency allocations.
- A discrepancy on the return on rate base included in the cost of service study results in an estimated $60,000 increase in Newfoundland Power's revenue requirement and a corresponding decrease in Labrador Interconnected revenue requirement.
- The 2017 revenue deficiency was calculated with incorrect compliance base rates resulting in an overstatement of $465,000 for Newfoundland Power and $36,000 for Industrial customers.
- The 2014 revenue deficiency calculation was not updated to reflect actual 2014 No. 6 fuel costs.
- The Rural Rate Alteration credits in the RSP were discontinued upon the implementation of new interim base rates on July 1, 2015.
- The 2015 test year No. 6 fuel price of $64.41 was not used when recalculating the RSP for 2015 and 2016.
- The 2017 RSP Fuel Rider was calculated using the September 2015 rather than September 2016 Cdn$/US$ Noon Exchange rate.
- The RSP Recovery Adjustment Rate was based on the Industrial Customer RSP current year balance as of December 31, 2016 with an April 1, 2017 effective date.
- The Industrial Customer RSP Surplus balance is depleted by the RSP Surplus adjustments and, as of March 31, 2017, the balance is estimated to be approximately $500,000 owing to Hydro.
- Changes to the language of two deferral accounts – the Isolated Systems Supply Cost Variance and the Energy Supply Cost Variance.
- The impact of a July 1, 2017 rate implementation date rather than April 1, 2017.

Intervenor Submissions

On April 7, 2017 Newfoundland Power filed submissions in relation to the Compliance Application arguing that costs were included which do not reflect Order No. P.U. 49(2016). These costs include: i) depreciation costs associated with $146 million in disallowed capital expenditures, ii) inclusion of the 2014 revenue deficiency in rate base for rate setting purposes, and iii) an error which inaccurately increases costs allocated for recovery from its customers. Newfoundland Power also commented on issues related to the proposed change in the date for implementation of rates from April 1, 2017 to July 1, 2017, including the 2017 revenue deficiency calculations and the 2017 RSP operation.

Hydro's Industrial customers filed several submissions on April 10, 2017. A submission was filed on behalf of the Industrial Customer Group and individual submissions were filed by CBPPL, NARL and Vale in relation to the revenue deficiencies and the collection of specifically assigned charges. The Industrial Customer Group's submission addressed:

- the inclusion of the 2014 deficiency in 2014 rate base
- the 2014 deficiency balance to be used in calculating the rate base for 2015 and beyond
- an error related to the calculation of the 2017 revenue deficiency
- the Cdn$/US$ exchange rate to be used in calculating the go-forward RSP fuel rider
- 2016 regulatory costs to be included in rates

In addition the Industrial Customer Group confirmed that a claim for costs will be filed in relation to the general rate application including both the original application, the amended application, the Prudence Review and the Compliance Application.

In individual submissions CBPPL and NARL took opposing positions in relation to Hydro's proposal to recover the revenue deficiencies for the period 2014 to 2017 by a transfer from the Industrial Customer segregated load variation of the RSP. CBPPL stated that Hydro's proposal is reasonable and meets the standard for acceptance by this Board and should be accepted. CBPPL submitted that it is not in favor of further delays as finality is required at this time. NARL submitted that Hydro's proposal has widely disparate impacts among the Industrial Customers and would result in rates and rate impacts that are not just and reasonable and would be unjustly discriminatory as between the industrial customers. Vale's submission supported the Industrial Customer Group's submission as well as CBPPL's position with respect to the recovery of revenue deficiencies. Vale submitted that Hydro's proposal provides rate certainty that the recovery of the deficiencies from a balance available in the RSP is equitable and is consistent with Hydro's evidence and past practice of collecting past balances on a class, as opposed to individual customer, basis.

The Consumer Advocate filed a submission on April 10, 2017 supporting Newfoundland Power's position that final rates arising out of the general rate application will require a revised compliance application reflecting a July 1, 2017 implementation date. The Consumer Advocate submitted that, prior to implementing rates on July 1, 2017, the Board must be satisfied that the evidence presented will ensure the lowest possible cost for power being delivered to consumers.

The Consumer Advocate filed a second submission on April 12, 2017 related to the RSP. The Consumer Advocate submitted that the RSP should be reexamined and reset to focus on its original purpose to assist domestic ratepayers. According to the Consumer Advocate ratepayers are not informed of potential RSP impacts in a timely manner and are therefore deprived of an opportunity to adjust consumption accordingly. The Consumer Advocate commented that there are jurisdictions with adjustments on a quarterly basis which would provide an opportunity for consumers to adjust consumption, and that consumers should be empowered to manage their own consumption. In the Consumer Advocate's view adjustments should now be made quarterly and not annually. The Consumer Advocate argued that it is unacceptable that domestic ratepayers are burdened with the cost of disputes among other ratepayers and Nalcor relating to the RSP.

Hydro's Reply Submission

Hydro filed a reply submission on April 13, 2017 addressing the issues raised by Grant Thornton and the Intervenors. Hydro agreed to revise its proposals to reflect:

- the correction of the discrepancy in the rate base used in the 2014 cost of service study
- the correction of the error with respect to incorrect compliance base rates in the calculation of the 2017 revenue deficiency
- a July 1 rate implementation date rather than April 1, 2017
- a fuel rider calculated using a fuel forecast that reflects the more current Cdn$/US$ Noon Exchange rate
- minor amendments in relation to the Isolated Systems Supply Cost Variance Deferral Account and the Energy Supply Cost Variance Deferral Account

Hydro did not agree with Newfoundland Power's submissions on overstated depreciation expense in the 2014 revenue deficiency or on the inclusion of the 2014 revenue deficiency in the calculation of test year rates.

With respect to the submissions of the Industrial Customer Group and Vale, Hydro stated that it did not agree that the inclusion of the 2014 revenue deficiency in rate base inappropriately seeks to charge interest on the deficiency in 2014. With respect to the individual submissions of NARL, CBPPL and Vale on the recovery of revenue deficiencies from the load variation component of the RSP allocated to the Industrial customer class, Hydro submitted that NARL is effectively proposing an individual customer cost of service approach to determine the allocation of revenue deficiency, which it does not support. Hydro agreed with the submission of CBPPL that the RSP credit balance reflects a collective benefit to the Industrial customer class and not an entitlement of any given customer.

Hydro submitted that the issues raised by the Consumer Advocate in his second submission are not relevant to the proceeding currently before the Board.

Follow-up Submissions

On April 17, 2017 NARL filed a further submission in reply to Hydro's reply submission. NARL submitted that specifically assigned charges are not treated as a class cost of service but energy sales are. NARL stated that the treatment and impact of energy sales within the RSP are disaggregated from each industrial customer's payment of specifically assigned charges. NARL asked that the impact of what is being proposed by Hydro be transparently identified and analyzed by Hydro so it can be determined whether the approach is fair and reasonable and non-discriminatory. NARL submitted that increased and decreased usage is accounted for by the normal operation of the RSP when it comes to load and fuel price variations, which are treated as class-wide impacts, but this is not the approach taken in the RSP with respect to specifically assigned charges. NARL submitted that it would be unprecedented to use the RSP credit balance without the agreement of all of the current Industrial customers.

Hydro filed a response to NARL's reply on April 17, 2017. Hydro submitted that its proposal to use the RSP credit balance to offset the revenue deficiency owing by Industrial customers, on a class basis, is reasonable and is consistent with the historical treatment of the RSP balance as being a class balance. Hydro noted that from 2007 to 2014 more than 90% of the industrial customer load reduction relative to the 2007 test year can be attributed to load requirements of the pulp and paper industry, and more than 90% of the load reduction for 2015 and 2016 is a result of a slower ramp up of operations by Vale than was contemplated in the 2015 test year. In Hydro's opinion NARL is suggesting that the revenue deficiency arising from interim rates should be calculated on an individual customer basis while the RSP funds used to offset this same deficiency should remain at the class level. Hydro submitted that this approach is inconsistent with maintaining the RSP credit balance as a "class-wide benefit."

Matters Arising and Follow-up Correspondence

In the course of considering Hydro's Compliance Application a number of issues were raised with respect to the RSP operation for both the Industrial Customers and Newfoundland Power which resulted in additional correspondence to Hydro and Intervenor comment.

i) Industrial Customer RSP

In its review of the individual submissions the Board noted NARL's concerns with Hydro's proposal to offset the revenue deficiency with a transfer from RSP credit balances. In particular NARL submitted that the impact of specifically assigned charges in relation to the revenue deficiency and Hydro's approach for its recovery is not transparent and clear and that the Board should establish a process to allow for due consideration and consultation to determine whether a consensus can be achieved on the manner of application of RSP credit balances allocated to Industrial customers in relation to the revenue deficiency.

Order No. P.U. 49(2016) also approved changes to the RSP Rules related to the suspension of the Industrial Customer RSP Adjustment Rate on April 1, 2017, which Hydro determined requires an Industrial Customer RSP adjustment be applied as of April 1, 2017 to provide for disposition of the current year balance as of December 31, 2016 . Grant Thornton noted that there were other options that could be considered. In addition Grant Thornton noted that treatment of the Industrial Customer RSP Surplus balance in the finalization of Industrial customer rates is an issue that requires consideration by the Board.

On April 21, 2017 the Board advised Hydro that it had determined that NARL had identified issues which should be addressed before Hydro's proposal could be considered and issued a further request for information. The Board advised that the Industrial Customer RSP issues would be addressed together, in a separate order of the Board.

ii) RSP Fuel Price Projection

As required by the RSP Rules on April 12, 2017 Hydro filed its RSP fuel price projection for the period July 2017 to June 2018 and the corresponding estimated fuel riders to be implemented as of July 1, 2017, concurrent with the implementation of new base rates arising from the Compliance Application. Hydro explained that the new fuel riders, based on the March 2017 fuel price forecast, would replace the fuel riders filed in the Compliance Application, which were based on the September 2016 fuel price forecast.[1]

On April 18, 2017 Hydro filed an updated RSP fuel price projection and set out the estimated fuel riders for Newfoundland Power and Industrial customers as of July 1, 2017 of 0.672¢/kWh and 0.625¢/kWh respectively. The revised fuel riders are calculated using the most recent $Cdn/$US exchange rate (March 2017), as suggested by Grant Thornton and accepted by Hydro. Hydro advised that, based on the updated fuel price forecast and exchange rate, the forecast average No. 6 fuel price for the period July 2017 to June 2018 is $81.40 per barrel ($Cdn) compared to the 2015 test year forecast of $64.41 ($Cdn) accepted by the Board in Order No. P.U. 49(2016).

In light of the significant increase in the updated estimated fuel riders, on April 19, 2017 the Board requested Hydro to provide the current expected percentage rate impacts for both Newfoundland Power and Industrial customers as a result of the Compliance Application and the updated fuel price projection update. In response to the Board's request Hydro provided the estimated impact on customer rates for July 1, 2017 as a result of the Compliance Application and the updated fuel price projection, as well as the resetting of the Current Plan RSP Recovery Rate Adjustments for the Utility rate to Newfoundland Power and the discontinuance of the RSP Surplus adjustments for Industrial customers.[2] Hydro estimated that, as a result of these RSP adjustments and the base rate increases arising from the Compliance Application, the Utility rate to Newfoundland Power is forecast to increase by 27.6% on July 1, 2017, with an estimated increase in retail customer rates of 18.6%. The average rate impact for Industrial customers is forecast to be 16.6%, with impacts for individual customers ranging from 12.2% to 38.0%.

On April 25, 2017 Newfoundland Power and the Industrial Customer Group filed comments on Hydro's RSP forecast. Newfoundland Power noted the forecast rate increase for its customers as a result of the operation of the RSP for July 1, 2017 and suggested that the segregated load variation balance in the RSP of approximately $48.9 million owing to Newfoundland Power customers be used to offset part of this increase. Newfoundland Power stated that this is a reasonable approach in these extraordinary circumstances and would be consistent with the underlying purpose of the RSP, which is to smooth fluctuations in Hydro's cost of supply.

The Industrial Customer Group expressed concern that the Compliance Application adjustments and the RSP adjustments do not yet fully represent the full scope of related rate impacts and liabilities to which customers are exposed. They noted the outstanding disposition of the deferral

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[1] Compliance Application, Exhibit 4, Appendix A.
[2] Section D of the RSP Rules requires Hydro to calculate a new Current Plan Balance commencing July 1 of each year.

accounts approved by the Board in Order No. P.U. 49(2016), the unused deferred RSP load variation amounts related to the Industrial customers, and the balance in the hydraulic portion of the RSP that has been previously proposed for assistance in rate transitions. The Industrial Customer Group requested that Hydro update these deferred balances and associated class liabilities and potential offsets, and that a schedule be established for Hydro's filings of the applications necessary to address these matters.

Hydro filed a reply to the comments of Newfoundland Power and the Industrial Customer Group, stating that it considers approval of the new RSP adjustments, including the discontinuance of the RSP Surplus adjustments, to be consistent with establishing rates that reasonably reflect the cost of providing service to customers. Hydro acknowledged that the projected rate increases are material but noted that retail customers received material rate decreases in both 2015 and 2016 due to annual RSP adjustments. With respect to the proposed use of the RSP load variation credit balance to mitigate the impact of the rate increase, Hydro noted a number of issues: i) the RSP adjustment rate would remain materially negative, which would delay the rate increase to provide full cost recovery to July 1, 2018; ii) outstanding supply costs deferral balances of $38.8 million will still have to be recovered through a separate rate rider; iii) intergenerational equity concerns; and iv) deferral of rate increases in the face of anticipated higher costs which will have to recovered in future rates.

Board Findings

The Board will address the following issues in this Decision and Order:

1. Allocation of Revenue Deficiencies to the Labrador Interconnected System
2. 2014 Test Year Capital Expenditures Depreciation Expense
3. 2014 Revenue Deficiency in the Calculation of Rate Base
4. Calculation of the 2014 Revenue Deficiency Balance
5. Fuel Cost in the 2014 Revenue Deficiency
6. Fuel Cost in the RSP for 2015 and 2016
7. Discontinuation of the Rural Rate Alteration Credit on July 1, 2015
8. 2016 Regulatory Costs
9. Errors and Omissions Identified by Grant Thornton
10. July 1, 2017 Rate Implementation and RSP Operation

<u>Allocation of Revenue Deficiencies to the Labrador Interconnected System</u>

In Order No. P.U. 49(2016) the Board directed Hydro to file a proposal for the recovery of the revenue deficiencies and stated that is was concerned about the impacts on customers. In making its order the Board specifically commented on the impacts of recovery from customers on the Labrador Interconnected system. The Board stated that the portion of the revenue deficiency attributable to these customers would be recovered through future rates and further noted the potential for significant rate impacts.[3]

[3] Order No. P.U. 49(2016), pages 129 and 130.

Hydro has allocated the revenue deficiencies for 2014, 2015 and 2016 and the first quarter of 2017 to Newfoundland Power, the Industrial customers and Hydro's Rural customers. In its report Grant Thornton stated:

> According to Hydro as the rates for customers on the Labrador Interconnected system are final, Hydro does not feel it can propose recovery (refund) of revenue deficiencies (excess) from these customers and as such has excluded it in the proposed revenue deficiencies. As a result, any revenue deficiency or excess from Labrador Interconnected system over this period is absorbed as part of Hydro's profit or loss.[4]

Grant Thornton calculated the net excess of the revenue deficiencies for 2014, 2015 and 2016 as $568,000 for Labrador Interconnected customers and $511,000 for Labrador Industrial Transmission customers.[5,6,7] Hydro did not provide a calculation for these customers for 2017. Hydro retained these amounts as a part of its earnings on the basis that the rates for these customers were final.

The Board notes that the revenue deficiencies were established as deferral accounts and as recognized by the Court of Appeal, the Board has broad discretion with respect to the manner in which deferral accounts can be dealt with.[8] The Court of Appeal stated:

> The operation of deferral accounts is permissible under the existing regulatory scheme in this province regardless of whether it might be argued they incidentally have retrospective or retroactive effect. Deferral accounts are utilized in public utility regulation to deal with the effects of uncertain or volatile costs in a manner that ensures that rates are reasonable, not unjustly discriminatory and that the utility earns a just and reasonable return. They permit the recovery or rebate in a subsequent period of any deficiency or excess between forecast and actual costs. Regulatory regimes generally permit the operation of deferral accounts.[9]

The Court went on to state that funds in a deferral account are effectively encumbered revenues as the rates are subject to the deferral account mechanisms established by the Board.[10] The Court concluded that implicit in the creation of deferral accounts is the power to order the disposition of the funds contained in them.[11]

In the Board's view, the fact that rates for Labrador Interconnected customers and the Labrador Industrial Transmission customers were final does not mean that these customers cannot share in the recovery of the revenue deficiencies. The Court of Appeal has made it clear that deferral accounts permit recovery or rebate of costs in a subsequent period. The Board has broad authority

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[4] Grant Thornton Report, page 33.

[5] Ibid., page 34.

[6] On page 36 Grant Thornton also noted that, as a result of a discrepancy in the return on rate base used in the cost of service study, the revenue requirement allocation to Newfoundland Power is $60,000 higher than it should be with a revenue requirement allocation to Labrador Interconnected customers too low by the same amount. Hydro confirmed that this will be corrected its compliance rate filing.

[7] Rates for Labrador Industrial Transmission customers were made final in Order No. P.U. 49(2016).

[8] Newfoundland (Board of Commissioners of Public Utilities), Re (1998)164 Nfld and P.E.I.R. 60(NLCA), para 36; Newfoundland and Labrador Hydro v. Newfoundland and Labrador (Board of Commissioners of Public Utilities) (2012), 323 Nfld and P.E.I.R. 127(NLCA).

[9] Ibid., para 63.

[10] Ibid., para 65.

[11] Ibid., para 116.

with respect to the disposition of the revenue deficiencies as these deficiencies were approved by the Board in the exercise of its discretion to establish deferral accounts. Based on the information provided the revenue deficiencies which would be allocated to these customers would result in a credit. Instead of applying this credit to the benefit of these customers Hydro proposed that it be retained to its earnings. The Board believes that it is reasonable in the circumstances for the Labrador Interconnected customers and Labrador Industrial Transmission customers to be included in the disposition of the deferral accounts associated with the 2014 to 2017 revenue deficiencies.

Hydro will be required to revise the proposed recovery of the revenue deficiencies for 2014 to 2017 to include Labrador Interconnected customers and the Labrador Industrial Transmission customers.

<u>2014 Test Year Capital Expenditures Depreciation Expense</u>

Newfoundland Power submitted that the 2014 depreciation expense of $0.4 million associated with the disallowed 2014 capital expenditures of $146 million was not deducted from the calculation of the 2014 revenue deficiency. Newfoundland Power stated that disallowance of a capital cost should exclude from revenue requirement those costs directly associated with the disallowance including depreciation and argued that the 2014 and 2015 revenue deficiency calculation should be reduced.

Hydro submitted that Newfoundland Power's suggestion that the depreciation expense is overstated is incorrect. Hydro submitted that the Board stated that the 2014 average rate base should be adjusted to reflect the actual plant additions which Hydro explained would have resulted in an increase in revenue requirement of $0.1 million. Hydro elected to forego this adjustment given the relatively immaterial increase and the fact that there was no specific direction in the Board's order as to how the adjustment should be made. Hydro submitted that to further reduce depreciation expense as suggested by Newfoundland Power would result in an understatement of Hydro's 2014 test year depreciation expense of $0.5 million. Hydro submitted that Newfoundland Power's assertion that the 2014 test year should reflect actual additions to rate base combined with only downward forecast adjustments to depreciation expense is inconsistent and not supported by the Board's order.

In Order No. P.U. 49(2016) the Board accepted Hydro's proposed reduction to the 2014 forecast test year revenue requirement for calculating the 2014 revenue deficiency to reflect the impact of the delayed in-service of 2014 capital projects.[12] These assets included the Holyrood combustion turbine and other capital assets that were originally scheduled to go into service in 2014 but actually went into service in 2015. Hydro estimated that this would reduce the average 2014 rate base by $73.7 million, with a corresponding reduction in the 2014 revenue requirement of $2.1 million.

The Board notes that Hydro confirmed that $73.7 million was deducted from its 2014 rate base to adjust for capital assets that were originally scheduled to go into service in 2014 but did not go into service until 2015.[13] While the Board was silent on the treatment of the corresponding 2014

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[12] Order No. P.U. 49(2016), pages 82-83.
[13] Compliance Application, Exhibit 2, Table 7, page 11.

depreciation expense associated with these assets, it would be expected that these expenses would be removed from the 2014 forecast revenue requirement since there would be no matching used and useful asset. According to NP-NLH-003 total depreciation expense for the Holyrood combustion turbine and the other capital projects that were carried over into 2015 was $400,000. The Board agrees with Newfoundland Power that these expenses should also be deducted from the 2014 forecast test year revenue requirement for the purposes of determining the 2014 revenue deficiency.

Hydro argued that its 2014 depreciation expense included in the 2014 revenue deficiency is actually understated by $100,000. The Board notes Hydro's explanation in NP-NLH-003 that the reduction in depreciation expense as a result of the carry forward of capital projects was "off-set by assets that went into service earlier in the year and/or had lower service lives than originally budgeted." In Order No. P.U. 49(2016) the Board accepted Hydro's 2014 forecast test year revenue requirement with the exception of certain disallowances for operating expenses and the findings of the Board in the prudence review. Hydro also estimated a reduction of $2.1 million to the 2014 test year revenue requirement as a result of the $73.7 million adjustment to rate base, which was accepted by the Board. It is not clear from the evidence in the Compliance Application whether this adjustment to the 2014 test year revenue requirement included the net depreciation expenses identified by Hydro in the Compliance Application. Any other adjustments to the 2014 test year revenue requirement in relation to depreciation expense other than those approved by the Board are not accepted.

Hydro will be required to reduce its 2014 and 2015 test year revenue requirement for revenue deficiency calculation by $400,000 to reflect the depreciation expenses associated with the capital projects that were carried over into 2015.

<u>2014 Revenue Deficiency in the Calculation of Rate Base</u>

Hydro is requesting approval of the 2014 revenue deficiency in the amount of $38.1 million and proposes to reflect the 2014 revenue deficiency in the calculation of rate base for the purpose of determining the 2014, 2015 and 2016 revenue deficiencies as well as for rate setting purposes.

According to the Industrial Customer Group the 2014 revenue deficiency should not be included in the 2014 rate base. The Industrial Customer Group submitted that rate shortfalls routinely arise within a test year and Hydro's filing inappropriately seeks to charge interest to these amounts within the same test year when they arise. Further the Industrial Customer Group stated that it does not seem appropriate that the decision of the Board to delay the collection from December 31, 2014 as proposed to a later date should entitle Hydro to a half-year of interest costs on the 2014 deficiency.

Newfoundland Power submitted that it is inappropriate to include the 2014 revenue deficiency in the calculation of test year rates. Newfoundland Power argued that the evidence is clear that, at the time new rates are implemented on July 1, 2017, Hydro will no longer be funding the 2014 revenue deficiency and it is therefore not appropriate to include it in the 2015 average rate base for purposes of determining customer rates. According to Newfoundland Power the exclusion of the 2014 revenue deficiency from the 2015 average rate base reduces the 2015 test year revenue requirement for rate setting purposes by approximately $1.3 million.

According to Hydro the proposed treatment of the 2014 revenue deficiency in determining rate base for rate setting purposes is consistent with the Board approved treatment of deferral account balances in accordance with the Asset Rate Base Method. Hydro submitted that its entitlement to financing costs on rate base is inherent in the Asset Rate Base Method. Hydro argued that the approach suggested by the Industrial Customer Group would be a departure from the well-established method for the calculation of average rate base which is based on the average of the opening and closing balances. Hydro submits that this approach offers a "give-and-take" and cites the combustion turbine example whereby the asset was placed into service early in the year but, because it was not in service on January 1, 2015, it was not included in the opening balance of rate base and practically Hydro did not begin to earn on it until July 1, 2015.

Hydro explained that the Asset Rate Base Method which is used in determining rate base in rate-setting for both Hydro and Newfoundland Power includes approved deferral account balances. Hydro referenced Newfoundland Power's submission that, by the end of 2016, the 2014 revenue deficiency is offset by revenue surpluses in 2015 and 2016 for the purposes of setting rates. Hydro noted that Newfoundland Power acknowledged that this excludes "the net impacts associated with recomputing the RSP for 2015 and 2016 of $76.4 million and a 2016 cost deferral associated with 2015 and 2016 supply costs of $38.8 million." Hydro stated:

> Exclusion of the $76.4 million RSP balance to be reversed after approval of new customer rates is a material omission in considering the cost of financing the 2014 Revenue Deficiency for 2017. For the first six months of 2017, the rate setting year, $76.4 million of Hydro's revenue will continue to reside inside the RSP to be financed by Hydro. Therefore, Hydro will not have an opportunity to recover the financing cost for the first 6 months of 2017 related to the 2014 Revenue Deficiency unless the 2014 Revenue Deficiency is included in the rate base opening balance for the purpose of setting customer rates (as reflected in Hydro's Compliance Application).[14]

Hydro noted that the full balance would be disposed of in 2017 and that only half of the 2014 revenue deficiency is reflected in the 2015 test year average rate base for rate setting purposes.

In Order No. P.U. 58(2014) the Board granted Hydro approval to create a deferral account in relation to the proposed 2014 revenue requirement and to segregate $45.9 million in the deferral account as of December 31, 2014 but did not approve any recovery with respect to this deferral. The Board explained:

> The Board also finds that considering all of the circumstances and issues associated with Hydro's amended application, it cannot determine at this time whether Hydro should be granted recovery of any amount in relation to the proposed 2014 revenue requirement. While it is possible that the Board will, after a full review, grant approval for Hydro to recover all or part of the $45.9 million, there is no certainty at this time of any recovery.[15]

In Order No. P.U. 49(2016) the Board approved recovery for Hydro with respect to the 2014 revenue deficiency. The Board stated:

> The Board finds that the evidence shows that the 2014 revenue from existing rates was insufficient to address the increase in Hydro's revenue requirement since its last general rate application in

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[14] Hydro's Reply Submission, April 13, 2017, page 9.
[15] Order No. P.U. 49(2016), page 9.

> 2007. In the extraordinary circumstances of this case, and considering the interests of both the utility and ratepayers, the Board is satisfied that it is appropriate in the circumstances to grant relief to Hydro in relation to 2014. The Board will allow recovery with respect to 2014 and will assess the proposed 2014 test year revenue requirement to determine the amount of the deferred 2014 revenue deficiency that will be recovered by Hydro.[16]

The Board directed Hydro to file a revised 2014 test year revenue requirement as well as a revised 2014 test year forecast average rate base for purposes of calculating the 2014 revenue deficiency reflecting the findings of the Board. The Board also directed Hydro to file a revised 2015 test year forecast average rate base for purposes of calculating the 2015 revenue deficiency as well as a 2015 test year forecast average rate base for rate setting purposes. In addition the Board noted that delayed implementation of rates might result in a further revenue deficiency for 2016.

In the Compliance Application Hydro filed a revised 2014 revenue deficiency, revised 2014 and 2015 test year forecast average rate base for purposes of calculating the revenue deficiencies, and a revised 2015 test year forecast average rate base for rate setting purposes. The proposed 2014 test year forecast average rate base includes the 2014 revenue deficiency in the closing balance. Because it was not included in the opening balance only half of the deficiency is reflected in 2014. The proposed 2015 test year forecast average rate base for purposes of calculating the 2015 and 2016 revenue deficiencies includes the 2014 revenue deficiency in both the opening and closing balances. The proposed 2015 test year forecast average rate base for purposes of setting rates includes the 2014 revenue deficiency in the opening balance but not the closing balance so that only half of the deficiency is reflected in the year.

The Board accepts that Hydro's treatment of the 2014 revenue deficiency in the calculation of the test year forecast average rate base for both 2014 and 2015 is consistent with the usual treatment of deferral accounts in accordance with the Asset Rate Base Method, approved by the Board and used by both Hydro and Newfoundland Power. Nevertheless the Board believes that, given the unusual circumstances surrounding the 2014 revenue deficiency, as discussed in Order No. P.U. 58(2014), and the Board's broad discretion in relation to deferral accounts, it is open to the Board to find that the Asset Rate Base Method should not be followed in the circumstances.

The Board accepts that, as argued by the Industrial Customer Group, the net effect of Hydro's proposal is that Hydro would receive what is akin to interest on the 2014 revenue deficiency during half of calendar year 2014. The Board notes that, while the 2014 Revenue Deficiency was not approved until December 24, 2014,[17] this deficiency represents the shortfall which was forecast for 2014. The Board also accepts that, if Hydro's original proposal to transfer the amount of the deficiency from the RSP as at December 31, 2014 had been approved, there would have been no interest earned in 2014 since the RSP would have effectively provided for immediate recovery of the proposed deferral to Hydro. However, the Board did not approve recovery of any amount at the time. Recovery of the 2014 revenue deficiency was approved in Order No. P.U. 49(2016). Based on this approval the Board is satisfied that Hydro should be allowed recovery of the costs associated with the 2014 revenue deficiency. The Board believes that the inclusion of the approved 2014 revenue deficiency in the closing balance of the 2014 rate base provides for the usual recovery of costs associated with the deferral. While the circumstances surrounding the 2014

[16] Ibid., page 72.
[17] Order No. P.U. 58(2014).

revenue deficiency are unusual, the Board believes that it is appropriate to allow the inclusion of the 2014 revenue deficiency in the closing balance of the 2014 rate base.

Newfoundland Power submitted that it is not appropriate to include the 2014 revenue deficiency in the 2015 rate base for the purpose of setting rates on the basis that the evidence is clear that when new rates are implemented on July 1, 2017, Hydro will no longer be funding the 2014 revenue deficiency. The Board notes Hydro's position that unless its proposal is approved it will not have an opportunity to recover the financing cost related to the 2014 revenue deficiency for the first six months of 2017. The Board accepts that, as a result of the unusual and protracted course of this general rate application, the 2014 revenue deficiency will effectively not be recovered by Hydro until rates are implemented in 2017. To provide Hydro with recovery of the costs associated with the 2014 revenue deficiency the Board believes that Hydro's proposal to include the 2014 revenue deficiency in the opening balance of the 2015 test year forecast average rate base for rate setting should be accepted. The Board notes that as the 2014 revenue deficiency is not included in the closing balance of the 2015 test year forecast average rate base for rate setting, only half of the balance will be reflected in rates. Further the Board acknowledges the concerns related to the 2014 revenue deficiency being reflected in forward looking rates but notes that these rates will be in place a short time as Hydro is required to file its next general rate application in July of 2017.

The Board is satisfied that Hydro's proposals with respect to the treatment of the 2014 revenue deficiency in the 2014 and 2015 test year forecast average rate base are appropriate in the circumstances.

<u>Calculation of the 2014 Revenue Deficiency Balance</u>

The Industrial Customer Group submitted that Hydro's calculation of the rate base asset related to the uncollected 2014 revenue deficiency value does not appear appropriate. The Industrial Customer Group submitted that Hydro has used $44.2 million, instead of the revised value of $38.1 million, for the purposes of calculating the 2015 and 2016 rate base asset related to the uncollected 2014 revenue deficiency. Hydro submitted that the Industrial Customer Group is mistaken on this point and explained that the amount of $44.2 million was reduced by $6.1 million for prudence and that $38.1 million was included in the computation of average rate base.

The Board is satisfied with Hydro's explanation in relation to the calculation of the rate base asset related to the 2014 revenue deficiency.

<u>Fuel Cost in the 2014 Revenue Deficiency</u>

In Order No. P.U. 49(2016) the Board stated that the No. 6 fuel costs to be included in the 2014 test year for purposes of calculating the 2014 revenue deficiency should be adjusted to reflect the actual 2014 No. 6 fuel price. Grant Thornton noted that, in the Compliance Application, Hydro did not include proposals to update its 2014 revenue deficiency calculation to reflect actual 2014 No. 6 fuel costs.

Hydro submitted that its approach in relation to the use of the actual fuel costs in the 2014 revenue deficiency is appropriate given the complexities of the RSP, and the fact that variances from 2014 test year No. 6 fuel costs sheltered by the RSP have already been passed on to customers. Hydro submitted that its approach of using the 2007 test year cost of $55.40 per barrel for fuel results in the most accurate computation of revenue deficiencies and further that reflecting the $64.41 per barrel fuel price on a historical basis in the RSP would require Hydro to retroactively determine what rates would have been in place for 2015 and 2016 and would not be consistent with rate setting on a prospective basis. The Board accepts that the normal operation of the RSP for 2014 has addressed the cost variances in the 2014 test year No. 6 fuel costs.

The Board is satisfied that Hydro's proposal to not reflect the use of actual No. 6 fuel costs in the 2014 test year revenue requirement for the purpose of determining the 2014 revenue deficiency is appropriate in the circumstances.

Fuel Cost in the RSP for 2015 and 2016

In Order No. P.U. 49(2016) the Board directed Hydro to reflect the updated fuel price of $64.41 in the 2015 test year revenue requirement for the purpose of determining the 2015 revenue deficiency. Grant Thornton noted that, in the recalculation of the RSP for 2015 and 2016, Hydro did not use the 2015 test year price of $64.41 but continued to use the 2007 test year price of $55.40 per barrel. Hydro stated that calculating revenue deficiency for 2015 and 2016 using $64.41 would result in an overstatement of revenue deficiency to be collected from customers as the fuel cost variance has been dealt with through the operation of the RSP.

The Board is satisfied that Hydro's proposal to continue to use the 2007 test year price of fuel of $55.40 per barrel in the recalculation of the RSP for 2015 and 2016 is appropriate in the circumstances.

Discontinuation of the Rural Rate Alteration Credit on July 1, 2015

The Rural Rate Alteration (RRA) normalizes Hydro's rural revenues for adjustments as result of Newfoundland Power rate changes. Grant Thornton noted that Hydro discontinued the RRA credits on July 1, 2015. According to Hydro, when new interim base rates were approved by the Board for July 1, 2015 they considered the rates to be new base rates and discontinued the RRA credits. Hydro submitted that this approach was reasonable, and that Grant Thornton supported Hydro's interpretation. Hydro explained that, if the RRA credits had been continued, the July 2016 adjustment would have resulted in a larger decrease to retail customers but would have required a larger RSP credit reversal in 2017.

Grant Thornton explained that while Section B, rule 1.3 of the RSP rules does not state that interim base rates would be considered new cost of service rates, it considers Hydro's approach to be appropriate. The Board also notes that, as of July 1, 2015, the rate Newfoundland Power charged its customers equaled the base rate Hydro charged its rural customers. There was no requirement for the RRA to continue.

The Board is satisfied that Hydro's proposal to discontinue the RRA credits on July 1, 2015 is appropriate in the circumstances.

2016 Regulatory Costs

Grant Thornton noted that Hydro has included $1.0 million in the 2015 test year for rate setting purposes "as it represents other anticipated studies and hearings related to the preparation of the 2018 General Rate Application which are required to be completed and do not relate to the disallowance from the Prudency Application."[18]

The Industrial Customer Group submitted that Hydro's proposed $1 million upward adjustment in regulatory costs is inappropriate and should be rejected.

Hydro submitted this amount was set out in its prudence compliance application and represents future anticipated studies and hearings which are required to be completed and is not related to the disallowance of specific costs associated with regulatory studies and filings associated with the Board's ongoing investigation of outages and events on the Island Interconnected system. Hydro noted that the Board accepted the prudence compliance application as being in accordance with Order No. P.U. 13(2016) related to the Prudence Review.

The Board notes that the disallowance ordered by the Board in Order No. P.U. 13(2016) related to the calculation of Hydro's 2015 revenue deficiency. However the Board accepted that, for the purposes of setting rates, Hydro should be allowed to recover the forecast costs for future regulatory studies and hearings related to the preparation of the 2018 general rate application. In accordance with the Board's order Hydro excluded $1.0 million from the 2015 revenue deficiency.

The Board is satisfied that Hydro's proposal related to regulatory costs in the 2015 test year revenue requirement is appropriate in the circumstances.

Errors and Omissions Identified by Grant Thornton

In its reply submission Hydro accepted a number of issues raised by Grant Thornton.

Hydro will be required to revise its proposals to incorporate its accepted changes related to the issues raised by Grant Thornton.

July 1, 2017 Rate Implementation and RSP Operation

Subsequent to the filing of the Compliance Application Hydro indicated a final rate implementation date of July 1, 2017 instead of April 1, 2017 was preferable.[19] As a result the normal RSP adjustment will be implemented at the same time as new base rates. The Board believes that implementing the rate changes associated with Hydro's general rate application at the same time as the annual RSP adjustment on July 1, 2017 will provide for the orderly implementation of new rates.

In its updated fuel price projection Hydro provided the following summary of changes to RSP adjustments for Newfoundland Power and the Industrial customers to be effective July 1, 2017:

[18] Grant Thornton Report, page 14.
[19] Hydro letter, February 20, 2017.

Newfoundland Power RSP Adjustments

Particulars	Existing	New
RSP – Current Plan	(1.213) ¢/kWh	(0.117) ¢/kWh
RSP – Fuel Rider	(0.023) ¢/kWh	0.672 ¢/kWh
Total RSP Rate	**(1.236) ¢/kWh**	**0.555 ¢/kWh**

Industrial Customer RSP Adjustments

Particulars	Existing	New
RSP – Current Plan	-	(0.373)¢/kWh
RSP – Fuel Rider	-	0.625 ¢/kWh
RSP – Teck Adjustment	(1.141) ¢/kWh	-
RSP – IC Surplus Credit (Energy)	(0.294) ¢/kWh	-
Total RSP Energy Rate	**(1.435) ¢/kWh**	**0.252¢/kWh**
RSP – IC Surplus Credit (Demand)	**(1.52) $/kW**	**-**

Based on the information provided by Hydro the usual operation of the RSP would result in a significant increase in the rate charged to Newfoundland Power which will be flowed through to customers of Newfoundland Power. The estimated combined rate impact of the general rate application and the annual July 1 RSP adjustment is 27.6% to Newfoundland Power with an estimated average end customer impact of 18.6%.[20] The average rate impact for Industrial customers is forecast to be 16.6%, with impacts by individual customers ranging from 12.2% to 38.0%.

The Board notes that Newfoundland Power suggested that the use of the RSP Load Variation Balance to offset the increases for retail customers would be a reasonable approach in these extraordinary circumstances and would be consistent with the underlying purpose of the RSP to smooth fluctuations in Hydro's cost of supply. According to Newfoundland Power the estimated increases for retail customers are large in the context of the range of rate impacts associated with the annual RSP adjustment over the last 20 years of -7.9% to +9.9%. However the Board accepts Hydro's submission that there a number issues that may need to be considered in relation to Newfoundland Power's suggestion. Hydro argued that applying the RSP Load Variation balance as proposed would result in rates which would not recover the cost to serve. Hydro also raised intergenerational equity concerns and noted that the use of the RSP Load Variation balance would mean that a new rate rider would be required to recover 2015 and 2016 supply costs which were deferred in Order No. P.U. 56(2016). Hydro also raised concerns in relation to deferring rate increases when there are other cost drivers that are expected to result in increases in future customer rates.

The annual rate impacts for retail customers associated with the operation of the RSP have historically been the range of +/-10 %, however, the estimated impact in July 2017 is much larger, with an estimated rate increase for retail customers in the order of 18-19%. The Board is very concerned about increases of this magnitude which are well outside of the normal range. The Board acknowledges that the estimated rate increase is a result of the normal operation of the RSP and

[20] Hydro letter, April 21, 2017.

that the last two annual RSP adjustments resulted in material decreases. However the estimated rate increase for July 2017 is such a significant increase that it may be argued that it would cause rate shock, despite the earlier rate decreases. In addition such a significant rate increase in one year after the two material rate decreases may raise concerns as to whether the RSP is appropriately smoothing fuel price variations in the circumstances. While Hydro acknowledged that the rate increase is material it did not address the potential for rate shock and did not provide any alternatives to address the magnitude of the impact. In particular Hydro did not provide its estimate of the impact of the use of all or part of the RSP Load Variation balance and did not provide information related to other considerations and approaches which may be taken to address the magnitude of the rate increase.

The Board finds that the information which has been filed is insufficient to reach a determination on the July 1 RSP adjustment for Newfoundland Power and whether measures should be adopted to address the projected significant rate increases. As such the Board will not address the RSP rate adjustment for Newfoundland Power in this Decision and Order. Hydro will be given further direction as to the additional information which is required in relation to alternatives and impacts to allow consideration of a fair and balanced approach in the circumstances. This issue will be addressed in a further order of the Board.

The Board notes that the Consumer Advocate raised issues related to the timing of RSP adjustments and suggested a quarterly rather than annual RSP adjustment. The Board finds that it is not practical to address proposals for material changes to the operation of the RSP in this Compliance Application process. The Board believes that Hydro's next general rate application which will be filed in July of 2017 will provide a reasonable opportunity to fully address suggested changes to the design and operation of the RSP.

In addition the Board notes that the Industrial Customer Group asked that Hydro be required to file further information related to the impacts of the operation of the RSP on customer rates considering all of the circumstances. As discussed earlier the issues related to the Industrial Customer RSP have also been deferred to a subsequent order of the Board.

In light of the Board's findings in this Decision and Order Hydro will be required to file a revised compliance application.

IT IS THEREFORE ORDERED THAT:

1. Hydro shall file a revised Compliance Application arising from Order No. P.U. 49(2016), incorporating the findings of the Board in this Decision and Order.

2. Hydro shall pay all costs and expenses of the Board arising from this Application.

DATED at St. John's, Newfoundland and Labrador, this 1st day of May 2017.

Andy Wells
Chair & Chief Executive Officer

Darlene Whalen, P. Eng.
Vice-Chair

Dwanda Newman, LL.B.
Commissioner

James Oxford
Commissioner

Cheryl Blundon
Board Secretary