

July 30, 2018

Via Email & Courier

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

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

Dear Ms. Blundon:

**Re: 2017 General Rate Application (GRA) – Supplemental Evidence filed on July 20, 2018 –
Request for Further Information**

Background

When Hydro originally filed its 2017 GRA, Hydro proposed to set rates for 2018 and 2019 based on the continued supply of energy from No. 6 fuel consumed at the Holyrood Thermal Generating Station. Through the early use of the Maritime Link and Labrador-Island Link transmission lines, constructed for the Muskrat Falls Project, Hydro forecasted that savings could be realized by using off-island energy e.g. Recapture Power from Churchill Falls, imports from other provinces etc. as compared to the cost of fuel.

Hydro therefore proposed that any savings as a result of off-island power purchases would be set aside in a regulatory deferral account (the Off-Island Purchases Deferral Account) under jurisdiction of the Board of Commissioners of Public Utilities (the Board). These funds would be returned to customers, with interest, and intended to smooth the transition to higher post Muskrat Falls rates. The timing and depletion rate of the fund would be at the Board's discretion.

When the Muskrat Falls Project was sanctioned in 2012, it was anticipated that the transmission and generation assets would be completed at the same time. It was not expected or considered that the lines would be available for early use. However, based on the current situation, Hydro saw that using these transmission lines to access cheaper energy created an opportunity for savings. Hydro therefore proposed that it pool the savings in an Off-Island Purchases Deferral Account as, from Hydro's perspective this proposal offered several benefits for customers.

First, the price and amount of off-island purchases available to Hydro was, and continues to be, uncertain.¹ Under the Off-Island Purchases Deferral Account, savings would accumulate over time and be used by the Board to mitigate future customer rate increases. If savings from off-island power purchases were less than forecasted, there would be no risk to customers as savings would not be presupposed in current rates.

Second, these savings are only made possible through transmission lines built in association with the Muskrat Falls Project. Future customers will be required to provide recovery of the capital costs of these transmission lines when the Muskrat Falls Project is fully commissioned. Hydro therefore considered it reasonable that future customers also receive the benefit from any savings that can be achieved through early use of these transmission assets. An external expert who filed evidence with the Board on Hydro's behalf concluded that this approach would be *"consistent with established regulatory principals."*²

Third, this proposal would both smooth the transition to rates reflecting the Muskrat Falls Project and provide approximately \$170 million for mitigation of future customer rates.

As a result, Hydro considered this proposal to be both in the best long-term interest of customers as well as consistent with established ratemaking principals in this jurisdiction.

Through the course of the GRA process, it became clear that this position was not shared by the intervening parties in Hydro's 2017 GRA. On January 4, 2018, five months after Hydro had filed the 2017 GRA, the Consumer Advocate filed an application with the Board to delay Hydro's application stating, among other things, that *"There is no precedent in this jurisdiction for the rate mitigation initiative proposed by Hydro and the PUB could not endorse any such "plan" based on the information thus far provided by Hydro."*³

As a result of this application, Hydro's 2017 GRA was delayed and Hydro was required to file cost of service studies reflecting its expected cost of supplying customers with service from off-island power purchases.⁴ Hydro's 2017 GRA hearing, which was originally scheduled to begin on January 30, 2018 was delayed until April 16, 2018 and continues currently.

As long as Hydro maintained its application for the Off-Island Purchases Deferral Account, it was clear a supplemental negotiated settlement with the parties was unlikely. This increased the risk of a protracted 2017 GRA which would not only increase the cost of the hearing portion of Hydro application but also would place significant schedule risk for Hydro's upcoming regulatory applications required to be filed with the Board prior to the in-service of the Muskrat Falls Project.

¹ The Labrador-Island Link has not yet been fully commissioned and the price of market based off-island power purchases is subject to change, however, the cost of available recapture energy from Churchill Falls at very low prices. This assures that the total delivered cost to the island portion of the province is well below the cost of equivalent energy from Holyrood.

² Report of JT Browne Consulting dated December 4, 2017, *"Newfoundland and Labrador Hydro Of-Island Purchases Deferral Account"*, page 16.

³ Motion from the Consumer Advocate, dated January 4, 2018, paragraph 8.

⁴ See Board Order No. P.U. 2(2018).

As a result, Hydro entered into a settlement agreement dated July 16, 2018 which proposes to establish customer rates based on the expected cost of supply (the Expected Supply Scenario). Under the Expected Supply Scenario, customer rates in 2018 and 2019 will reflect forecast savings from off-island power purchases of \$130 million. Should actual savings be less than this forecast, these amounts would need to be recovered from future customers which could result in higher rates for customers at the same time as the in-service of the Muskrat Falls Project.

It is in the context of this and other future rate risks in which Hydro raised the concept of a rate stability rider in 2019. A similar approach is currently being taken in Manitoba.⁵ Further, this approach was suggested by the Consumer Advocate's own expert⁶ and acknowledged by the Office of the Consumer Advocate by way of letter dated May 7, 2018.⁷ As such, Hydro believed that this concept would be more palatable to the parties, specifically the Consumer Advocate.

On July 20, 2018, Newfoundland and Labrador Hydro (Hydro) filed Supplemental Evidence which provided the revenue requirement estimates reflecting the settlement agreements, recovery of the 2015 to 2017 deferred energy supply costs for the Island Interconnected System, and the estimated 2018 revenue deficiencies (or excess revenues) by class, amongst other items.

On July 26, 2018 the Board requested that Hydro file:

1. A clear statement as to the rates that it proposed to be implemented for each customer class effective January 1, 2019;
2. Clarification on whether Hydro proposes the implementation of a rate stability rider, and if so, Hydro's proposal for the same; and
3. A revision to its 2017 GRA by August 2, 2018, reflecting the significant changes that have been made throughout this proceeding, including the supplemental evidence.

This letter addresses the Board's first two requests with an additional filing to follow on or before August 2, 2018.

⁵ As noted on Page 1.12 of Hydro's 2017 GRA Evidence, "In Order 73/15, Manitoba's Public Utilities Board approved an interim rate increase for Manitoba Hydro of 3.95%. The revenues from 2.15% of that rate increase are to be placed in a deferral account to mitigate expected rate increases from when the Bipole Transmission Reliability Project (Bipole III) comes into service in 2018/19. In Order 73/15, the Manitoba regulator stated that, "Because very significant rate increases will be needed at that time, the Board sees a compelling policy reason to gradually increase rates to avoid rate shock for consumers three years from now."

⁶ Expert Evidence of C. Douglas Bowman, dated December 4, 2017, page 17 reads: "I therefore recommend that the Board direct Hydro to undertake the following: ... Propose a rate mitigation plan based on the format referenced in Manitoba with a fixed rate adder over and above any required rate increase (if a rate increase is indeed required)."

⁷ Letter from the Office of the Consumer Advocate dated May 7, 2018, point number 4 states "The parties through negotiations decide whether or not it is desirable to include a rate rider or surcharge to recover revenues beyond the approved revenue requirement for the purposes of future rate mitigation."

Hydro's 2019 Rate Proposal

In accordance with the settlement agreement dated July 16, 2018 Hydro is proposing 2019 rates which recover its 2019 Revenue Requirement reflecting the Expected Supply Scenario;⁸ this revenue requirement is shown in Schedule 3 of the Supplemental Evidence dated July 20, 2018. In the same filing, Hydro provided forecast customer rate impacts to the in-service of the Muskrat Falls Project. Included in this forecast was the option of a rate stability rider in 2019 which was provided for the Board's consideration when setting 2019 customer rates at the conclusion of Hydro's 2017 GRA.

However, Hydro is not seeking to implement a rate stability rider as part of this proceeding. Hydro's 2017 GRA seeks 2019 base rates which will collect its 2019 Test Year Revenue Requirement reflecting the Expected Supply Scenario, and as further delineated in the settlement agreements, without a rate stability rider.

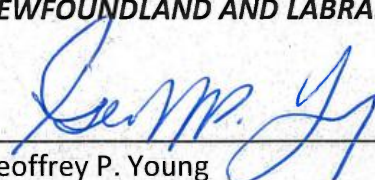
Information on Rate Smoothing Options

The uncertainty of forecast rates reflecting the in-service of the Muskrat Falls project has been raised several times through Hydro's 2017 GRA proceedings, both in written Requests for Information as well as through cross examination. Clearly this is an issue of great interest to our utility and industrial customers, the Consumer Advocate, and the public at large. Therefore, in the spirit of openness and transparency and using the best information Hydro has regarding possible future rate increases, Hydro provided the Board with three potential rate impact scenarios to achieve an illustrative retail customer rate of 18¢ per kWh, beginning with forecast final rates at the conclusion of the 2017 GRA. These scenarios do not form part of Hydro's application for 2019 customer rates.

Should the Board determine that further analysis is appropriate with respect to a rate smoothing mechanism, Hydro would provide the Board with alternatives to achieve reasonable customer rates in 2019 and 2020.

Yours truly,

NEWFOUNDLAND AND LABRADOR HYDRO



Geoffrey P. Young
Corporate Secretary & General Counsel
GPY/sk

cc: Gerard Hayes - Newfoundland Power
Paul Coxworthy - Stewart McKelvey
Denis J. Fleming - Cox & Palmer
ecc: Van Alexopoulos - Iron Ore Company
Senwung Luk - Labrador Interconnected Group

Dennis Browne, Q.C. – Browne, Fitzgerald, Morgan & Avis
Dean Porter - Poole Althouse

Benoît Pepin - Rio Tinto

⁸ In addition to these 2019 base rates, Hydro will also propose rate riders which will charge or credit any 2018 Revenue Deficiency or Excess as a result of the Board's final 2017 GRA order, as well as recovery riders for any approved 2015, 2016, and 2017 Deferred Supply Costs.