

Office of the Consumer Advocate

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April 30, 2018

Board of Commissions of Public Utilities
120 Torbay Road, P.O. Box 2140
St. John's, NL A1A 5B2

**Attention: G. Cheryl Blundon, Director of
Corporate Services / Board Secretary**

Dear Ms. Blundon:

**Re: Hydro's Application regarding a Motion for the Deferral of Cost of Service
Methodology Issues Raised in the 2017 General Rate Application to the
Cost of Service Methodology Review Hearing**

On April 4, 2018 Hydro filed with the Board an "*application regarding a Motion for the deferral of cost of service methodology issues raised in the 2017 General Rate Application to the Cost of Service Methodology Review Hearing*" (the "Application"). The Consumer Advocate's understanding is that if there are written submissions to be filed in response to the Application they must be filed by April 30, 2018, and Hydro will have the opportunity to reply to such filings by May 11, 2018. This document serves as the Consumer Advocate's written submission in response to Hydro's Application.

Hydro's Application

In clause 17 of the Application, Hydro states its position that "*the cost of service methodology issues to be dealt with in the 2017 GRA be limited to proposals set out in Chapter 5 of Hydro's evidence. These include:*

- (i) *the generation credit service agreement between Hydro and CBPP, which was approved on a pilot basis by the Board in Order No. P.U. 4(2012);*
- (ii) *the assignment of the frequency converter to CBPP as a specifically assigned asset;*
- (iii) *the methodology for allocation of operating and maintenance expenses to specifically assigned assets;*
- (iv) *the classification of purchases of wind energy; and*
- (v) *the methodology for allocation of the rural deficit.*

In clause 19, Hydro submits “*the goal of regulatory efficiency in regards to the present GRA is best achieved by the Board making a pre-hearing determination of this Application, and thereby clarifying the scope of the proceeding as it regards cost of service methodology issues.*”

In clause 20, Hydro “*seeks a Board order that defines the scope of the cost of service methodology issues to be dealt with in the 2017 GRA.*”

Concerns with Hydro’s Application

The Consumer Advocate has a number of concerns with Hydro’s Application, including:

1. Hydro bases its submission on “*the goal of regulatory efficiency*” but does not define what it means by “*regulatory efficiency*”, and does not rank the importance of regulatory efficiency relative to cost of service and rate design issues such as fairness and efficiency of the price signal. It would appear from its submission that Hydro believes regulatory efficiency is best obtained by considering only its own cost of service and rate design issues, and disregarding those raised by the parties, particularly the Consumer Advocate. Hydro believes that it is best to push cost of service and rate design issues off to a future GRA rather than the current hearing which is expected to establish rates for the three-year period 2018 through 2020.¹
2. With respect to “*regulatory efficiency*”, it is important to consider that Hydro filed its 2017 GRA with the Board on July 28, 2017, and then filed a revised application on September 15, 2017, and then filed another revised application on October 16, 2017, and then filed another revised application on October 27, 2017, and then filed another revised application on November 27, 2017 (see clause 10 of Application). In addition to these five submissions, Hydro has filed three cost of service studies, two of which do not reflect its Expected Supply Scenario, and has filed another application for interim rates on April 13, 2018. This does not appear to be consistent with regulatory efficiency.
3. Hydro is requesting the Board to issue an order that limits discussion of cost of service to the five issues included in clause 17 of its Application. It is not clear if Hydro is proposing this restriction on all cost of service issues raised by the parties or only the Consumer Advocate, and on all systems for which Hydro has submitted cost of service studies or only the Island Interconnected System.
4. Hydro does not say why it is requesting that the Board issue an order limiting discussion on cost of service to the five issues identified in clause 17 when these issues could likewise be deferred to the cost of service methodology review and the 2019 GRA. In the interests of what Hydro considers “*regulatory efficiency*”, why has it not proposed to eliminate discussion on all cost of service issues at the 2017 GRA thus removing the need for cost of service witnesses to appear at

¹ It is understood that the cost of service methodology review and the 2019 GRA relate to the post-Muskrat Falls period, and that Muskrat Falls is scheduled for service in late 2020.

the hearing on the 2017 GRA? We note that of the five issues Hydro identifies in clause 17 for discussion, one of the issues, allocation of the rural deficit, has already been agreed to by the parties in the draft Settlement Agreement. The other four issues were all raised by the Island Industrial Customers. Why is Hydro proposing to allow discussion of one party's cost of service issues while eliminating discussion of cost of service issues raised by other parties?

5. Hydro appears to believe that the possibility of a cost of service hearing later in 2018 and another GRA filing in 2019 is grounds for eliminating discussion of cost of service issues at the 2017 GRA (see clause 10 of Application). Hydro appears to suggest that fairness and efficiency of rates are unimportant because rates established in the 2017 GRA will be superseded by new rates in the future. First, there will always be another GRA on the horizon. Second, there has been a dramatic change in supply to the Island Interconnected System this year with the addition of new transmission links enabling off-island purchases to displace expensive Holyrood generation. There will be another dramatic change in supply to the Island Interconnected System when Muskrat Falls generation is commissioned, expected late 2020. The cost of service study in the 2017 GRA should reflect the dramatic change in supply during this pre-Muskrat Falls commissioning period to ensure rates are fair and equitable. The cost of service study included in Hydro's 2017 GRA ignores this dramatic change in supply, so effectively ensures rates that are not fair and equitable.
6. Hydro's schedule for the cost of service hearing and the 2019 GRA appears unrealistic. In clause 10 of the Application Hydro states "*Hydro plans to file an application in the third quarter of 2018 to conduct a Cost of Service and Rate Design Methodology Review to determine the changes required to reflect the Labrador-Island interconnection*". As stated in clause 5 of the Application "... *Hydro would file a Cost of Service Methodology Review Report with the Board by March 31, 2016, and would also conduct a comprehensive **Cost of Service Methodology Review Hearing in 2016***" (emphasis added). Clearly, the cost of service review hearing is quite late. Further, there is no guarantee that the Board will have time to hear the cost of service application in 2018 given its busy schedule. The current schedule of the 2017 GRA hearing is expected to go through August 2018, and possibly later. Presumably, Hydro will need a decision on this 2017 GRA before it can file its 2019 GRA. The rates deriving from the 2017 GRA are likely to be in place through 2020, and possibly beyond given Hydro's track record with GRAs².
7. Hydro does not mention in its Application the recently filed *Additional Cost of Service Information* dated March 22, 2018 (filed in compliance with Board Order No. P.U. 2(2018)). This submission includes two additional cost of service studies: a "Revised Deferral Account Scenario" and an "Expected Supply Scenario". The "Revised Deferral Account Scenario" is the same cost of service study filed with the 2017 GRA but modified to incorporate a more up-to-

²The 2013 GRA was submitted on July 30, 2013. On December 1, 2016 the Board issued Order No. 49(2016) for the 2014 and 2015 test years.

date fuel price forecast. The “Expected Supply Scenario” is a cost of service study reflecting Hydro’s forecast of costs in the 2018 and 2019 test years including the impact of off-island purchases. By requesting that the Board issue an order limiting discussion of cost of service to only the five issues in clause 17 of the Application, Hydro appears to be asking the Board to issue an order that eliminates discussion of the Expected Supply Scenario. In effect, Hydro is asking the Board to issue an order that annuls its previous Order No. P.U.2(2018).

8. By requesting the Board to issue an order restricting discussion on cost of service issues in the 2017 GRA Hydro appears to be eliminating discussion on Board jurisdiction and cost recovery of the Muskrat Falls project under OC2013-343.

Clarification of the Consumer Advocate’s Position on Cost of Service

In its Application, Hydro specifically addresses issues raised by the Consumer Advocate, in particular, the classification/allocation of transmission line TL267 and the Newfoundland Power wholesale rate design (clause 12 (e) of the Application). Hydro does not specifically mention cost of service issues raised by other interveners. The following points attempt to clarify the Consumer Advocate’s position on cost of service in the 2017 GRA.

1. With respect to classification/allocation of transmission line TL267, as Hydro points out in clause 12 (c), the Board has already ruled in Order No. P.U. 35(2017) that “ ... *effective and efficient regulation is served by full disclosure of information which may be relevant early in the process to allow for appropriate focus on relevant matters as the matter progresses.*” The Board goes on to say “ ... *TL267 is a significant asset which is being added to the rate base as of 2018 for which customers will begin to pay in rates arising from this proceeding. As such the Board acknowledges that the fair classification and allocation of costs for the TL267 transmission line may be an issue which the parties may wish to argue should be addressed in this proceeding in advance of the scheduled cost of service hearing.*” Hydro’s response to CA-NLH-90 indicates that changing the classification/allocation of TL267 to recognize that it provides energy as well as capacity benefits would reduce the cost allocated to Newfoundland Power by \$800,000. While Hydro believes in the interests of regulatory efficiency that this issue should be ignored in the 2017 GRA, the Consumer Advocate believes that in the interests of fairness and equity, it should be considered in the 2017 GRA. The Consumer Advocate would change its position on this issue if Hydro were to agree to withdraw its proposal to recover the costs of TL267 from the 2017 GRA.

In clause 13 Hydro states that it has followed the approved cost of service methodology for classification of common transmission assets between demand and energy. The Consumer Advocate does not take issue with the continued use of this methodology in the 2017 GRA. However, we do take issue with using this methodology for the classification/allocation of TL267, a new transmission line that Hydro is only now applying for cost recovery, and which has received no prior vetting before the Board. Hydro states (Volume I, page 3.25, lines 15 to 18) “*The reduced production forecast for Hydro’s Island Interconnected System gas turbines and*

diesels for 2017 through to the 2019 Test Year reflect the reliability benefit of the planned in service of a third transmission line from Bay d'Espoir to Western Avalon (TL267)." Further, Hydro states that the new transmission line will reduce transmission system losses (Volume I, page 3.28, line 18), and will enable more efficient use of, and decreased spill from, hydro generation (IC-NLH-090). These statements suggest that the new transmission line will provide energy benefits, so a proposal to classify 100% of its costs as capacity-related results in an unfair allocation of costs to customer classes. This is an equity issue, and Hydro's response to CA-NLH-90 shows that the impact is material.

2. In clause 14 of its Application Hydro states that it proposes to "*continue to apply the accepted wholesale rate design approach for Newfoundland Power*". The Consumer Advocate likewise proposes that the accepted wholesale rate design approach continue including the concept that the tail-block energy rate reflect the marginal cost of energy to promote efficient consumption decisions by Newfoundland Power. Hydro proposes a tail-block energy rate that reflects Holyrood production costs while acknowledging that Holyrood no longer reflects the marginal cost of production on the Island owing to the availability of off-island purchases. Hydro proposes a tail-block energy rate of 14.141 cents/kWh (Application Volume 1 (rev 3), page 5.18, lines 3 - II) based on the production cost of Holyrood, but forecasts that the annual average marginal cost of energy in 2019 will be 5.0 cents/kWh³ (CA-NLH-81). Hydro is proposing that Newfoundland Power respond to a price signal of 14.141 cents/kWh when it should be responding to a price signal of 5.0 cents/kWh. Clearly, this will not promote efficient consumption decisions, and is inconsistent with Board direction that "*marginal costs should be considered in the future design of the wholesale rate*" (Application Volume 1 (rev 3), page 5.17, lines 10- 11). Hydro proposes that the Board issue an order restraining discussion of the Consumer Advocate's proposal on the basis of what it considers "regulatory efficiency" while totally ignoring the gross inefficiency brought on by its proposal to establish a wholesale rate with a price signal that is almost three times its forecast of marginal energy costs. The Consumer Advocate believes that since marginal energy costs are trending lower, the tail-block energy charge in the wholesale rate should likewise trend lower.
3. Hydro does not raise in its Application the issue of the Capacity Assistance Agreements with Island Industrial Customers. The Consumer Advocate does not object to the continuation of these agreements but believes they should reflect the value of capacity on the system and provide benefits to both participating and non-participating customers. Hydro has not filed evidence to suggest these agreements are needed, or that they provide value to all customers. The Consumer Advocate does not object to the continuance of these agreements provided Hydro absorbs all costs that are over and above the value of the capacity to the system.
4. In Order P.U. 2(2018) (page 8, lines 5 to 15), the Board directs Hydro to "*file 2018 and 2019 revenue requirements and cost of service studies based on the expected supply scenario, setting*

³ In its response to CA-NLH-258, Hydro indicates that the forecast marginal cost of energy in 2020 is expected to average 5.323 cents/kWh.

out the assumptions which were made and the support for those assumptions. The information filed should reflect the expected supply scenario as relates to:

- i) *off-island purchases and sales over the LIL and ML;*
- ii) *the allocation of the operating and maintenance costs of the LIL and the LTA;*
- iii) *the classification and allocation of off-island power purchases;*
- iv) *the Holyrood fuel conversion rate;*
- v) *the Holyrood capacity factor; and*
- vi) *Holyrood fuel inventory used in rate base.”*

Clearly, if the Board is to “*evaluate which approach is most reasonable for establishing customer rates during the Muskrat Falls pre-commissioning period*” as suggested by Hydro in CA-NLH-248, there are a number of other cost of service issues to consider beyond those five issues identified by Hydro in its Application.

Summary

A summary of the Consumer Advocate’s concerns with Hydro’s Application follows:

- a) The Application fails to recognize that there has been a significant change in supply to the Island Interconnected System and that a cost of service study is needed to reflect this change if rates are to be fair and equitable during the 2018 to 2020 time-frame when rates established by the 2017 GRA are expected to be in place.
- b) Hydro has not explained if it is proposing a restriction on cost of service issues raised by all parties at the 2017 GRA, or only the Consumer Advocate, or why it is proposing that the Board issue an order allowing discussion of cost of service issues raised by the Island Industrial Customers, but not other parties in the 2017 GRA.
- c) Hydro has not explained why it considers the possibility of a cost of service methodology hearing later in 2018 and another GRA filing in 2019 as grounds for eliminating discussion of cost of service issues at the 2017 GRA when these filings will address the post-Muskrat Falls period and not the pre-Muskrat Falls period when rates established as a result of the 2017 GRA are expected to be in place.
- d) Hydro’s schedule for the cost of service methodology hearing and the 2019 GRA appear unrealistic given its past experience with GRAs and the Board’s busy schedule.
- e) Hydro appears to be requesting the Board to restrict discussion of the Expected Supply Scenario which would effectively annul the Board’s order requiring Hydro to file the information in the first place (Order No. P.U. 2(2018)).

- f) Hydro appears to be requesting the Board to dismiss discussion on Board jurisdiction as it relates to the Muskrat Falls project cost recovery (OC2013-343).

Consumer Advocate's Recommendation

Hydro should not be allowed to pick and choose which cost of service issues are allowed for consideration in the 2017 GRA. This would defeat the purpose of expert testimony and the hearing process and result in a less than ideal outcome than would be expected under the current system with experts representing the views of the different customer classes and suppliers in the Province. It would appear that Hydro is requesting the Board to place a restriction on the parties, and to overturn its Order No. P.U. 2(2018) requiring Hydro to file a cost of service study reflecting the Expected Supply Scenario. To date, there has been no attempt by the parties at settlement of the additional cost of service information filed on March 22, 2018.

The Consumer Advocate recommends that the Board reject Hydro's Application in full. It would set a bad regulatory precedent and be detrimental to the Province's electricity consumers. Hydro's submission that a cost of service hearing and another GRA is on the horizon is immaterial – there will always be another GRA on the horizon, and rates deriving from the 2017 GRA are expected to be in place for the three-year period prior to Muskrat Falls commissioning. The better method for improving "regulatory efficiency" would be for the parties to negotiate a settlement on cost of service issues. In this regard, the Consumer Advocate recommends that the Board set aside time in the immediate future for settlement discussions on cost of service and the Expected Supply Scenario.

We trust this is in order.

Yours truly,



Stephen Fitzgerald
Counsel for the Consumer Advocate

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