Q. (2017 GRA, Volume 1, page 1.5) It is stated (lines 2 to 8) "*This presents an opportunity to reduce the use of costly Holyrood generation by using lower cost off-island purchases in 2018, 2019, and 2020. Hydro's 2018 and 2019 Test Year revenue requirements, as submitted, reflect the continued use of Holyrood fuel with no access to off-island purchases. Hydro is proposing that any costs or savings associated with the use of the Labrador-Island Link and the Maritime Link prior to the full commissioning of the Muskrat Falls Project be set aside in a deferral account.*" Please confirm that the test year revenue requirements for 2018 and 2019 do not reflect Hydro's best estimates of fuel/supply costs in these years.

A. There is material uncertainty in Hydro's fuel/supply costs to be incurred in 2018 and 2019 as a result of the planned interconnection to the North American grid. The potential for supply cost variability from the test year costs is outside of Hydro's control as the availability of off-island purchases depends on: (i) the timing of availability of the Labrador-Island Link (LIL); (ii) the availability of LIL during the testing period; (iii) the amount of Recapture Energy available from Labrador; (iv) the availability and pricing of purchases from other jurisdictions including the terms of availability (i.e., firm vs. non-firm)There is currently no cost recovery mechanism in place to deal with supply cost variability that results from off-island supply.[1]

Hydro considers it fair to set aside the savings from off-island purchases that are achieved during the pre-commissioning period in a deferral account and use those savings to help mitigate the increase in rates required to provide recovery of the Muskrat Falls Project costs.

[1] Hydro has deferral accounts in place to deal with supply cost variability on the Island Interconnected System (but not including cost variability due to off-island purchases).

Reflecting anticipated savings from off-island purchases during the pre-commissioning period in the 2018 and 2019 Test Years would reduce the revenue requirement in 2018 and 2019 and result in lower rates for current customers. However, this approach would likely contribute to higher percentage rate increases in the future given the forecast rates projected to provide recovery of the costs of the Muskrat Falls Project.[2]

If the 2018 and 2019 Test Year revenue requirements were reduced to reflect projected savings from off-island purchases and these savings did not materialize, the current supply deferral accounts do not provide recovery of the additional Holyrood fuel costs that would be incurred. Assuming the Board approved the proposed mechanism to provide deferred recovery of these costs, the additional Holyrood fuel costs incurred due to lower than forecast off-island purchases would create a large fuel cost balance owing to be recovered from future customers. In this circumstance, current customers would pay rates that would be below cost and future customers would be required to pay rates that include both the cost of deferred Holyrood fuel costs and the costs of the Muskrat Falls Project.

Hydro considers its approach to determining its Test Year revenue requirements to be reasonable for establishing customer rates that are fair, consistent with intergenerational equity principles and consistent with the objective of providing customer rate stability.

[2] Nalcor's June 2017 project update stated that average island electricity rates would increase to 22.89¢ per kWh (plus HST) in 2021.