

1 Q. Re: Pre-filed Testimony of Mr. P. Bowman, page 29, line 17:

2 "The 2018 shortfall is material (\$22.6 million in 2018) and does not fit with the
3 concept of the rate base."

4 Please confirm that the inclusion of revenue deficiencies in rate base is
5 consistent with the Asset Rate Base Method.

6 A. Not Confirmed.

7 It is Mr. P. Bowman's understanding that the term "Asset Rate Base Method",
8 as used in this question, ultimately relates back to a 2003 Newfoundland
9 Power proceeding, where a relatively non-traditional approach to calculating
10 return on rate base that had been used by NP was changed to a more
11 traditional utility definition of "Rate Base" and "Return on Rate Base". The
12 definition of Asset Rate Base Method used, per PUB-250 from the NP 2003
13 GRA, applies to items that can be included in rate base (and in Mr., Bowman's
14 experience, are typically included in Rate Base) but previous to this time were
15 not included in NP's calculation of Rate Base. That RFI notes that the
16 "difference between the two is usually attributable to deferred charges,
17 deferred pension expenses for example, that are related to the operations of
18 the utility but are not bricks and mortar hard assets supplying utility services
19 directly".

20 It is important to note that previous to adopting the referenced "Asset Rate
21 Base Method", NP had used an approach that was termed the "Invested
22 Capital Approach", which NP described as follows (PUB-250 from the 2003 NP
23 GRA):

24 Although both methodologies result in the same dollar figure, the Asset
25 Rate Base methodology is the most prevalent methodology for
26 regulating U.S. energy utilities and most Canadian utilities.
27 Nevertheless, the Total Invested Capital adopted by the Public Utilities
28 Board for Newfoundland Power produces the same dollar result as
29 explicitly including other utility-related deferred items in the definition of
30 rate base. The costs of financing Newfoundland Power's deferred

1 charges, which account for the majority of the difference between its rate
2 base and invested capital, can be recovered by either method.

3 In short, the change was more mechanical than anything having a material
4 effect on outcomes.

5 More important, neither approach is cited to relate specifically to a large,
6 discrete, short-term receivable of the type represented by the 2018 shortfall.
7 The example used by NP was primarily related to a deferred pension expense
8 asset, though reference in the discussion was also made to items such as
9 NLH's deferred unamortized foreign exchange losses (Grant Thornton April 3,
10 2003 report on NP's 2003 GRA, Supplementary Evidence). These types of
11 asset can be large, long-term or even permanent, and relatively stable.

12 The theoretical background on the matter is that any utility asset (including a
13 2008 shortfall) that is carried for a sufficiently long period of time should recover
14 financing costs from ratepayers. There are three related issue:

- 15 1. The period for defining what is "sufficiently long"
- 16 2. The manner of the recovery
- 17 3. The rate to be used for carrying costs

18 In regard to issue #1, Mr. P.Bowman does not disagree that the 2008 shortfall
19 is being carried for a sufficiently long period to recover carrying costs. Mr.
20 Bowman's only disagreement on this matter is the date for beginning the
21 calculation of carrying costs. In Mr. P. Bowman's experience, no financing
22 costs are appropriate for recoveries that occur within the same test year as the
23 deficiency arises, and a similar conclusion was reached by the NWT Public
24 Utilities Board in the reference provided in Mr. P.Bowman's pre-filed testimony,
25 at page 30.

26 In regard to issue #2, there are two options. One is to add the asset to rate
27 base such that it receives a "return" blended into base rates, while the other is
28 to accrue interest to the asset itself. Mr. P.Bowman's experience is that shorter
29 term and/or more volatile accounts, such as the 2008 shortfall, suit the second
30 approach. This is because amounts added to rate base become part of base
31 rates that are set to operate over periods of years or more, while the second

1 approach appropriately adjusts by month, and is designed to prevent
2 introducing unstable elements into base rates. This is the same logic used to
3 determine that the RSP should be excluded from rate base (even though,
4 under the definitions provided above, on first blush it would fit within rate base
5 under the Asset Rate Base Method as defined for the 2003 NP proceeding, in
6 that it is a utility-related deferred account). The approach of accruing interest
7 to the asset itself is also highly recommended for the 2018 deficiency as it
8 avoids the need for circular calculations that are needed under Hydro's
9 proposed approach. Note that this is a very different context than
10 Newfoundland Power's pension expense asset that was the focus of the Asset
11 Rate Base Method change

12 In regard to issue #3 (the rate to be used for financing), this only arises as a
13 discrete question for assets that have been taken out of rate base, like the
14 RSP. The question for the appropriate rate for financing is tied to the term and
15 the risk of the asset in question. For the RSP, which is effectively a permanent
16 account, there is a logic to using a long-term cost of capital. For the 2018
17 deficiency however, there is effectively no risk of recovery and the recovery
18 will occur over a very short period. This is no logical linkage between this
19 balance and risk capital (such as equity) or long-term capital (such as long-
20 term debt). This is why a short-term debt approach is recommended.