HAND DELIVERED

December 23, 2013

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

Attention: G. Cheryl Blundon
Director of Corporate Services
and Board Secretary

Ladies and Gentlemen:

Re: Newfoundland and Labrador Hydro - Amended General Rate Application

Please find enclosed the original and 12 copies of Newfoundland Power's Submission in relation to the above-noted Application.

For convenience, the Submission is provided on three-hole punched paper.

A copy of this letter, together with enclosures, has been forwarded directly to the parties listed below.

If you have any questions regarding the enclosed, please contact the undersigned at your convenience.

Yours very truly,

Gerard M. Hayes
Senior Counsel

Enclosures

Newfoundland Power Inc.
55 Kenmount Road • P.O. Box 8910 • St. John's, NL A1B 3P6
PHONE (709) 737-5609 • FAX (709) 737-2974 •
newfoundlandpower.com

WHENEVER. WHEREVER.
We'll be there.

NEWFOUNDLAND POWER
A FORTIS COMPANY

c.

Geoffrey Young
Newfoundland and Labrador Hydro

Paul Coxworthy
Stewart McKelvey

Dennis Browne, QC
Miller & Hearn

Senwung Luk
Olthuis, Kleer, Townshend LLP

Thomas Johnson, QC
O'Dea Earle Law Offices

Thomas O'Reilly, QC
Vale Newfoundland and Labrador Limited

Yvonne Jones, MP
Labrador

Genevieve Dawson
Nunatsiavut Government

Newfoundland Power Inc.
55 Kenmount Road • P.O. Box 8910 • St. John's, NL A1B 3P6
PHONE (709) 737-5609 • **FAX** (709) 737-2974 •
newfoundlandpower.com

Newfoundland and Labrador Hydro
2013 General Rate Application - Amended

Written Submissions
of Newfoundland Power

December 23, 2015

NEWFOUNDLAND POWER
A FORTIS COMPANY

TABLE OF CONTENTS

A. INTRODUCTION

A.1 The Original Application

On July 30, 2013, Newfoundland and Labrador Hydro ("Hydro") filed a General Rate Application (the "Original Application") seeking, among other things, approval by the Board of new customer rates, effective January 1, 2014, based on a 2013 Test Year. The Original Application was the first general rate application filed by Hydro since 2006.

The projected wholesale rate impact for Newfoundland Power was an average decrease in the base rates of 4.8%; including an average decrease of 3.2% for end consumers and rural customers.

Reference: *Original Application; Finance; Schedule III, page 1 of 2; Finance; Schedule I, page 4 of 11.*

Following public notice of the Application, the Board issued Order No. P.U. 28 (2013) on September 19, 2013, which set out the schedule of dates and procedures for the hearing of the Original Application. This Order established a detailed schedule providing for: review of the Application by Grant Thornton, the Board's financial consultants; written interrogation of the Application by intervenors; filing of evidence by intervenors; Board facilitated negotiations; and a public hearing, all in accordance with established Board practice.

In June of 2014, one month prior to the scheduled public hearing of the Original Application, Hydro advised the Board of its intention to file an amended general rate application, citing the need to "update the financial information to provide a more current and relevant basis for rate setting purposes." Settlement negotiations and the public hearing were postponed.

Reference: *Hydro letter to the Board dated June 6, 2014.*

A.2 The Amended Application

On November 10, 2014, Hydro filed its amended general rate application (the "Amended Application"). In addition to proposing new rates based on a 2015 Test Year, the Amended Application proposes that the Board also test costs for 2014 for purposes of addressing a forecast net income deficiency of $45.9 million for that year (the "2014 Revenue Deficiency").

The Amended Application included a number of other proposals which varied substantially from those included in the Original Application including, but not limited to, issues related to rate design and cost of service methodologies. These changes included a new Hydro proposal to change the methodology for the allocation of the Rural Deficit, which would have the effect of shifting a greater portion of the costs to Newfoundland Power's customers.

The wholesale rate impact for Newfoundland Power of the Amended Application was a 4.1% increase, as compared to the 4.8% decrease proposed in the Original Application. The estimated average rate impact on end consumers of the proposals in the Amended Application was a 2.8% increase, as compared to a 3.2% decrease in the Original Application.[1]

A.3 Process

Eight intervenors representing diverse interests participated in the hearing process for the Original Application and the Amended Application. The Board and intervenors issued a total of over 2,000 requests for information to Hydro.

[1] The percentage change in these customers' base rates is in comparison with existing rates. The relative increase in comparison to the rates proposed in the Original Application is 6%.

The public hearing of the Amended Application commenced on September 9, 2015 and concluded on December 3, 2015 after a total of 42 hearing days.

During the course of the public hearing, Hydro witnesses undertook to respond to a total of 192 questions they could not immediately answer or to provide other information that was not readily available. As late as December 17, 2015, Hydro continued to file revised responses to requests for information and written undertakings.

A.4 Settled Issues

As a result of Board facilitated negotiations, a Settlement Agreement with respect to certain matters raised in the Amended Application was reached on August 14, 2015 between Hydro, the Consumer Advocate, Newfoundland Power, the Industrial Customer Group, Vale and Board staff.

The settled issues included (i) Hydro's allowed range of return on rate base; (ii) certain accounting matters related to the 2014 Revenue Deficiency and the 2015 Test Year Revenue Requirement; (iii) certain cost of service issues; (iv) the rate design for Industrial Customers; (v) allocation of the year-to-date net load variations in the RSP in the event the load variation is maintained as an element of the RSP; (vi) deferral and recovery mechanisms for Conservation and Demand Management and approved hearing costs; (vii) continuation of the generation credit agreement between Hydro and Corner Brook Pulp and Paper Limited on a pilot basis; (viii) a wheeling rate; (ix) the implications of Hydro's Customer Service Strategic Roadmap 2015-2017; (x) Hydro's obligation to continue reporting on key performance indicators; (xi) Hydro's obligation to complete various studies related to the Labrador-Island interconnection; and (xii) the timing of Hydro's next GRA filing.

Reference: *Consent 1.*

Following commencement of the public hearing, a Supplemental Settlement Agreement was agreed by the parties. Matters agreed in the Supplemental Settlement Agreement included (i) most of the remaining cost of service issues (save and except for the methodologies for allocation of the Rural Deficit and specifically assigned O&M charges); (ii) Newfoundland Power's rate design; (iii) Hydro's proposed Conservation and Demand Management Cost Recovery Adjustment; and (iv) Hydro's obligation to complete a cost of service methodology review in 2016 on agreed terms.

Reference: *Consent 2.*

Submission

Newfoundland Power submits that, in its order on this Application, the Board should implement the Settlement Agreement and the Supplemental Agreement.

B. REGULATORY POLICY AND PROCESS

B.1 General Policy Framework

The regulatory policy framework under which Hydro is regulated by the Board is established primarily by the *Electrical Power Control Act, 1994* and the *Public Utilities Act*. That regulatory policy framework requires the Board to balance the interests of Hydro and its customers in its consideration of the Amended Application.

The *Public Utilities Act* defines the Board's powers in the regulation of public utilities in its jurisdiction, including Hydro. In addition, the *Public Utilities Act* sets out the obligations and rights of Hydro as a public utility providing a regulated service.

The *Public Utilities Act* provides for the Board's general supervision of Hydro's utility operations (s.16) and, amongst other things, requires the Board to specifically approve rates (s.70), capital expenditures (s.41) and the issue of securities (s.91).

Hydro has an obligation under the *Public Utilities Act* to provide service to all who require it (s.54) and to ensure that its service and facilities are reasonably safe and adequate (s.37). This obligation is commonly referred to as the "obligation to serve".

Section 80 of the *Public Utilities Act* entitles Hydro to the opportunity to earn annually a just and reasonable return on its rate base in addition to recovering its reasonable and prudent operating expenses.

The *Electrical Power Control Act, 1994* sets out the electrical power policy of the province. The electrical power policy of the province deals specifically with rates [s. 3(a)] and management of utility resources [s.3(b)].

Section 3 (a) of the *Electrical Power Control Act, 1994* provides, in part, as follows:

> *"3. It is declared to be the policy of the province that*
> *(a) the rates to be charged, either generally or under specific contracts, for the supply of power within the province*
> *(i) should be reasonable and not unjustly discriminatory,*
> *(ii) should be established, wherever practicable, based on forecast costs for that supply of power for 1 or more years,*
> *(iii) should provide sufficient revenue to the producer or retailer of the power to enable it to earn a just and reasonable return as construed under the Public Utilities Act so that it is able to achieve and maintain a sound credit rating in the financial markets of the world,…".*

Section 3 (b) of the *Electrical Power Control Act, 1994* provides, in part, as follows:

> *"3. It is declared to be the policy of the province that*
> *(b) all sources and facilities for the production, transmission and distribution of power in the province should be managed and operated in a manner*
> *(i) that would result in the most efficient production, transmission and distribution of power,*
> *(ii) that would result in consumers in the province having equitable access to an adequate supply of power,*
> *(iii) that would result in power being delivered to consumers in the province at the lowest possible cost consistent with reliable service,…".*

The electrical power policy of the province encapsulates the interests of both Hydro and the consumers of Hydro's electricity service, which the Board must balance in its consideration of the Amended Application. On the one hand, the electrical power policy entitles Hydro to charge rates that will provide it with an opportunity to earn a just and reasonable return. On the other hand, it obliges Hydro at all times to operate efficiently, so it is able to provide a reliable supply of power to all of its customers consistent with the "least cost" standard.

B.2 Regulatory Balance

The balance contained in the regulatory policy framework in this province has been recognized by the Board on a number of occasions including in Order No. P.U. 32 (2007), where the Board observed:

> *"The real challenge for the Board, in keeping with its legislative mandate, is to balance ofttimes competing objectives within the regulatory environment to ensure a set of sound and reasoned decisions serving the interests of both customer and utility alike."*

Reference: *Order No. P.U. 32 (2007), Appendix A, Page 8.*

B.3 Evidentiary Considerations

The Board is legally required to determine issues on the basis of the evidence before it. In this proceeding, the onus is on Hydro to prove that its management of its facilities has been prudent and that the costs it seeks to recover from customers through rates are reasonable. Hydro has acknowledged and accepted that burden of proof.

Reference: *Transcript, September 23, 2015, page 112, line 23 to page 113, line 21.*

The size of the record of this proceeding, and the breadth and complexity of the issues, presents challenges. Firstly, the extensive body of evidence before the Board presents numerous instances of conflicting information. This raises concerns as to the reliability of the evidence, in particular, the financial information provided by Hydro. In addition to such inconsistencies in the record, evidence presented during the public hearing disclosed significant differences between test year forecasts and actual experience in 2014 and 2015. This raises questions regarding the reasonableness of Hydro's test year forecasts. While some degree of variance is to be expected due to the inherent imprecision of a forecast, a test year is intended to reasonably represent the utility's costs.

Hydro acknowledged that the utility is at the risk of variances between test year costs and actual costs when actual costs are higher. This is consistent with the principle that the utility is not entitled to recover from customers any costs not proven to be reasonable.

Reference: *Transcript, October 7, 2015, page 96, lines 10-24.*

Hydro is asking the Board to depart from generally accepted regulatory practice in the determination of Hydro's rate base for rate setting purposes to provide it with an opportunity to earn "the appropriate return" in 2016, the first year in which rates to be established in this proceeding will apply. This suggests the 2015 test year forecast may not provide an appropriate basis for prospective rate setting. Meanwhile, Hydro has chosen not to update its test year forecasts.

Reference: *Transcript, November 19, 2015, page 67, line 18 to page 72, line 10.*

Hydro is the custodian of its financial information and accounting resources. It is accountable for the evidence it presents and for its conduct of the Amended Application. Where substantial questions arise as a result of conflicting evidence on the record, such questions should be resolved in favour of Hydro's customers. Where it is proposed that the Board depart from generally accepted regulatory practice, such proposals should be supported by expert regulatory evidence.

B.4 Context of the Amended Application

B.4.1 General

In its consideration of the Amended Application, the Board's principal task is to determine whether the substantial increases in Hydro's costs since 2007 are reasonable based on the evidence presented, and whether they provide a reasonable basis for regulatory decision making. The Board's determinations will be made against the backdrop of Hydro's declining service reliability, which became especially evident following the supply issues and customer outages experienced in January 2014. Since its last rate proceeding, Hydro has undergone major organizational changes, largely related to the creation of the energy corporation now known as Nalcor Energy ("Nalcor").

B.4.2 The Changing Organizational Structure

In 2008, a new Crown corporation was established to take a lead role in the development of the Province's energy resources. Hydro is now a 100% owned subsidiary of Nalcor. Nalcor and Hydro share personnel through a matrix organizational model, which provides the ability to share costs and resources among Hydro, Nalcor and Nalcor's non-regulated lines of business. Hydro's management decision-making in the context of this matrix organizational model was a prominent focus of the public hearing of the Amended Application.

Reference: *Amended Application, Volume I, page 3.39, lines 17-24.*

The evidence shows that the introduction of the matrix organizational model has influenced decision making and the sharing of resources among Hydro and its affiliates. Hydro's management decisions in relation to system operations and maintenance is an issue in this proceeding.

In Newfoundland Power's submission, the evidence in this proceeding related to lines of authority and accountability at Hydro lacks clarity. The coincidence of this lack of clarity with major increases in Hydro's costs and worsening service reliability indicate that management performance should continue to be a focus of the Board's regulatory supervision of Hydro.

B.4.3 Operating Efficiency

The Amended Application contains proposals for the recovery of costs from Hydro's customers, including Newfoundland Power. Hydro's executive and management witnesses testified that Hydro has maintained reasonable control over its controllable costs. The evidence is not consistent with that assertion.

Reference: *Transcript, September 23, 2015, page 113, line 22 to page 115, line 20.*

The evidence indicates that Hydro's costs have increased well beyond inflationary levels since Hydro's 2007 general rate application. Hydro's operations and maintenance ("O&M") costs have increased by 47.9% since 2007. Total O&M costs in Hydro's 2015 Test Year costs have increased by $44.8 million over the 2007 Test Year. This is a 33.2% increase on an inflation adjusted basis. Gross Salaries have increased by 43.3% on an inflation adjusted basis over the same period.

Reference: *Amended Application, Volume I, page 1.13R, Table 2; Responses to Requests for Information NP-NLH-315; and NP-NLH-314.*

The evidence is not consistent with the exercise of reasonable control by Hydro over its controllable costs. Hydro's 2014 forecast O&M costs were 12.7% higher than the 2013 actual costs, and the 2014 actual costs exceeded forecast by a further 5%. O&M Costs for the 2015 Test Year were initially forecast to increase an additional 9% over the 2014 forecast; however, by August of 2015, a revised forecast indicated further increases by year end.

Reference: *Responses to Requests for Information NP-NLH-315; NP-NLH-307, Revision 1, Attachment 1, page 9, line 36; Undertaking 55, Attachment 2.*

In Order No. P.U. 7 (2002-2003), arising out of Hydro's 2001 general rate application, the Board stated that "the onus is on [Hydro] to bring forward performance measures which clearly demonstrate the efficiency of its operations." At that time, the Board determined that Hydro had not demonstrated the efficiency of its operations, and imposed a productivity allowance on Hydro of $2.0 million.

Reference: *Order No. P.U. 7 (2002-2003), page 73.*

The evidence of Hydro's executive and management witnesses is that no specific performance measures or directed programs have been implemented by Hydro to improve or measure efficiency. Instead, Hydro claims its productivity efforts are built in to the annual budgeting process and its efforts to try to take advantage of opportunities as they arise. Hydro was unable to identify any specific areas where operating costs have been significantly reduced as a result of such efforts.

Reference: *Transcript, September 10, 2015, pages 1-4; Transcript, September 16, 2015, page 155, line 22 to page 168 line 7; Transcript, September 22, page 88, line 7 to page*

92, line 3; Transcript, September 24, 2014, pages 128-140; Transcript November 16, page 147, line 17 to page 152, line 8.

In its consideration of the Amended Application, the Board must determine whether the increases in costs indicated by Hydro's proposed 2014 and 2015 test year revenue requirements are reasonable and consistent with those of an efficiently-run electrical utility. In Newfoundland Power's submission, Hydro has not presented evidence of this.

These written submissions recommend specific cost reductions and disallowances in Hydro's 2014 and 2015 test years. Detailed submissions supporting these recommendations are set out in Sections C and D.

B.4.4 Service Reliability

The increases in Hydro's costs since 2007 have taken place in a period during which there has been a decline in the reliability of the service Hydro provides to its customers. Following the supply issues and service interruptions of January 2014, the Board initiated an investigation of the causes of the widespread electricity outages experienced by customers on the Island Interconnected system (the "Supply Issues Investigation").

The Board's preliminary report on the Supply Issues Investigation concluded that the outages were caused or contributed to by a number of decisions and failures by Hydro. In particular, the Board found that "the number and nature of equipment failures that occurred is unusual, raising questions as to Hydro's operation and maintenance of its equipment…". The preliminary report of the Board's consultant, The Liberty Consulting Group ("Liberty"), found that "a continuing and unacceptably high risk" of outages remains for 2015-2017.

Reference: *The Board's Interim Report dated May 15, 2014, pages 25-26; Liberty Interim Report dated April 24, 2014, page 4.*

The Supply Issues Investigation is ongoing. During the course of Phase One of the Supply Issues Investigation, the Board imposed certain detailed reporting obligations on Hydro. The Board continues to require reporting in relation to accuracy of load forecasting and winter readiness. Hydro has also committed to filing an annual report with the board on generation adequacy.

Reference: *Board letter to Hydro dated August 14, 2015 as to load forecasting accuracy reporting, and October 8, 2015 as to winter readiness reporting. Hydro letter to the Board dated September 16, 2015 as to generation adequacy reporting.*

Hydro should remain subject to those detailed reporting requirements until the Board is satisfied that the unacceptably high risk of outages on the Island Interconnected system is not a concern.

Phase Two of the Supply Issues Investigation is anticipated to conclude in 2016. This phase of the investigation is focused on reliability on the Island Interconnected system following the interconnection with Muskrat Falls. Newfoundland Power will file with the Board its detailed submissions regarding future reliability of supply on the Island Interconnected system in that proceeding.

B.4.5 The Prudence Review

In February 2015, as part of its investigation and review of the Amended Application, the Board retained Liberty to provide expert assistance relating to a prudence review undertaken by the

Board relating to certain actions and decisions taken by Hydro and whether associated costs are to be recovered from Hydro's customers (the "Prudence Review"). The Prudence Review was formally constituted as a separate procedure within the public hearing of the Amended Application. Liberty's review culminated in a finding that Hydro's decisions and actions were imprudent in relation to 7 of the 11 specific programs and projects under review.

In its consideration of the Amended Application, the Board must consider whether Hydro's management decision-making has been prudent and has resulted in the provision to Hydro's customers of electrical service that is consistent with the electrical power policy of the Province and Hydro's obligation to serve.

Newfoundland Power's written submissions on the Prudence Review have been filed with the Board in separate written submissions dated December 23, 2015. The written submissions on the Prudence Review should be considered together with these written submissions.

B.5 Regulatory Balance and the Amended Application

In Newfoundland Power's view, a general rate application to enable Hydro to rebalance its rates with its costs is long overdue. However, Hydro should only recover those costs, forecast or otherwise, which have been tested and proven to be reasonable in accordance with accepted regulatory principles.

In assessing the entirety of the evidence and the submissions of the parties, the Board must balance the interests of the utility and electricity consumers within the regulatory policy framework described above.

In Newfoundland Power's view, Hydro's approach to test year forecasting and the presentation of cost information in this proceeding has hindered a satisfactory understanding of Hydro's costs. As noted below, there are measures available to the Board to address shortcomings in the evidence in the short term. However, as Hydro's President and Chief Executive Officer has testified, a mismatch between utility revenues and costs over the longer term can have serious repercussions for the utility and its customers.

Reference: *Transcript, September 10, 2015, page 20, line 24 to page 23, line 9.*

Newfoundland Power's submissions on costs, if accepted by the Board, would result in significant adjustments to Hydro's 2014 and 2015 test year revenue requirements. It is Hydro's evidence that any such adjustments would be recorded by Hydro in its 2016 financial results. On that basis, the adjustments recommended in these written submissions would have implications for Hydro's opportunity to earn a just and reasonable return in 2016.

Reference: *Transcript, November 19, 2015, page 42, line 10 to page 45, line 11.*

The entitlement of a utility to earn a just and reasonable return has been described by the Newfoundland and Labrador Court of Appeal as follows:

> *"[23] This statutory entitlement of the utility to earn a "just and reasonable" return is the linguistic touchstone for the balancing exercise. This phrase emphasizes the fairness aspect, both to the utility, in earning sufficient revenues*

> *to make its continued investment worthwhile and to maintain its credit rating in financial markets, and to the consumer, in obtaining adequate service at reasonable rates. It also emphasizes the need for a tempering of each interest group's economic imperative by consideration of the interests of the other.*
>
> *[24] Having said that, the entitlement of the utility to a fair return on its investment is always regarded as of fundamental importance…"*

Reference: *Stated Case, Page 16, paragraphs 23 and 24.*

Highlighting the balance inherent in utility regulation, the Supreme Court of Canada in a recent judgment determined that the entitlement of a public utility to a fair return is not absolute in all circumstances. In upholding a decision of the Ontario Energy Board to disallow certain operating costs of Ontario Power Generation ("OPG"), a public utility, the Court stated as follows:

> *"I have noted above that it is essential for a utility to earn its cost of capital in the long run. The Board's disallowance may have adversely impacted OPG's ability to earn its cost of capital in the short run. Nevertheless, the disallowance was intended "to send a clear signal that OPG must take responsibility for improving its performance". (Board Decision, at p. 86). Such a signal may, in the short run, provide the necessary impetus for OPG to bring its compensation cost in line with what, in the Board's opinion, consumers should justly expect to pay for an efficiently provided service. Sending such a signal is consistent with the Board's market proxy role and its objectives under s. 1 of the Ontario Energy Board Act, 1998."*

Reference*:* *Ontario (Energy Board) v. Ontario Power Generation Inc., 2015 SCC 44, at paragraph 120.*

Newfoundland Power believes that the financial integrity of Hydro benefits customers. For that reason, Hydro's entitlement to an opportunity to earn a just and reasonable return should always be a fundamental consideration for the Board. The Board's decisions in this proceeding must balance that consideration against the customers' interest in receiving an efficiently provided service.

These written submissions contain Newfoundland Power's assessment of the evidence. In Newfoundland Power's submission, it is appropriate that costs judged by the Board to flow from imprudent decisions not be borne by customers. It is also appropriate that costs not proven on the evidence to be reasonable should not be recovered from customers.

On the basis of the Supreme Court of Canada's recent statement of the law, it is within the Board's authority to order cost disallowances or adjustments to proposed revenue requirements that could have an adverse impact on Hydro's ability to earn its allowed rate of return *in the short term* if such disallowance or adjustment, in the Board's opinion, constitutes an appropriate signal that Hydro must take responsibility for improving its performance.

The appropriateness of such a measure should be considered in light of the short time horizon in which the Board's determinations in this proceeding will apply. During negotiations prior to the start of the hearing, it was agreed that Hydro will file its next general rate application, for rate changes based on a 2018 test year, on or before March 30, 2017.

***Reference**:* *Consent 1.*

The anticipated time between the Board's order in this proceeding and Hydro's filing of another general rate application is just over a year. This provides time for Hydro to respond to the Board's order and provide evidence that demonstrates improvement in its performance. Although challenges remain, there is evidence that Hydro has made progress.

In its report to the Board dated December 17, 2014, Liberty stated that Hydro has made "substantial progress" in addressing its problems that contributed to transmission equipment failures, in making recommended enhancements to its maintenance practices and in improving program execution in identified areas of its asset management program.

Reference: *Liberty Consulting Group, Report on Island Interconnected System to Interconnection with Muskrat Falls addressing Newfoundland and Labrador Hydro, Executive Summary, ES-1 to ES-3.*

Liberty's witnesses testified during the prudence segment of the public hearing that the work Hydro has done since the commencement of the Supply Issues Investigation "has been aggressive, commendable, the programs the instituted were extensive…important work remains, but on balance, I think Hydro was very responsive to Liberty's findings."

Reference: *Transcript, November 12, 2015, page 124, lines 6-14.*

During the public hearing of the Amended Application, Hydro acknowledged the need to improve its performance. At its next general rate application, the Board will have an opportunity to assess whether it has made reasonable progress in that regard.

Reference: *Transcript, October 29, 2015, page 95, line 22 to page 99, line 6; Transcript, October 30, 2015, page 123, line 3 to page 125, line 1.*

C. COSTS FOR RATEMAKING PURPOSES

C.1 General

Hydro's proposal for future rates is based on a forecast 2015 test year. 2015 is almost over. Hydro has clearly indicated that it does not intend to adjust its test year forecast to reflect updated information.

For many costs, the evidence simply does not support what is reflected in Hydro's test year. In these instances, adjustments are required in order to ensure that electrical power is being delivered to Hydro's customers "at the lowest possible cost consistent with reliable service."

Reference: *Electrical Power Control Act, 1994 SNL 1994, Ch. E-5.1, s. 3(b)(iii).*

In total, the required adjustments to Hydro's 2015 test year exceed $100 million. The most significant single required test year cost adjustment relates to Hydro's fuel costs.

In correspondence to the Board dated October 28, 2015, Hydro proposed to update its No. 6 fuel and diesel production costs, as well as its diesel purchases, to reflect lower fuel costs. The impact on Hydro's proposed test year fuel costs would be a reduction of $77.8 million. Hydro has not filed an amendment to the Amended Application to reflect these updates. The compliance filing following the Amended Application should reflect the most recent fuel prices.

Reference: *Hydro Letter to the Board dated October 28, 2015, page 2, Table 1.*

Several additional, non-fuel, test year cost adjustments are also required based on the evidence before the Board. Due to conflicting evidence before the Board, the required adjustments may lack the element of precision in some cases. Nevertheless, the overall impact on Hydro's 2015 revenue requirement is substantial. The total required adjustments to Hydro's 2015 test year non-fuel costs are in the range of $26.3 million to $31.1 million.

Required adjustments to Hydro's 2015 test year non-fuel costs include reductions to Hydro's proposed rate base, production costs, operating costs and other costs.

The most significant rate base adjustments relate to the timing of Hydro's capital additions. For 2015, Hydro's opening rate base balance should be reduced to reflect those assets included in Hydro's forecast rate base which were not in service on January 1, 2015. Other adjustments should be made to remove those capital expenditures assessed to be imprudent by the Board in the Prudence Review.

Hydro's 2015 test year production costs should be lower because the evidence does not support the proposed Holyrood fuel conversion factor. Operating cost adjustments are required in the areas of Human Resources, Intercompany Charges and Professional Services. Disallowances for operating costs assessed to be imprudent by the Board in the Prudence Review will also be necessary.

Other 2015 revenue requirement adjustments relate to Hydro's proposals for recovery of (i) the debt guarantee fee, (ii) the fuel supply cost deferral from 2014, and (iii) Hydro's asset retirement obligations. Finally, the evidence before the Board supports the imposition of a productivity allowance as an incentive for operating efficiency.

C.2 Costs Unsupported by Evidence in the 2015 Test Year

C.2.1 Unsupported Rate Base Items

Hydro seeks approval for a forecast average rate base for 2015 of $1,802.0 million. This represents an increase of $312.7 million over the 2007 approved rate base. Hydro seeks a 2015 return on average rate base of $122.8 million at a rate of return on rate base of 6.82%.

***Reference**: Evidence, Section 3.4.1, page 3.20, Table 3.9; Section 3.3.6, page 3.17, Table 3.7.*

Hydro has overstated its 2015 average rate base. The evidence does not support Hydro's proposals for inclusion of certain planned additions to plant in service and forecast capital expenditures for projects Liberty has determined were imprudent. Furthermore, the evidence shows that Hydro's allowances for fuel inventory and deferred charges as well as interest capitalized during construction have been overstated. Hydro's proposed 2015 average rate base should be reduced accordingly.

The rate base adjustments will have corresponding effects on the return on rate base and amortization. In this section, Hydro's estimates of return on rate base and amortization impacts have been used when available. Otherwise, return on rate base impacts are estimated on the basis of the proposed rate of return on rate base of 6.82%. Amortization impacts are estimated on the basis of Hydro's average depreciation rate of 3.5%. These impacts should be confirmed by Hydro in its compliance filing.

Reference: *TIR-NP-NLH-011, footnote 3.*

C.2.1.1 Overstated Plant in Service

Holyrood Combustion Turbine

Construction on the new 100 MW Holyrood combustion turbine ("Holyrood CT") began following the award of a contract to ProEnergy in May 2014. The contract included an in-service target of December 31, 2014. Hydro acknowledged that this was a "stretch target." The Holyrood CT was not in service until sometime between the third week of January and the end of February 2015.

Reference: *Transcript, November 4, 2015, page 13, line 21 to page 14, line 21; PR-DD-NLH-005.*

Hydro proposed an adjustment to its rate base for the purposes of calculating a 2015 Net Income Deficiency in the 2015 Cost Recovery Deferral Application. This adjustment was in acknowledgement of the fact that the Holyrood CT and other forecast additions to plant were not in service at the beginning of 2015. No such adjustment is proposed for rate-making purposes. Instead, Hydro proposes that the Holyrood CT remain in rate base for rate making purposes as it will be "used and useful" during the period in which new rates are in effect.

Reference: *Amended 2015 Cost Deferral Application, November 12, 2015, Evidence, page 5; Transcript, November 19, page 67, line 19 to page 68, line 17.*

Hydro acknowledges this is a departure from generally accepted regulatory practice. Hydro claims this is necessary so that it does not earn a return on rate base in 2016 which would be below the low end of the allowed range. Hydro has not presented any expert evidence in support of its proposal.

Reference: *Transcript, November 19, 2015, pages 62-72.*

Submission

A reduction in the opening balance of Hydro's 2015 rate base is required in the circumstances. Hydro estimates that such a reduction would be between $110 million and $112.7 million.

Reference: *TIR-NP-NLH-011; TIR-NP-NLH-003.*

Table C-1 shows the required reduction to the 2015 test year average rate base and revenue requirement related to the removal of the Holyrood CT.

Table C-1
2015 Test Year
Holyrood CT
($000s)

	Rate Base		
	Year End	**Average**	**Return on Rate Base**
Holyrood CT	110,000	55,000	3,746

Reference: *TIR-NP-NLH-011.*

Incomplete/Under Spent Capital Projects

Hydro's capital expenditures have consistently been under budget. The average annual variance between 2009 and 2013 was 15% below budget.

Reference: *Grant Thornton Report, June 12, 2015, page 110, lines 8-17 and Table 85.*

In 2014, Hydro's actual additions to assets in service were under budget by $148.0 million. The largest contributor to this variance was the Holyrood CT. Other incomplete projects totaling $38.0 million were carried forward to 2015.

These additions are included in the 2015 rate base at full value. A reduction in the opening balance of Hydro's 2015 rate base is required to reflect the fact that the related assets were not in service as of December 31, 2014.

Reference: *TIR-NP-NLH-011.*

Apart from 2014 carryovers, Hydro's 2015 forecast rate base included an addition of approximately $84.1 million to plant in service. Hydro submits that these additions, and all carryovers from 2014, will be in service by 2015. Hydro claims this would bring its cumulative additions in at less than 1% under budget for the 2014 and the 2015 years. This would not be consistent with Hydro's recent experience.

Reference: *Undertaking 158, page 3.*

The evidence has not established that Hydro's historical trend of overestimating capital expenditures by 15% annually will not be repeated in 2015. Because Hydro's proposal to include the entire forecast plant additions in rate base for rate making purposes is not consistent with recent experience, it would be an unwarranted burden on ratepayers.

Submission

A 15% reduction in the 2015 forecast plant in service would more accurately reflect Hydro's historical completion of capital work. This would reduce the 2015 average rate base by $6.3 million.

Table C-2 shows the reduction to 2015 test year average rate base and revenue requirement related to incomplete/under spent capital projects.

Table C-2
2015 Test Year
Incomplete/Underspent Capital Projects
($000s)

	Rate Base		**Revenue Requirement**		
	Year End	**Average**	**Return on Rate Base**	**Amortization**	**Total**
2014 Actual	37,971	18,985	1,296	664	**1,960**
2015 Reduction[1]	12,615	6,308	430	221	**651**
Total	**50,586**	**25,293**	**1,726**	**885**	**2,611**

Reference: *TIR-NP-NLH-011; Undertaking 158.*

C.2.1.2 Capital Expenditure Disallowances for Imprudence

In its July 6, 2015 report, Liberty determined that Hydro's actions and management decisions were imprudent in relation to 7 of the 11 projects the Board had asked Liberty to review for prudence. Liberty recommended cost disallowances for 6 of these projects, subject to a compliance review by the Board's financial experts. For the reasons stated in its written submissions on the Prudence Review, Newfoundland Power agrees with some of Liberty's findings. Hydro's customers should not be burdened with costs which would not have arisen but for the imprudent decisions or actions of Hydro.

Reference: *Liberty Report, July 6, 2015, page ES-2.*

[1] Year-end rate base: $84,100,000 x 15% = $12,615,000. Average rate base: $12,615,000 x 50% = $6,307,500. Return on rate base: $6,307,500 x 6.82% = $430,172. Amortization: $6,307,500 x 3.5% = $220,763.

Submission

Hydro's 2015 test year revenue requirement should be adjusted to reflect the cost implications of its imprudent decision and actions.

Table C-3 shows the reduction to 2015 test year average rate base and revenue requirement related to the disposition of the Prudence Review advocated by Newfoundland Power.[2]

Table C-3
2015 Test Year
Capital Cost Disallowances
($000s)

Project	**Average Rate Base**	**Return on Rate Base**
Western Avalon Tap Changer	1,429	97
Sunnyside Transformer	3,855	263
Holyrood/Sunnyside Breakers[3]	1,002	68
January 2013 Holyrood Repair	3,970	271
Total	**10,256**	**699**

***Reference**: TIR-NP-NLH-003.*

2 In its written submissions on the Prudence Review, Newfoundland Power advocates a total of $10 million in capital cost disallowances related to these items.

3 The average rate base amount of $1,078,000 shown in TIR-NP-NLH-003 for the Holyrood and Sunnyside Breakers includes the Holyrood Unit 3 fan, which was found to be a prudent capital project by Liberty. The 2014 capital expenditure for this project was reported by Liberty to be $76,407 (see page 23 of the July 6, 2015 Liberty Report). The estimated average rate base related to the Holyrood and Sunnyside Breakers is $1,001,593 ($1,078,000 – $76,407). The return on rate base impact is estimated to be $68,309 ($1,001,593 x 6.82%).

C.2.1.3 Rate Base Allowances

Fuel Inventory

Hydro's average rate base for 2015 includes a forecast allowance for fuel inventory of $66.6 million. This figure includes No.6 fuel costs of $58.9 million, diesel fuel costs of $3.5 million and combustion turbine fuel costs of $4.2 million.

This forecast is 30.8% higher than the $50.9 million forecast included in the Original Application.

Reference: *Evidence, Original Rate Application, Section 3, Schedule III, page 2, line 12; Evidence, Amended Application, Section 3, Schedule III, page 2, line 12; Grant Thornton Report, June 12, 2015, page 27, Table 12; and Amended Application, Exhibit 13, Schedule 1.1, page 2, lines 3 to 5.*

Fuel prices in 2015 are significantly lower than Hydro's test year forecast. For example, Hydro's forecast monthly inventory costs for No. 6 fuel for 2015 ranged from $27 million to $53 million, an average of approximately $40 million. Those monthly forecasts are based on the $65.63/bbl fuel price used in Hydro's 2015 Interim Rates Application. The average is approximately $19 million lower than the 2015 test year forecast. The evidence does not substantiate a fuel inventory allowance for No. 6 fuel above $40 million. Hydro's 2015 average rate base should be reduced by at least $19 million on account of the No. 6 fuel price.

Reference: *Amended Application, Exhibit 13, Schedule 1.1, page 2, line 3; IC-NLH-199.*

Table C-4 shows the reduction to 2015 test year average rate base and revenue requirement related to fuel inventory.

Table C-4
2015 Test Year
Fuel Inventory
($000s)

	Average Rate Base	Return on Rate Base
Fuel Inventory	19,000	1,296
Total	**19,000**	**1,296**

Reference: *Amended Application, Exhibit 13, Schedule 1.1, page 2, line 3; IC-NLH-199.*

Hydro has not filed updated fuel inventory costs for diesel and combustion turbine fuels. Newfoundland Power submits that Hydro should include updated fuel inventory costs for all fuel types in its compliance filing.

Deferred Charges

Hydro's average rate base for 2015 includes a forecast allowance for deferred charges of $77.5 million. This amount is $12.9 million higher than 2013 actuals, and $6.3 million higher than the 2014 forecast.

Reference: *Grant Thornton Report, June 12, 2015, page 27, Table 12.*

The 2015 test year includes certain charges approved for deferral subject to the Prudence Review. Amongst other costs, these included (i) extraordinary repairs relating to air blast circuit breakers and transformers; and (ii) additional capacity-related supply costs incurred by Hydro in January of 2014.

Reference: *Grant Thornton Report, June 12, 2015, page 116, Table 88.*

Newfoundland Power has advocated that the recovery of the cost associated with the first item should be disallowed. As for the second item, Liberty proposes disallowance of $1.7 million and Hydro proposes a disallowance of $0 or $1 million. As these disallowances do not include the return on rate base impacts associated with the unamortized portion of these amounts, they are understated.

Reference: *Newfoundland Power Written Submission - Prudence Review, page 14.*

Reductions in the closing rate base balances for 2014 and 2015 are required to reflect the overstated deferred charges associated with capital and deferred cost consequences arising from Hydro's imprudence.

Submission

Table C-5 shows the required reductions in the 2015 average rate base for the deferred charges related to the disposition of the Prudence Review advocated by Newfoundland Power.

Table C-5
2015 Test Year Average Rate Base
Deferred Charges
($000s)

	2014 Year End Balance	2015 Year End Balance	Average
Supply Cost Deferral	1,000 – 1,700	1,000 – 1,700	**1,000 – 1,700**
Extraordinary Repairs	-	996	**498**
Total	**1,000 – 1,700**	**1,996 – 2,696**	**1,498 – 2,198**

References: *Grant Thornton Report, June 4, 2015, page 116, Table 88; Liberty Report, page ES-3.*

Table C-6 shows a summary of the required reduction in 2015 test year average rate base and revenue requirement for overstated rate base allowances.

Table C-6
2015 Test Year Average Rate Base
Rate Base Allowances
($000s)

	Average Rate Base	Return on Rate Base
Fuel Inventory *(Table C-4)*	19,000	1,296
Deferred Charges *(Table C-5)*	1,498 – 2,198	102 - 150
Total	**20,498 – 21,198**	**1,398 – 1,446**

C.2.1.4 Interest Capitalized During Construction

Order-in-Council 2014-033 directed Hydro to commence construction of a 230 kV transmission system, in Western Labrador, to provide service to the proposed Kami mine. The project was suspended indefinitely in September of 2014, with no anticipated completion date. Hydro has identified $8.1 million in interest capitalized during construction (“IDC”) for 2015.

Reference: *CA-NLH-326, page 1, lines 8-10; PUB-NLH-309, Attachment 3, page 2.*

The Board’s financial experts have indicated that the IDC associated with the proposed Western Labrador transmission system was included in “work in progress” for 2015. If that is the case, there should be no effect on revenue requirement as a result of the suspension of the project. Hydro identified this amount as having been included in rate base for 2015. If Hydro’s statement is accurate, this amount should be removed from rate base and Hydro’s 2015 test year revenue requirement reduced accordingly.

Reference: *Grant Thornton Report, June 12, 2015, page 114, lines 27-28; PUB-NLH-309, Attachment 3, page 2; NP-PUB-012.*

Submission

Table C-7 shows the required reductions to the 2015 average rate base and revenue requirement associated with the removal of IDC for the 230 kV transmission system in Western Labrador.

Table C-7
2015 Test Year
Interest Capitalized During Construction
($000s)

	Rate Base		
	Year End	Average	Return on Rate Base
Interest Capitalized During Construction	8,108	4,054	276
Total	**8,108**	**4,054**	**276**

Reference: *PUB-NLH-309, Attachment 3, page 2.*

C.2.1.5 Summary of Unsupported Rate Base Items

Table C-8 summarizes the required reductions in average rate base and associated revenue requirement impacts for the 2015 test year.

Table C-8
2015 Test Year Average Rate Base
Summary of Adjustments
($000s)

		Revenue Requirement		
	Average Rate Base	**Return on Rate Base**	**Amortization**	**Total**
Holyrood CT *(Table C-1)*	55,000	3,746	-	3,746
Incomplete/Underspent Projects *(Table C-2)*	25,293	1,726	885	2,611
Prudence Disallowances *(Table C-3)*	10,256	699	-	699
Rate Base Allowances *(Table C-6)*	20,498 – 21,198	1,398 – 1,446	-	1,398 – 1,446
Interest Capitalized During Construction *(Table C-7)*	4,054	276	-	276
Total	**115,101 – 115,801**	**7,845 – 7,893**	**885**	**8,730 – 8,778**

C.2.2 Unsupported Production Costs

C.2.2.1 Holyrood Conversion Factor

Hydro's existing rates are predicated on a conversion factor of 630 kWh/bbl. This was set by the Board after considerable review in Order No. P.U.14 (2004). Hydro proposed the same conversion factor in its 2006/2007 general rate application. In the Amended Application, Hydro proposes to set rates on the basis of a conversion factor of 607 kwh/bbl. The revenue requirement impact of the proposed change to the Holyrood conversion factor is in the order of $7.0 million.

Reference: *Evidence, Section 3.8.2, page 3.50, lines 7-13; TIR-NP-NLH-007.*

Hydro cites (i) lower production requirements; (ii) lower fuel heating content due to a switch to fuel with a 0.7% sulfur content; and (iii) lower unit net average loading, as contributors to recent experiences with lower conversion factors. The evidence does not support Hydro's suggestion that higher conversion factors will not be obtainable in the future.

Reference*:* *Evidence, Section 2.1, page 2.4, lines 1-4; NP-NLH-379; NP-NLH-377.*

With respect to production requirements, the evidence suggests that Holyrood production will increase significantly in the test period and the fuel conversion factor generally increases in line with production.

Reference: *NP-NLH-377.*

Regarding heating content, Hydro concedes there is no direct evidence that the heating content of fuel decreases with sulfur content. Hydro has recently switched fuel suppliers. There is no evidence that Hydro will not be able to obtain No. 6 fuel with a higher heating content in future.

Reference: *NP-NLH-377; Transcript, September 23, 2015, page 91, line 14 to page 92, line 10.*

Finally, on the impact of average gross loading per unit, Hydro has not commissioned any study to investigate the impact of this, or any other factor, on Holyrood efficiency.

Reference: *NP-NLH-194, Revision 1, page 2, lines 4-17 and page 3, footnote 1.*

Hydro's regression analysis is evidence only of the conversion factor experienced historically. The evidence of the impact on Holyrood efficiency of operational and maintenance issues in 2013 and 2014 is unclear. Hydro has not provided evidence that the conversion factor of 630 kWh/bbl currently used in rates will not be attainable at higher forecast loads or through reasonable efficiency modifications in the future.

Reference: *Evidence, Section 2, Schedule V.*

Modifying the Holyrood Conversion factor from 630 kWh/bbl to 607 kWh/bbl has a significant effect on No.6 fuel production costs. This effect is increased when changes in fuel prices are factored in. Based on an average cost per barrel of $93.32/bbl, No.6 fuel production costs included in the Amended Application are $244.9 million. Using the updated average fuel price of $64.41/bbl, No. 6 fuel production costs were $75.9 million lower.

Reference: *Hydro Letter to the Board dated October 28, 2015, page 2, Table 1.*

The No. 6 fuel production costs in the Third Interim Rate Application reflected an average No. 6 fuel price of $65.63/bbl. At that price, No. 6 fuel production costs would be approximately $7.1 million dollars lower if the Holyrood conversion factor remained at 630 kWh/bbl. Based on the updated fuel price of $64.41/bbl. and a Holyrood conversion factor of 630 kWh/bbl., the 2015 test year No. 6 fuel production costs should be approximately $7.0 million lower.

Reference: *Evidence, Section 2.6.1, page 2.76; Evidence, Section 3, Schedule II, page 1, line 10; TIR-NP-NLH-007.*

The Island Industrial Customers' cost of service witnesses recommended a conversion rate of 622 kWh/bbl as an alternative to Hydro's proposed Holyrood conversion factor of 607 kWh/bbl. This alternative was based on concerns that the station service factor of 6.61% which was used in Hydro's calculations did not take into account growing customer loads. A more representative station service factor of 5.85% was recommended. The lower station service factor results in an improvement in the overall conversion factor by 7kWh/bbl. They also opined that Hydro had not sufficiently accounted for efficiencies due to the installation of variable frequency drives on the Holyrood units. The variable frequency drives are expected to improve Holyrood efficiency by an additional 8 kWh/bbl.

Reference: *NP-NLH-189 (Revision 1) page 2; Updated Pre-filed Testimony of P. Bowman and H. Najmidinov, June 4, 2015, page 26, Figure 4-2 and lines 3-5; and page 27, lines 3-13.*

Submission

In Newfoundland Power's submission, no credible evidence has been brought forward to indicate that the 630 kWh/bbl conversion factor for Holyrood presently utilized for ratemaking purposes is unreasonable. Therefore, no reasonable basis exists to change the conversion factor in this proceeding.

In the alternative, if the Board is satisfied that an adjustment to the Holyrood conversion factor is warranted, the Holyrood Conversion Factor of 622 kWh/bbl recommended by the Industrial Customers' cost of service witnesses could be used for ratemaking purposes. The resulting impact of this alternative on revenue requirement is not readily discernible from the record. It would have to be provided in a compliance filing.

C.2.2.2 Gas Turbine Fuel

In 2015, Hydro's combustion turbine fuel expense decreased due to lower fuel prices. There is evidence that the overall impact on revenue requirement related to this decrease would be in the order of $0.6 million. Hydro proposes to include the revenue impacts of this decrease in a cost of service study to be included in its compliance filing.

Reference: *TIR-NP-NLH-008; TIR-NP-NLH-010.*

C.2.2.3 Summary of Unsupported Production Costs

Table C-9 summarizes the required reductions in revenue requirement for the 2015 test year related to production costs.

Table C-9
2015 Test Year Revenue Requirement
Summary of Production Costs Adjustments
($000s)

	Fuel
Holyrood Conversion Factor	7,116
Gas Turbine Fuel	580
Total	**7,696**

References: *TIR-NP-NLH-007; TIR-NP-NLH-010.*

C.2.3 Unsupported Operating Costs

C.2.3.1 Operating Cost Prudence Disallowances

Liberty recommends disallowances for operating costs from the 2015 test year related to imprudent actions of Hydro. The forecast 2015 operating costs which Liberty determined could have been avoided, but for imprudent actions of Hydro, were initially estimated at $2.6 million. Liberty subsequently acknowledged that depreciation costs included in the $2.6 million should be reduced by $0.2 million.

Reference: *Liberty Report, July 6, 2015, page ES-2; Reply of Liberty, September 17, 2015, page 17, lines 1-15.*

For the reasons stated in its written submission on the Prudence Review, Newfoundland Power agrees with some, but not all, of Liberty's recommendations regarding 2015 operating cost disallowances related to Hydro's imprudence. In summary, the effect of Newfoundland Power's written submission in the Prudence Review is that a total of $1,174,000 should be disallowed from Hydro's 2015 test year. This is composed of $800,000 of depreciation associated with Holyrood Unit 1, $174,000 associated with operating cost consequences related to Hydro maintenance deficiencies, and $200,000 representing the test year amortization of the 2015 extraordinary transformer and breaker repairs.

Reference: *Newfoundland Power's Written Submission – Prudence Review, Tables 4, 6 and 8.*

Submission

Hydro's revenue requirement for the 2015 test year should be reduced by $1,174,000 to reflect the 2015 operating cost consequences of the Board's Prudence Review.

C.2.3.2 Overstated Human Resources Costs

Since 2007, Hydro's actual salary costs have increased by 43.3% on an inflation adjusted basis. The salary and benefit costs included in the 2015 test year are $88.9 million.

Hydro claims they strive to maintain operating costs within inflationary levels. Salary costs are exempt from that level of control. Hydro cites a "tightening labour market" and an increase in its capital program as reasons for the increase in salary and benefits.

Reference: *Grant Thornton Report, June 12, 2015, page 64, Table 40; NP-NLH-314; Undertaking 4, Revision 1, page 5, 2013 Budget O&M Guidance; Evidence, Section 1.4.1.1, page 1.21, lines 3-6.*

Hydro prepares annual workforce budgets based on full-time-equivalent positions ("FTEs"). In 2015, Hydro has budgeted for a significant increase over previous years' experience. Between 2007 and 2013 Hydro maintained its net FTEs between 797 and 813. In 2014 and 2015, Hydro forecasts an increase in net FTEs to 860 and 888, respectively.

Reference: *Evidence, Section 3.7.3, page 3.40, Chart 3.5.*

Hydro acknowledges that vacancies can occur from time to time and that an allowance or adjustment to workforce budgets should be made in computing test year costs. It is Hydro's practice to include a vacancy adjustment in test year costs to reflect forecast vacancies. For the 2015 Test Year, Hydro has made an adjustment of $3.3 million, reflective of 40 FTE vacancies, at $83,000 per FTE.

Reference: *CA-NLH-104, Revision 1, page 4, lines 14-16; IC-NLH-005, Revision 1.*

Hydro's recent vacancies have been much higher than is accounted for in the 2015 test year. In 2012, 2013 and 2014, Hydro experienced 52, 51 and 52 vacancies, respectively. As of September 2015, Hydro was forecasting 65 vacancies for 2015.

Reference: *NP-NLH-310 Transcript, September 16, page 182, line 14.*

Hydro has not proposed any adjustment to the 2015 test year to reflect the higher number of vacancies. Hydro claims that it will maintain a workforce within the forecast 40 vacancies for the test period.

Reference: *Transcript, September 16, 2015, page 180, line 21 to page 181, line 21.*

This is not consistent with past experience or the evidence. Further, Hydro's suggestion that lower Human Resources costs due to higher vacancies would be offset by increased overtime and consultant costs was not proven by evidence. For these reasons, the $88.9 million in salaries and fringe benefits sought to be recovered from ratepayers is unreasonable.

Reference: *Transcript, November 17, 2015, page 12, line 17 – page 16, line 12.*

Submission

The 2015 revenue requirement should be reduced by $2.1 million to reflect the higher vacancies actually expected in the 2015 test year.[4]

[4] 65 forecast vacancies less 40 test year vacancies = 25 vacancies. 25 vacancies x $83,000 = $2,075,000.

C.2.3.3 Intercompany Charges

Among other services, Hydro renders common services to affiliates in the functional areas of human resources, safety and health and information services ("IS"). These services are performed by home-based Hydro employees. Affiliates are charged for those services on the basis of a billing allocator. Costs for the first two functional areas are allocated using FTEs as an allocator. IS related costs are recovered on the basis of average number of users.

Reference: *Evidence, Exhibit 8, Intercompany Transaction Costing Guidelines, page 3.*

The Board's transfer pricing expert, Mr. Rolph, reviewed Hydro's intercompany transaction policies and found them to be more or less reasonable with some exceptions. Mr. Rolph did not audit actual transactions for reasonableness; nor did he consider whether any specific transactions within the matrix organization could affect the operational or managerial integrity of Hydro as a regulated entity.

Reference: *Transcript, October 19, 2015, page 29, lines 4-16 and page 40, lines 1-21.*

In his June 1, 2015 report, Mr. Rolph raised the concern that the common services charges which Hydro recovers from its affiliates may not be fully burdened. As such, they are understated. Hydro has acknowledged this deficiency.

Reference: *Transcript, November 16, 2015, page 9, line 15 to page 10, line 19.*

According to Hydro, the resulting impact of the understatement on the 2015 test year is $114,000.

Reference: *Undertaking 151.*

In addition to the concern raised by Mr. Rolph, Newfoundland Power submits that the manner in which Hydro's core shared services costs are allocated is not consistent with least cost principles. All of the personnel providing core shared services for Nalcor's lines of business are Hydro employees. Because these costs are allocated based on the total FTEs of the Nalcor group, more of the costs of common services are allocated to regulated Hydro. If those costs were allocated as if the employees were home based in the parent company, Nalcor, Hydro's 2015 revenue requirement would be lower by approximately $882,000. In Newfoundland Power's submission, this would be a more equitable approach for rate payers.

Reference: *NP-NLH-204.*

Submission

The 2015 revenue requirement should be reduced by $114,000 to correct the understatement of the common services charges Hydro recovers from its affiliates. The 2015 revenue requirement should be further reduced by $882,000 to reflect a more equitable allocation of common services costs.

Table C-10 summarizes the required reductions to revenue requirement for the 2015 test year related to intercompany charges.

Table C-10
2015 Test Year Revenue Requirement
Intercompany Charges
($000s)

	Operating
Fully burdened costs	114
Allocation method[5]	882
Total	**996**

Reference: *Undertaking 151; NP-NLH-204.*

C.2.3.4 GRA and Board Related Costs

Under the heading of Professional Services, Hydro seeks to recover a total of $8.4 million after cost recoveries from affiliates in the 2015 test year. This amount includes $2.3 million in GRA and Board Related Costs.

Reference: *Evidence, Section 2.4.1, page 2.39, Table 2.7.*

From 2007 to 2014 inclusive, Hydro's annual GRA and Board Related Costs averaged $1.5 million. This average includes $3.8 million from 2014, an outlier year in which Hydro filed the Amended Application, updated and responded to RFIs from both the Original and Amended Applications, and filed two interim rates applications.

Reference: *Grant Thornton Report, June 12, 2015, page 80, Tables 64 and 65.*

5 Allocation method: See NP-NLH-204, page 2 of 2. Scenario (i) of $8,919,000 less Scenario (ii) of $8,037,500 = $881,500.

In 2012 and 2013, Hydro prepared and filed the Original Application, as well as a number of related applications. Its actual costs for those years were $1.8 and $1.2 million, respectively. In Newfoundland Power's submission, Hydro has not provided an evidentiary basis to establish that GRA and Board Related costs in excess of $1.5 million annually are reasonable.

Submission

Hydro's proposed 2015 test year GRA and Board related costs should be reduced from $2.3 million to $1.5 million.

C.2.3.5 Summary of Unsupported Operating Costs

Table C-11 summarizes the required reductions in Hydro's 2015 test year revenue requirement related to operating costs.

Table C-11
2015 Test Year Revenue Requirement
Summary of Operating Cost Adjustments
($000s)

	Operating
Prudence Disallowances *(page C-20)*	1,174
Overstated Human Resources Costs *(page C-22)*	2,075
Intercompany Charges *(Table C-10)*	996
GRA and Board Related Costs *(page C-26)*	800
Total	**5,045**

C.2.4 Unsupported Other Costs

C.2.4.1 Debt Guarantee Fee

Hydro pays an annual fee to the provincial government to guarantee its debt. Hydro has included a forecast fee of $4.4 million in the 2015 Test Year, citing a Provincial Government direction in an Order-in-Council as the basis for both the requirement to pay and the amount to be paid.

Reference: *Evidence, Section 3.5.3, page 3.32, Table 3.13; NP-NLH-254.*

Historically, this fee was paid as directed by the Lieutenant Governor in Council pursuant to section 32 of the *Hydro Corporation Act*, which stated as follows:

> *"32. (1) The corporation shall pay annually to the Minister of Finance a fee in respect of loans guaranteed by the Minister of Finance under this Act.*
> *(2) The Lieutenant-Governor in Council may make regulations*
> *(a) respecting the calculation of the fee referred to in subsection (1); and*
> *(b) respecting the manner in which and the time at which the fee referred to in subsection (1) shall be paid."*

Reference: *RSNL 1990 Ch. H-16.*

Section 32 of the *Hydro Corporation Act* was repealed by section 36 of the *Regulatory Reform Act*, SNL 1996 Ch. R-10.1. The *Hydro Corporation Act* was repealed in 2007 with the passing of the *Hydro Corporation Act, 2007* SNL 2007 Ch. H-17.

The Order-in-Council is made under the authority of sections 21 to 25 of the *Hydro Corporation Act, 2007*. These sections contain no provision directing Hydro to pay a debt guarantee fee to the Minister of Finance, nor do they grant specific powers to the Lieutenant-Governor to make regulations respecting the calculation of any fee. Sections 21 to 25 essentially mirror sections in the repealed legislation. Neither refer to a debt guarantee fee.

Reference: *SNL 2007 Ch. H-17; OC-2011-218.*

Given the repeal of the legislative requirement to pay a debt guarantee fee the direction to Hydro in OC-2011-218 was *ultra vires* and is therefore unenforceable. Hydro is not legally obliged to pay the debt guarantee fee. On that basis, Hydro's 2015 test year revenue requirement should be reduced by $4.4 million.

If the Board is satisfied that payment of a debt guarantee fee is in the interests of ratepayers, the Board should consider whether the proposed fee is a reasonable one. In that regard, the Board should be mindful that the fee is to be paid to a related party.

Order-in-Council 2011-218 directs Hydro to pay a fee on the outstanding balance of the debt obligations of Hydro, net of related sinking funds from 2011 forward. The fee is equal to 25 basis points on all outstanding debt set to mature in 10 years, plus 50 basis points on longer term debt.

Reference: *PUB-NLH-058, Attachment 1.*

The Board's financial experts found the fee charged on both the short-term and the long-term debt of Hydro does not reflect an equitable apportionment between Hydro and the Provincial Government of the "cost savings" attributable to the debt guarantee. Grant Thornton recommended that a more equitable apportionment be considered.

Reference: *Grant Thornton Report, June 12, 2014, page 20, lines 7-18.*

The Board's financial experts also raised concerns that the 50 bps charged by the province for guaranteeing Hydro's long-term debt was high in comparison to the average differences in the province's long term bond yields and yields of the proxy group of comparable utilities considered by Hydro's expert.

***Reference**:* *Grant Thornton Report, June 12, 2015, page 20, lines 13-15.*

The fee proposed by Hydro is not shown to be reasonable by the evidence. In the event the Board determines that ratepayers derive a benefit from Hydro's payment of a debt guarantee fee, Newfoundland Power proposes that the fee should reflect an equal sharing of the cost savings between Hydro and the province and a more reasonable yield range. These issues are addressed by the fee calculated in Undertaking 139. Calculating the debt guarantee fee in this manner would result in a downward adjustment of $2.6 million in the 2015 test year revenue requirement.

Reference: *Undertaking 139.*

Submission

Newfoundland Power submits that the debt guarantee fee is unenforceable and should therefore not be recovered from Hydro's customers. If the Board determines that the debt guarantee fee benefits customers, the portion of the debt guarantee fee of $4.4 million proposed to be recovered from customers should be reduced by $2.6 million.

Table C-12 shows the required range of adjustment to the 2015 test year revenue requirement related to the debt guarantee fee.

Table C-12
2015 Test Year Revenue Requirement
Debt Guarantee Fee
($000s)

	Range
Debt Guarantee Fee	2,600 - 4,447

References: *Undertaking 139; PUB-NLH-060, Revision 1, Attachment 1.*

C.2.4.2 Fuel Supply Cost Deferral

The 2015 test year as filed includes an amortization of a fuel supply cost deferral of approximately $2.0 million. This represents Hydro's proposal to recover approximately $10.0 million in additional energy and fuel supply costs related to the January 2014 outages over a five year period.[6]

Reference: *Evidence, Section 3, Schedule 1, page 6, line 11.*

In its written submissions on the Prudence Review, Newfoundland Power indicates a disallowance of between $1 million to $1.7 million in deferred January 2014 supply related costs.

Reference: *Newfoundland Power Written Submission – Prudence Review, pages 13-14.*

[6] The fuel supply deferral proposed by Hydro is $9,956,000. The annual amortization is $1,991,000.

Submission

In accordance with Newfoundland Power's written submissions in the Prudence Review, Hydro's 2015 test year revenue requirement should be reduced by between 1/5 of $1 million (or $200,000) and 1/5 of $1.7 million (or $340,000) to reflect the disallowance of a portion of deferred January 2014 supply related costs.[7]

C.2.4.3 Asset Retirement Obligations

In the Settlement Agreement, the parties agreed that Hydro's proposal to include depreciation and accretion expenses associated with Asset Retirement Obligations in 2015 should be reduced from $3.2 million to $2.6 million in the 2015 Test Year. This $0.6 million reduction reflects the exclusion of certain construction and selective decommissioning costs at the Holyrood thermal generating station. These costs will be incurred to the benefit of customers subsequent to the Labrador-Island Interconnection, and Hydro may apply for recovery of such costs in the future.

Reference: *Consent 1, page 2.*

Submission

Newfoundland Power submits that the Board should reduce Hydro's 2015 test year revenue requirement by $0.6 million to reflect the reduction related to Asset Retirement Obligations agreed in the Settlement Agreement.

[7] Because the proposed recovery of the deferred January 2014 supply related costs is over a 5 year term, the appropriate recognition of the reduced recovery for 2015 is 1/5 of the amount disallowed.

C.2.4.4 Summary of Unsupported Other Costs

Table C-13 summarizes the required reductions in the 2015 test year revenue requirement related to other costs.

Table C-13
2015 Test Year Revenue Requirement
Summary of Other Cost Adjustments
($000s)

	Other
Debt Guarantee Fee *(Table C-12)*	2,600 – 4,447
Fuel Supply Cost Deferral *(page C-31)*	200 – 340
Asset Retirement Obligation *(page C-31)*	600
Total	**3,400 – 5,387**

C.2.5 Productivity Allowance

Hydro is obligated under the *Electrical Power Control Act, 1994* to manage and operate its facilities in a manner that results in power being delivered to customers of the province at the lowest possible cost consistent with reliable service. Hydro's executive and management team takes the position that Hydro has exercised reasonable control over its controllable costs. The evidence offered in this proceeding is not consistent with that position.

Reference: *Electrical Power Control Act, 1994, SNL 1994, Ch. E-5.1, s. 3(b)(iii).*

Hydro's President and Chief Executive Officer testified that efficiency is "a key factor in terms of cost control." Hydro has not provided evidence of performance measures that demonstrate the efficiency of its operations. Hydro does not have specific programs directed towards efficiency improvement. At the time of Hydro's 2001 General Rate Application, the Board imposed a productivity allowance on Hydro's controllable costs.

Reference: *Transcript, September 10, 2015, page 62, lines 12-14; Order No. P.U. 7 (2002-2003), page 73.*

Submission

Newfoundland Power submits that the evidence before the Board justifies imposition of a productivity allowance similar to the one the Board imposed on Hydro in Order No. P.U. 7 (2002-2003).

Table C-14 shows a range of adjustments from 1% to 3% of Hydro's 2015 test year operating costs.

Table C-14
2015 Test Year Revenue Requirement
Productivity Allowance
($000s)

	@ 1%	**@ 2%**	**@ 3%**
2015 Operating Costs	138,179	138,179	138,179
Productivity Allowance	1%	2%	3%
Total	**1,382**	**2,764**	**4,145**

Reference: *Evidence, Section 3, Schedule 1, page 1, line 7.*

C.2.6 Summary of Costs Unsupported by Evidence in the 2015 Test Year

The total reductions to revenue requirement are summarized in Table C-15 below.

Table C-15
2015 Test Year Revenue Requirement
Summary of Adjustments
($000s)

Rate Base Items (Table C-8)		
Holyrood CT	3,746	
Incomplete/Underspent Projects	2,611	
Prudence Disallowances	699	
Rate Base Allowances	1,398 – 1,446	
Interest Capitalized During Construction	276	
		8,730 – 8,778
Production Costs (Table C-9)		
Holyrood Conversion Factor	7,116	
Combustion Turbine Fuel	580	
		7,696
Operating Costs (Table C-11)		
Prudence Disallowances	1,174	
Overstated Human Resources Costs	2,075	
Intercompany Charges	996	
GRA and Board Related Costs	800	
		5,045
Other Costs (Table C-13)		
Debt Guarantee Fee	2,600 – 4,447	
Fuel Supply Cost Deferral	200 – 340	
Asset Retirement Obligation	600	
		3,400 – 5,387
Productivity (Table C-14)		**1,382 – 4,145**
Total		**26,253 – 31,051**

D. 2014 REVENUE DEFICIENCY

D.1 General

The Amended Rate Application presents a 2014 test year revenue requirement, not for the purpose of establishing rates, but to provide for recovery from Hydro's customers of a material revenue deficiency for 2014. The amount of the 2014 Revenue Deficiency for which Hydro seeks recovery in the Amended Application is $45.9 million.

Reference: *Evidence, Section 1.1.3, page 1.4, lines 1-11; Evidence, Section 3.1, page 3.10, lines 1-4.*

Hydro proposes to recover this amount by applying an accumulated credit balance in the RSP to offset the 2014 Revenue Deficiency, with any remainder to be recovered by means of a rate rider on future customer rates.

Reference: *Transcript, November 19, 2015, page 40, line 2 to page 41, line 6.*

Background

On November 28, 2014, Hydro filed an application seeking deferral and recovery of the 2014 Revenue Deficiency of $45.9 million so that Hydro would have the opportunity to earn a reasonable return for 2014. The application was one of a series of applications made by Hydro seeking interim relief in respect of the Original Application. Two earlier requests for interim relief on the Original Application were considered by the Board, and denied.

Reference: *Order Nos. P.U. 13 and 39 (2014).*

In Order No. P.U. 58 (2014), the Board, amongst other things, approved Hydro's segregation of $45.9 million in a deferral account but did not approve the recovery of this amount, either in part or in full.

Reference: *Order No. P.U. 58 (2014), page 9, lines 17-20.*

In approving the creation of Hydro's proposed 2014 Cost Deferral Account, the Board stated that the approval of the account and the segregation of $45.9 million in the account in 2014 would be subject to the Board's subsequent determination, following a full review, as to whether it is appropriate to grant any recovery to Hydro.

Reference: *Order No. P.U. 58 (2014), page 9, lines 1-20.*

Following the Board's issuance of Order No. P.U. 58 (2014), Hydro determined it was reasonable to record the $45.9 million as a regulatory asset in 2014. Any Board determination in a 2016 final order on the Amended Application that part, or all, of the $45.9 million 2014 Revenue Deficiency should not be recovered from customers will be recognized by Hydro for financial reporting purposes in 2016.

Reference: *Transcript, November 19, 2015, page 78, line 20 to page 79, line 10; Transcript, November 19, 2015, page 42, line 25 to page 45, line 2.*

D.2 2014 Test Year Costs

Hydro's proposed recovery of the 2014 Revenue Deficiency is based on full recovery of Hydro's 2014 test year costs. This includes costs associated with projects not yet approved by the Board for inclusion in rate base, costs that have not been shown by evidence to be reasonable, and costs that are subject to the Prudence Review. The 2014 Revenue Deficiency also assumes a 2014 target return on equity for Hydro of 8.8% based on an Order-in-Council that is not clearly applicable to 2014, since 2014 is not a year in which new rates are being set by the Board.

Newfoundland Power's submissions on a reasonable return for Hydro for 2014 are found in the following Section D.3. Submissions on regulatory practice considerations raised by Hydro's proposal to recover the 2014 Revenue Deficiency are found in Section D.4. Detailed submissions on Hydro's proposed 2014 test year costs are found in Section D.5.

D.3 Entitlement to a Reasonable Return for 2014

Hydro has stated that recovery of the 2014 Revenue Deficiency will provide it with an opportunity to earn a reasonable return on rate base for 2014. Calculation of the 2014 Revenue Deficiency of $45.9 million reflects a return on equity of 8.8%.

Reference: *Evidence, Section 1.1.3, page 1.4; Transcript, November 16, 2015, page 163, line 23 to page 165, line 2.*

By Order-in-Council, the Board has been directed to "set the same target rate of return on equity as was most recently set for Newfoundland Power through a General Rate Application or calculated through the Newfoundland Power Automatic Adjustment Mechanism." The Order-in-Council is to take effect "commencing with the first General Rate Application by Newfoundland and Labrador Hydro after January 1, 2009." In considering Hydro's proposed recovery of the 2014 Revenue Deficiency, the Board must determine whether the Order-in-Council applies to Hydro's 2014 Test Year.

Reference: *OC2009-063.*

In regulatory practice, a general rate application typically involves consideration of a utility's proposal for new rates, tolls and charges. In this jurisdiction, rates are designed to recover the utility's revenue requirement based on a forecast test year. In the Amended Application, Hydro proposes that the Board approve new rates based on a 2015 test year. A test year forecast of 2014 costs was also filed with the Amended Application. The 2014 test year is not proposed as a basis for setting customer rates. Rather, it is presented as a basis for recovery of Hydro's 2014 Revenue Deficiency. Hydro acknowledges that this is a departure from normal regulatory practice.

Reference: *Transcript, November 19, 2015, page 33, line 11 to page 34, line 6.*

The Order-in-Council does not specifically provide that a target rate of return on equity for Hydro based on the Newfoundland Power rate is intended to take effect prior to the year for which new rates are proposed. Further, it is not clear how establishing a new 2014 target rate of return on equity for Hydro in 2015 is consistent with the prospective nature of ratemaking in this jurisdiction. Accordingly, it is not clear that establishing a 2014 rate of return on rate base for Hydro based on Newfoundland Power's 8.8% target return on equity is required by the Order-in-Council.

The entitlement to earn a just and reasonable return is found in Section 80 of the *Public Utilities Act*. It has been considered by the Board on numerous occasions. In Order No. P.U. 39 (2014), the Board observed as follows:

> *"The Board agrees that Hydro is entitled to earn annually a just and reasonable return on its rate base, as provided for in section 80 of the Act, but notes that Hydro is not guaranteed to earn the established return. The rate of return is, where practicable, established by the Board on a prospective basis and Hydro must manage its business, working within the existing regulatory framework, so as to minimize the risks and maximize its opportunity for a just and reasonable return. The Newfoundland and Labrador Court of Appeal addressed this issue in Newfoundland (Board of Commissioners of Public Utilities), Re (1998), 164 Nfld and P.E.I. R.60, stating at paragraph 31:*
>
>> *[31] This leads to another point. Because the setting of the rate of return is based on projections one cannot be sure that the rate of return will be achieved in practice. Although the utility is "entitled" by s. 80 of the Act to have the Board determine a just and reasonable rate of return based on appropriate predictive techniques and methodologies, it is not "entitled", in the sense of being guaranteed, to that rate of return. The utility therefore takes the risk that its chosen management techniques and the future economic climate may not yield its expected success. Although some of the activities of the utility are regulated within the framework of the statutory objectives, the utility nevertheless remains subject to business risks and effects of management decisions. To that extent, the financial risks associated with the operation of the utility, just as in the case of any private business, are to be born by the investors in the enterprise, not the customer of the service.*
>
> *As indicated by the Court of Appeal in paragraph 32 "…the powers of the Board must be regulative and corrective, but not managerial, and they do not therefore contemplate a retroactive adjustment of the actions of management."*

Reference: *Order No. P.U. 39 (2014), page 9, line 24 to page 10, line 3.*

D.4 Regulatory Practice Considerations

Hydro's evidence indicates that "[a] revenue deficiency occurs when existing rates are not adequate to recover prudently incurred costs of operating a utility."

Reference: *Evidence, Section 3.2, page 3.6, lines 12 - 13.*

In Order No. P.U. 58 (2014), the Board noted concerns expressed by Newfoundland Power, Vale and the Industrial Customer Group "in relation to whether Hydro's proposals with regard to the 2014 revenue requirement can be considered good regulatory practice and as to the precedent that may be established."

Reference: *Order No. P.U. 58 (2014), page 7, lines 33 – 37.*

Hydro has not presented evidence in this proceeding as to whether using a test year as a basis for recovering losses or deficiencies is an acceptable regulatory practice or whether the practice has been used in other jurisdictions.

Reference: *Transcript, November 19, 2015, page 35, line 20 to page 38, line 14.*

In carrying out its duties under the *Public Utilities Act*, the Board is required to apply tests which are consistent with generally accepted sound public utility practice.

Reference: *Electrical Power Control Act, 1994, s. 4.*

A revenue deficiency is not a cost. It is the net financial result of a year of utility operation. Hydro's proposed recovery of the 2014 Revenue Deficiency is based on full recovery of Hydro's 2014 forecast costs. Approval by the Board of full recovery by Hydro of the 2014 Revenue Deficiency would effectively amount to a guarantee of Hydro's 2014 rate of return. In Newfoundland Power's submission, such approval would not be consistent with the "regulative and corrective" nature of the Board's powers as referenced by the Newfoundland and Labrador Court of Appeal. In Newfoundland Power's view, it is difficult to understand how the deferred recovery of a revenue deficiency from a prior year to recover the "incurred costs of operating a utility" would not be "…a retroactive adjustment of the actions of management."

D.5 Costs Unsupported by Evidence in the 2014 Test Year

D.5.1 General

Newfoundland Power submits that Hydro's application for recovery of the proposed 2014 Revenue Deficiency is inconsistent with generally accepted regulatory practice, and should be denied in its entirety. In the alternative, the evidence does not support recovery from customers for the costs comprising the 2014 Revenue Deficiency.

Certain costs included in Hydro's proposed 2014 test year are subject to the same evidentiary shortcomings as the 2015 costs addressed in Section C of this Brief of Argument. The 2014 test year costs which, in Newfoundland Power's submission, ought not to be recovered by Hydro total approximately $64 million to $67 million. If the Board determines that these 2014 costs should not be recovered from customers, this would more than fully offset the 2014 Revenue Deficiency and disentitle Hydro to any recovery from customers in respect of it.

Detailed submissions follow on 2014 test year costs unsupported by evidence.

D.5.2 Unsupported Rate Base Items

D.5.2.1 General

Hydro seeks approval for an average rate base of $1,692.6 million for 2014. This represents an increase of $203.2 million over its 2007 approved rate base. This increase is largely driven by an increase in net capital assets. Hydro seeks a 2014 return on average rate base of $120.6 million at a rate of return on rate base of 7.12%.

***Reference**: Evidence, Section 3.4.1, page 3.20, Table 3.9; Section 3.3.6, page 3.17, Table 3.7.*

Hydro has overstated its 2014 average rate base. Accordingly, rate base adjustments similar to those proposed in Section C of these written submissions are required.

The rate base adjustments will have corresponding effects on the return on rate base and amortization. In this section, Hydro's estimates of return on rate base and amortization impacts have been used when available. Otherwise, return on rate base impacts are estimated on the basis of Hydro's proposed rate of return on rate base of 7.12%. Amortization impacts are estimated on the basis of Hydro's average depreciation rate of 3.5%.

***Reference:** TIR-NP-NLH-011, footnote 3.*

D.5.2.1 Overstated Plant in Service

For 2014, Hydro forecast additions to plant in service of $239.0 million. Actual additions totaled $91 million. According to Hydro, the largest component of the $148.0 variance was the Holyrood CT at $110.0 million. The remaining $38.0 million appears to have been made up of other planned additions either canceled or carried over to 2015 or later years.

***Reference:** Grant Thornton Report, June 12, 2015, page 115, Table 87; TIR-NP-NLH-011; NP-NLH-308; Undertaking 32.*

Submission

Newfoundland Power submits that a reduction in the 2014 average rate base and 2014 test year revenue requirement is necessary on account of a $148 million overstatement of plant in service.

Table D-1 shows the required reduction to the 2014 test year average rate base and revenue requirement for overstated plant in service.

Table D-1
2014 Test Year
Overstated Plant in Service
($000s)

	Rate Base		**Revenue Requirement**		
	Year End	**Average**	**Return on Rate Base**	**Amortization**	**Total**
Holyrood CT	110,000	54,869	3,907	262	**4,189**
Incomplete/Underspent	37,971	18,985	1,296	664	**1,960**
Total	**147,971**	**73,854**	**5,203**	**926**	**6,149**

Reference: *TIR-NLH-011; NP-NLH-308.*

D.5.2.2 Capital Cost Disallowances for Imprudence

Liberty has recommended that the Board consider potential capital cost disallowances for 2014 totaling approximately $10.9 million. For the reasons stated in its written submissions on the Prudence Review, Newfoundland Power agrees with some of Liberty's findings. Hydro's customers should not be burdened with costs which would not have arisen but for the imprudent decisions or actions of Hydro.

Reference: *Liberty Report, July 6, 2015, page 44.*

Submission

Hydro's 2014 test year revenue requirement should be adjusted to reflect the cost implications of its imprudent decisions and actions.

Table D-2 shows the reductions to average rate base and return on rate base related to 2014 capital cost disallowances advocated by Newfoundland Power in the Prudence Review.

Table D-2
2014 Test Year
Prudence Disallowances
($000s)

Project	**Average Rate Base**	**Return on Rate Base**
Western Avalon Tap Changer	725	52
Sunnyside Transformer	1,955	139
Holyrood/Sunnyside Breakers[1]	252	18
January 2013 Holyrood Repair	5,015	357
Total	**7,947**	**566**

Reference: *NP-NLH-308; Liberty Report, pages ES-5 and 23.*

D.5.2.3 Rate Base Allowances

Hydro's forecast for fuel inventory in 2014 was $65.1 million. This forecast was overstated by $5.1 million in comparison with the 2014 actual amount of $60.0 million.

Reference: *Grant Thornton Report, June 12, 2015, page 29, Table 13.*

[1] The average rate base amount of $290,000 shown in NP-NLH-308 for the Holyrood and Sunnyside Breakers includes the Holyrood Unit 3 fan, which was found to be a prudent capital project by Liberty. The 2014 capital expenditure for this project was reported by Liberty to be $76,407 (see page 23 of the Liberty Report). The average rate base impact of this amount is $38,204 ($76,407 / 2). The estimated average rate base related to the Holyrood and Sunnyside Breakers is $251,796 (290,000 – 38,204). The return on rate base impact is estimated to be $17,928 ($251,796 x 7.12%).

Submission

Newfoundland Power submits that Hydro's 2014 average rate base should be reduced by $5.1 million to account for the overstatement of Hydro's 2014 forecast fuel inventory.

Table D-3 shows the reductions to 2014 test year average rate base and return on rate base related to rate base allowances.

Table D-3
2014 Test Year Average Rate Base
Rate Base Allowances
($000s)

	Average Rate Base	**Return on Rate Base**
Fuel Inventory	5,069	361
Total	**5,069**	**361**

Reference: *Grant Thornton Report, June 12, 2015, page 29, Table 13; Table D-3.*

D.5.2.4 Summary of Unsupported Rate Base Items

Table D-4 summarizes the required reductions in average rate base and associated revenue requirement impacts for the 2014 test year.

Table D-4
2014 Test Year Average Rate Base
Summary of Adjustments
($000s)

	Average Rate Base	**Revenue Requirement**
Overstated Plant in Service *(Table D-1)*	73,854	6,149
Prudence Disallowances *(Table D-2)*	7,947	566
Rate Base Allowances *(Table D-3)*	5,069	361
Total	**86,870**	**7,076**

D.5.3 Unsupported Production Costs

D.5.3.1 Holyrood Conversion Factor

The No.6 fuel production costs for the forecast 2014 year were calculated at $109.59 per barrel using a forecast conversion factor of 588 kWh/bbl. The total No. 6 fuel production costs included in the 2014 Test year were $255,841. The impact of modifying the Holyrood conversion factor from 630 kWh/bbl to 588 kWh/bbl, at the same fuel price, is $17.0 million.

Reference: *Evidence, Section 3, Schedule II, page 1, line 10; NP-NLH-340.*

For the same reasons set out in Section C.2.2, Newfoundland Power submits that Hydro has not proven that a modification to the existing Holyrood conversion factor is warranted for 2014.

Submission

Newfoundland Power submits that a reduction in Hydro's 2014 test year revenue requirement of $17.0 million is necessary to reflect a Holyrood conversion factor of 630 kWh/bbl.

Table D-5 shows the reductions to 2014 test year revenue requirement related to fuel production.

Table D-5
2014 Test Year Revenue Requirement
Fuel Production Adjustments
($000s)

	Fuel
Holyrood Conversion Factor	17,000

Reference: *NP-NLH-340.*

D.5.4 Operating Costs

D.5.4.1 Operating Cost Disallowances for Imprudence

In Liberty's review of prudence issues, Liberty indicated that Hydro had spent a total of $13.4 million that, but for imprudence, would have been avoided. Liberty subsequently acknowledged that the $13.4 million should be reduced by approximately $1.0 million to $12.4 million.

Reference: *September 17, 2015 Reply of Liberty, page 15, lines 19-25; page 16, lines 19-26; and page 17, lines 1-15.*

For the reasons set out in Newfoundland Power's written submission on the Prudence Review, Newfoundland Power agrees with some of, but not all, of Liberty's recommendations regarding 2014 operating cost disallowances related to Hydro's imprudence.

Submission

Newfoundland Power submits that there should be a $10.3 million to $11 million adjustment to Hydro's 2014 test year revenue requirement on account of disallowed operating costs.

Table D-6 summarizes the 2014 Hydro operating costs that Newfoundland Power submits should be disallowed by the Board.

Table D-6
2014 Operating Costs
Summary of Prudence Disallowances
($000s)

Cost Arising from Maintenance Deficiencies	1,085
January 2014 Supply Costs	1,000 – 1,700
Professional Services Costs	1,905
Overtime Costs	3,584
Salary Transfers	511
Holyrood Unit 1 Failure	2,220
Total	**10,305 – 11,005**

Reference: *Newfoundland Power Written Submission – Prudence Review, Table 4; Table 6; Table 8.*

Newfoundland Power's written submission on the Prudence Review contains its detailed position on each of these projects.

D.5.4.2 Overstated Human Resources Costs

Hydro acknowledges that vacancies can occur from time to time and that an allowance or adjustment to workforce budgets should be made in computing test year costs. It is Hydro's practice to adjust for such vacancies by way of an adjustment to the salary and benefits costs included in the test year. Hydro's evidence is that average annual salary and benefit costs per FTE for 2014 is $82,000.

Reference: *IC-NLH-006 (Revision 2), Table 2.*

It is unclear from the evidence what vacancy adjustment Hydro has applied to the 2014 test year. There is evidence on the record indicating that Hydro's 2014 test year reflects a vacancy of 40 FTEs. There is other evidence on the record that indicates the 2014 test year reflects a vacancy adjustment of 20 FTEs.

Reference: *CA-NLH-104 (Revision 1), page 3, lines 13-18; Undertaking 145, page 1.*

The actual number of vacancies experienced in 2014 was 52. A vacancy adjustment of either 20 or 40 FTEs is insufficient. Hydro's Human Resources costs are therefore overstated. A vacancy adjustment is necessary to reflect the understatement of vacancies by between 12 and 32 FTEs.

Reference: *NP-NLH-310.*

Submission

Newfoundland Power submits that Hydro's 2014 test year revenue requirement should be reduced by between $1.0 million and $2.7 million to reflect an appropriate vacancy adjustment.[2]

D.5.4.3 Intercompany Charges

For the reasons set out in Section C 2.3 under the heading Intercompany Charges, Hydro's 2014 test year revenue requirement should be reduced to correct the understatement of service charges

[2] At 12 FTE vacancies: $82,000 x 12 = $984,000. At 32 FTE vacancies: $82,000 x 32 = $2,624,000.

Hydro recovers from its affiliates and to reflect a more equitable allocation of common services costs.

Submission

Newfoundland Power submits that the appropriate reduction for 2014 is shown in Table D-7.

Table D-7
2014 Test Year Revenue Requirement Adjustments
Intercompany Charges
($000s)

Fully burdened costs	106
Allocation method[3]	882
Total	**988**

Reference: *Undertaking 151; NP-NLH-204.*

D.5.4.4 GRA and Board Related Costs

Under the heading of Professional Services, Hydro seeks to recover a total of $10.6 million after cost recoveries from affiliates in the 2014 test year. This amount includes $3.5 million in GRA and Board Related Costs. As indicated in Section C.2.3, Hydro's average annual GRA and Board Related Costs were in the range of $1.5 million from the 2007-2014 period.

Reference: *Evidence, Section 2.4.1, page 2.39. Table 2.7; Grant Thornton Report, June 12, 2015, page 80, Tables 64 and 65.*

Hydro's 2014 actual GRA and Board related costs exceeded $3.8 million. There is no evidence that these costs were reasonably incurred. In 2014, Hydro notified the Board of its intention to file the Amended Application, suspending the hearing process for the Original Application one

[3] Allocation method: See NP-NLH-204, page 2 of 2. Scenario (i) of $8,919,000 less Scenario (ii) of $8,037,500 = $881,500.

month before the start of the scheduled public hearing. Hydro's conduct of the Original Application and the Amended Application resulted in significant duplication of effort. In addition, Hydro filed two unsuccessful interim rate applications, which were denied by the Board due to lack of clarity or insufficient evidence. The above-average GRA and Board related costs incurred by Hydro in 2014 should not be borne by rate payers.

Reference*:* *Order No. P.U. 13 (2014), page 9, lines 1-6; Order No. P.U.39 (2014), page 10, lines 18-22.*

Submission

Newfoundland Power submits that Hydro's 2014 test year revenue requirement should be reduced by $2 million to reflect reasonable recovery of GRA and Board related costs.

D.5.4.5 Summary of Operating Costs

Table D-8 summarizes the proposed adjustment to revenue requirement for the 2014 test year for operating costs.

Table D-8
2014 Test Year Revenue Requirement
Summary of Operating Costs Adjustments
($000s)

	Operating
Prudence Disallowances *(Table D-6)*	10,305 – 11,005
Overstated Human Resources Costs *(page D-15)*	984 - 2,624
Intercompany Charges *(Table D-7)*	988
GRA and Board Related Costs (*page D-17*)	2,000
Total	**14,277 – 16,617**

D.5.5 Other Costs

D.5.5.1 Debt Guarantee Fee

The debt guarantee fee included in Hydro's 2014 test year is $3.7 million. For the reasons set out in Section C, Newfoundland Power submits that Hydro is not legally obliged to pay a debt guarantee fee. On that basis, Hydro's 2014 test year revenue requirement should be reduced by $3.7 million.

Reference: *Evidence, Section 3.5.3, page 3.32, Table 3.13.*

If the Board is satisfied that payment of a debt guarantee fee is in the interests of ratepayers, the Board should consider whether the proposed fee is a reasonable one. In Section C.2.4.1 Newfoundland Power makes submissions regarding a more reasonable approach to calculating the debt guarantee fee.

Hydro provided a calculation of the debt guarantee fee for 2015 based on the more reasonable approach set out in Section C. No such calculation was provided for 2014. Hydro has not proven that the debt guarantee fee reflected in the 2014 test year is reasonable.

Submission

Newfoundland Power submits that the debt guarantee fee is unenforceable and should not be recovered from Hydro's customers. Hydro's 2014 test year revenue requirement should therefore be reduced by $3.7 million.

D.5.5.2 Asset Retirement Obligations

In the Settlement Agreement the parties agreed that Hydro's proposal to include depreciation and accretion expenses associated with Asset Retirement Obligations in 2014 should be reduced from $3.1 million to $2.6 million in the 2014 Test Year. This $0.5 million reduction reflects the exclusion of certain construction and selective decommissioning costs at the Holyrood generating plant. These costs will be incurred to the benefit of customers subsequent to the Labrador-Island Interconnection, and Hydro may apply for recovery of such costs in the future.

Reference: *Consent 1, page 2.*

Submission

Newfoundland Power submits that the Board should reduce Hydro's 2014 test year revenue requirement by $0.5 million to reflect the reduction related to Asset Retirement Obligations agreed in the Settlement Agreement.

Table D-9 summarizes the reductions to 2014 test year revenue requirement related to other costs.

Table D-9
2014 Test Year Revenue Requirement
Summary of Other Costs Adjustments
($000s)

	Other
Debt Guarantee Fee	3,680
Asset Retirement Obligations	500
Total	**4,180**

Reference: *PUB-NLH-060, Revision 1, Attachment 1;*
Consent 1, page 2.

D.5.6 Return on Equity

For the reasons set out in Section D.3.1, Hydro is not entitled to a target return on equity of 8.80% for the 2014 test year. The return on Hydro's 2014 adjusted rate base should be limited to Hydro's marginal cost of debt, as approved in Order No. P.U. 8 (2007).

The impact of increasing Hydro's return on equity in the 2013 test year revenue requirement on which the Original Application was based was in the order of $20.9 million. The impact of increasing Hydro's return on equity in the 2015 test year revenue requirement on which the Amended Application is based is in the order of $23.1 million. There is no evidence on the record of the impact of an 8.80% target return on equity for the 2014 test year. The mid-point of the 2013 and 2015 impacts of $22.0 million represents a reasonable indicative impact.

Reference: *PUB-NLH-056, Attachment 1, line 22; PUB-NLH-056 (Revision 1), Attachment 1, line 22.*

Submission

Newfoundland Power submits that Hydro's return on rate base for the 2014 test year should be calculated based on a target rate of return on equity equal to Hydro's marginal cost of debt. For indicative purposes, the necessary reduction in Hydro's 2014 test year revenue requirement is in the order of $22 million.

D.5.7 Summary of 2014 Test Year Adjustments

Table D-10 summarizes the required adjustments to revenue requirement for the 2014 test year.

Table D-10
2014 Test Year Revenue Requirement
Summary of Adjustments
($000s)

Rate Base Items *(Table D-4)*		
Overstated Plant in Service	6,149	
Prudence Disallowances	566	
Rate Base Allowances	361	
		7,076
Production Costs *(Table D-5)*		
Holyrood Conversion Factor		**17,000**
Operating Costs *(Table D-8)*		
Prudence Disallowances	10,305 – 11,005	
Overstated Human Resources Costs	984 – 2,624	
Intercompany Charges	988	
GRA and Board Related Costs	2,000	
		14,277 – 16,617
Other Costs *(Table D-9)*		
Debt Guarantee Fee	3,680	
Asset Retirement Obligation	500	
		4,180
Return on Equity *(Page D-20)*		**22,000**
Total		**64,533 – 66,873**

E. REGULATORY MECHANISMS

E.1 Energy Supply Cost Variance Deferral Account

Hydro has proposed that the Board establish an Energy Supply Cost Variance Deferral Account to insulate Hydro from annual variances in supply purchase costs on the Island Interconnected System. The proposed account would apply to variations in (i) power purchases from wind generation, (ii) power purchases from CBPP, (iii) power purchases from hydraulic generation, (iv) diesel generation, and (v) Gas Turbine generation. The proposed deferral account would only address variances from forecast exceeding the proposed Cost Variance Threshold of ±$500,000. Disposition of any annual balance is to be dealt with by application to the Board.

Reference: *Amended Application, Volume 1, pages 3.48-3.50.*

The evidence reveals no volatility in price for any of Hydro's proposed power purchases. Long-term contracts with fixed components are in place for wind purchases and purchases from CBPP, with the variable components of these contracts limited to changes in the consumer price index.

The price of hydraulic purchases from the Exploits generation assets is fixed until 2016. Those assets are owned by the Province. Hydro should not be permitted to recover any cost variance related to a price controlled by a related entity without first submitting those costs to a reasonableness test. While Hydro indicated that there was some variability in the volume of purchases, there was no evidence that the volatility is so great as to justify insulating Hydro from any forecast risk.

Reference: *Transcript, November 18, page 137, line 5 to page 138, line 4.*

Hydro's main concern regarding supply related purchases appears to be supply cost volatility related to combustion turbine usage. In the 2015 Cost Deferral Application, Hydro stated that its energy supply costs related to gas turbine usage (largely related to the new Holyrood CT) were forecast to be $7.1 million higher than the 2015 Test Year forecast. Other energy supply costs were essentially tracking in line with the initial forecast.

References: *Transcript September 23, 2015, page 78, lines 2-12; 2015 Cost Deferral Application, Schedule 3, Appendix C.*

Hydro calculates that operation of the Holyrood CT in the range of 30-85 hours would, by itself, exceed the proposed ±$500,000 Cost Variance Threshold.

References*:* *Undertaking 59.*

The deferral account as proposed would require Hydro to file an application, no later than March 1st each year, to request disposition of any balance. Operation of the CT is subject to the judgment of Hydro. Hydro has acknowledged that an application for disposition of any cost variance should include evidence as to the circumstances of its operation in the prior year.

Reference: *Transcript October 20, 2015, page 140, lines 8-17.*

Newfoundland Power acknowledges that the Holyrood CT is critical to the system and that there should not be a disincentive to its prudent use for system reliability. Hydro should be permitted to recover costs associated with the operation of the Holyrood CT by means of an Energy Supply Cost Variance Deferral Account if, and only if, the costs are shown to be reasonable in the circumstances.

Submission

Newfoundland Power submits that Hydro's proposed Energy Supply Cost Variance Deferral Account should be approved only in relation to supply cost variances arising from the operation of the Holyrood CT.

E.2. Isolated Systems Supply Cost Variance Deferral Account

Hydro has proposed that the Board establish an Isolated Systems Supply Cost Variance Deferral Account to insulate Hydro from annual variances in supply costs on the Isolated Systems. The proposed deferral account would provide for recovery of isolated system supply cost variances from forecast exceeding a variance threshold of ±$500,000. Disposition of any annual balance is to be dealt with by application to the Board.

Reference: *Amended Application, Volume 1, pages 3.46-3.48.*

Hydro has produced evidence indicating volatility in the price of diesel fuel over the last several years with variances in the range of $0.3 million to $6.0 million. Such variances may be characterized as uncontrollable, although it is appropriate that Hydro attempt to mitigate against variability with improved forecasting.

Reference: *Amended Application, Volume 1, Section 3.8.2, page 3.47, lines 11-12.*

Submission

Newfoundland Power submits that Hydro's proposed Isolated Systems Supply Cost Variance Cost Deferral Account should be approved.

E.3. Holyrood Conversion Rate Deferral Account

Hydro has proposed a Holyrood Conversion Rate Deferral Account to provide for recovery of cost variances resulting from variations from the test year Holyrood fuel conversion rate. Transfers to the proposed Holyrood Conversion Rate Deferral Account are not subject to a variance threshold. The proposed deferral account would provide for recovery of all variances from the test year forecast of Holyrood fuel supply costs.

Reference: *Amended Application, Section 2, Schedule IX.*

In Newfoundland Power's submission, the evidence does not establish that there will be significant future volatility in the Holyrood fuel conversion rate such as would justify protection from inaccurate forecasting. Hydro has not commissioned any comprehensive studies on the factors which could impact the Holyrood fuel conversion rate, and has not established it is beyond Hydro's control.

Reference: *Transcript, September 23, 2015, page 91, line 14 to page 94, line 4.*

Hydro undertakes a variety of activities on a monthly and annual basis to operate Holyrood more efficiently. The proposed deferral account could remove the financial incentive to operate the plant as efficiently as possible.

Submission

Newfoundland Power submits that the evidence concerning Hydro's proposed Holyrood Conversion Rate Deferral Account does not justify its adoption at this time. Accordingly, the account should not be approved.

E.4 Return on Equity Automatic Adjustment Mechanism

By Order in Council, the Board is directed, in calculating Hydro's return on rate base, to set the same target return on equity as was most recently set for Newfoundland Power.

Reference: *OC2009-063.*

Newfoundland Power's 2016 general rate application is scheduled for hearing by the Board commencing in March 2016. The Board will be considering Newfoundland Power's target rate of return on equity at or about the time of issuance of its general rate order in this proceeding.

To ensure that the Order in Council is given full effect in these circumstances, it would be reasonable for Hydro's target rate of return on equity to be changed by way of an automatic adjustment mechanism in the event that Newfoundland Power's target rate is changed. Hydro concedes that such an order would be within the jurisdiction of the Board.

Reference: *Order-in-Council OC2009-063; Transcript November 16, 2015, page 71, line 20 to page 73, line 10.*

Submission

Newfoundland Power submits that the evidence supports the Board's implementation of an automatic mechanism to adjust Hydro's target rate of return on equity when Newfoundland Power's target rate of return on equity changes.

F. COST OF SERVICE

F.1 General

The Cost of Service issues associated with the Amended Rate Application were largely addressed in the two settlement agreements signed by the parties. The significant issues remaining to be considered by the Board include the allocation methods related to (i) the Rural Deficit, (ii) specifically assigned operations and maintenance ("O&M") costs and (iii) the Load Variation Component of the Rate Stabilization Plan ("RSP").

F.2 Rural Deficit Allocation

The Rural Deficit is essentially the difference between the cost of providing electrical service to, and the revenue received from, customers of Hydro on Isolated Diesel Systems, the L'Anse au Loup System and the Island Interconnected System. The Rural Deficit is projected to be in the order of $64.1 million for the 2015 Test Year, which is approximately $30 million higher than it was in 1995.

Reference: *Evidence, Volume 2, Exhibit 13, page 3; PUB-NP-005, Table 1.*

The Rural Deficit is currently allocated between Newfoundland Power and the customers of the Labrador Interconnected System using a Unit Cost Method. This allocation method was recommended by the Board following the comprehensive review of this issue in the 1992 Generic Cost of Service hearings. This method involves an equal commodity approach which divides the deficit between the two groups on the basis of (i) demand (ii) energy, and (iii) customer cost.

Reference: *Pre-filed Evidence of Larry Brockman, June 4, 2015, page 12, lines 6-16.*

Hydro proposes a change in allocation method from the Unit Cost Method. Hydro's proposal purports to be rooted in a "fairness assessment" which evaluates fairness on the basis of whether the customers of Newfoundland Power and Hydro's customers on the Labrador Interconnected System pay the same amount on a per customer basis. This proposal was not included in the Original Application.

Reference: *Evidence, Volume 2, Exhibit 13, page 3; Transcript, October 5, 2015, page 197, lines 17-21.*

There is no truly fair way to allocate the Rural Deficit, as the costs are not causally related to the customers funding it.

Reference: *Pre-filed Evidence of Larry Brockman, June 4, 2015, page 4, lines 14-15.*

Hydro's proposal is to allocate the Rural Deficit based on the revenue requirement method. This proposal would result in a change in the amount allocated to Newfoundland Power in the 2015 test year from $56.9 million to $61.7 million. The revenue requirement method of allocation was considered and rejected by the Board in the 1992 Generic Cost of Service report. It was the evidence of Newfoundland Power's cost of service expert, Mr. Brockman, who also testified at the 1992 Generic Cost of Service hearing, that none of the essential underpinnings of the Board's 1992 recommendation have changed.

Reference: *Grant Thornton Report, June 12, 2015, page 132, Table 99; Pre-filed Evidence of Larry Brockman, June 4, 2015, page 4, lines 5-11 and page 17, line 24 to page 18, line 5.*

Under the existing Unit Cost method of allocation, the Labrador Interconnected System customers pay more, on a per customer basis, than Newfoundland Power. This is largely a result of the higher per customer energy consumption on the Labrador Interconnected system. These circumstances existed in 1992. This would have resulted in Labrador Interconnected customers paying more, on a per customer basis, had Hydro implemented the Board's recommendations prior to 2001. The Board clearly understood that the methodologies considered could have varying impacts. However, in its report, the Board indicated that matters of impact could be dealt with by rate design.

Reference: *Evidence, Volume 1, Section 4.3.1, page 4.8; PUB-NP-005, page 2, Table 2; and response to Request for Information PUB-NLH-113, Attachment 1, pages 60, 62 and 65.*

In determining whether or not the allocation methodology should be changed, it is important for the Board to consider the circumstances of all of the funding parties. This includes the fact that Newfoundland Power relies on a combination of hydroelectric and more costly thermal energy to supply its customers. Labrador Interconnected customers have the benefit of hydroelectric energy as their sole source of energy. Under the revenue requirement method, Newfoundland Power would be burdened with a higher portion of the Rural Deficit because it already pays higher rates on a per kWh basis due to the mix of supply sources serving their customers.

Reference: *PUB-NLH-113, Attachment 1, page 64.*

The Board should also consider whether this is the right time to revisit the issue. Interconnection with Labrador is imminent. There is evidence that this could result in uniform rates for customers of the two interconnected systems. Any alteration in methodology in the short-term may result in "taking the Labrador Interconnected rates in the wrong direction".

Reference: *Pre-Filed Evidence, Larry Brockman, June 4, 2015, page 16, lines 9-11.*

It is Newfoundland Power's submission that Hydro's proposal to modify the Rural Deficit allocation methodology should be denied and the portion of the Rural Deficit proposed to be allocated to Newfoundland Power should be adjusted downward accordingly.

Hydro has committed to completing a number of major reviews, including embedded cost and marginal cost studies, in preparation for interconnection. Once those reviews are complete, the Board will have more current information on marginal costs on the electricity system. This would provide a better evidentiary basis for reconsideration of the Rural Deficit allocation methodology.

Should the Board determine it is appropriate to limit the rate impact to the customers of the Labrador Interconnected system associated with the Rural Deficit in the interim, the Board could, instead of changing the allocation methodology, determine an appropriate cap for the overall rate increase to Labrador Interconnected customers.

Reference: *PUB-NP-009, lines 12-17.*

Submission

Newfoundland Power submits that Hydro's proposal to change the Rural Deficit allocation methodology should not be approved.

F.3 Specifically Assigned O&M Charges

Hydro specifically assigns O&M charges by allocating forecast costs amongst its customers based on the original cost of plant in service. This has been the approved methodology for many years.

In its pre-filed evidence, Vale took issue with Hydro's method of allocating specifically assigned O&M charges on the basis that the approach fails to account for the time value of money. Specifically, Vale's expert witness, Mr. Dean, argued that this approach results in inequitable allocations to Vale because the majority of the plant specifically assigned to Vale is newer plant. It was Mr. Dean's assertion that newer plant should theoretically attract less O&M expense. There is no clear evidence on the record that this is the case. In August of 2011, Vale was clearly informed of the applicable methodology, and accepted the assignment of all transmission and terminal plant serving its Long Harbour facility on that basis.

Reference: *Undertaking 47, Attachment 1.*

Mr. Dean has recommended that the allocation procedure be modified such that all plant in service be restated to 2015 dollars, instead of original dollars. However, he was unable to provide any evidence that such an indexing approach has been applied to the assignment of O&M charges in any other jurisdiction.

Reference: *Transcript October 1, 2015, page 69, line 9 to page 74, line 4.*

As a practical approach to the issue, Newfoundland Power submits it would be appropriate for the Board to consider any such changes to the allocation of specifically assigned O&M after completion of Hydro's embedded cost and rate design reviews, which are already underway. At that time, a more comprehensive evidentiary basis for Vale's proposed change may be brought forward for the Board's consideration.

Submission

Newfoundland Power submits that the current methodology of allocating specifically assigned O&M costs should not be changed at this time.

F.4. Load Variation Component of the RSP

Hydro proposes changes to the Load Variation Component of the Rate Stabilization Plan rules to reflect an energy allocation approach, similar to the manner in which fuel price variation is allocated. The Rate Stabilization rules presently allocate cost effects to the customer group that caused the load variation. The parties to the Settlement Agreement have agreed that if the Load Variation Component is maintained in the RSP, it should be allocated on the basis of customer energy ratios. The Industrial Customer group has suggested that the Load Variation component should be eliminated.

Reference: *Consent 1, paragraph 16.*

Hydro proposes that the Load Variation balance that has accumulated in the RSP since September 1, 2013 should also be allocated on the basis of customer energy ratios. This balance was segregated in the RSP pending disposition of the Board in accordance with the terms of an Order in Council.

Reference: *OC 2013-089; Order No. P.U. 40 (2013).*

The consensus as to the allocation method in the Settlement Agreement is consistent with the position of Hydro, and that of the Board's cost of service expert, Dr. Wilson, that the customer energy ratio approach would result in a more equitable allocation of the Load Variation balance as "load variation has an impact on Holyrood energy costs for all customers."

Reference: *Report of J. W. Wilson and Associates, June 1, 2015, page 33.*

There is no principled basis or evidence supporting the allocation of the segregated balance in the Load Variation Component of the RSP on any basis other than the customer energy ratio approach.

Submission

Newfoundland Power submits that Hydro's proposal to allocate the Load Variation Component of the RSP on the basis of customer energy ratios should be approved. The same allocation methodology should be applied to the segregated balance that has accumulated in the Load Variation Component of the RSP since September 1, 2013.