

December 16, 2016

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

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

Dear Ms. Blundon:

Re: Newfoundland and Labrador Hydro – Application by Newfoundland and Labrador Hydro for approval of a proposed cost deferral account to provide Hydro the opportunity to earn a reasonable return on rate base in 2016 – Hydro's Reply

The following is Newfoundland and Labrador Hydro's (Hydro) submission with regard to the above noted application.

1.0 Application Background

On December 1, 2016, the Board of Commissioners of Public Utilities (the Board) issued Order No. P.U. 49(2016) providing its decisions on Hydro's Amended General Rate Application (Amended GRA) for 2014 and 2015 Test Years (the 2013 GRA Order). As a result of the timing of the 2013 GRA Order, it is not possible for Hydro to implement the direction and decisions of the Board before the end of 2016. As such, on December 9, 2016, Hydro filed an Application with the Board seeking approval of a 2016 Cost Deferral Account in the amount of \$38.8 million for financial reporting purposes to enable Hydro to earn a reasonable return in 2016. As detailed and explained in the evidence to Hydro's application, without approval of the 2016 Cost Deferral Account, the delayed implementation of the 2013 GRA Order will result in Hydro forecasting a net loss in 2016 in the amount of \$14.9 million.

2.0 Intervenor Submissions

Newfoundland Power Inc. (Newfoundland Power), in its letter dated December 15, 2016, has not commented on whether or not Hydro's application should be approved. Rather, Newfoundland Power stated that Hydro has not provided sufficient evidence as to why the accounting standards require a further order from the Board to record transactions associated with the supply cost deferral accounts.

Newfoundland Power also submitted that:

...the Board should order Hydro to file evidence indicating that the expenditures concerned are consistent with the least cost, reliable operation of the power system with either (i) Hydro's annual application for disposition of the balances in the supply cost deferral accounts (as indicated in the Order); or (ii) Hydro's compliance filing (as indicated in Hydro's evidence filed in support of the Application).¹

The Consumer Advocate does not oppose Hydro's Application.² Vale and the Island Industrial Customers have taken no position on Hydro's application.³

3.0 Hydro's Response

As noted above, the Consumer Advocate does not oppose Hydro's Application. Vale and the Island Industrial Customers have not taken a position on Hydro's Application.

It is not clear if Newfoundland Power supports or opposes Hydro's Application. With respect to Newfoundland Power's comment regarding accounting standards, Hydro submits that it is required to follow International Financial Reporting Standards (IFRS). International Accounting Standard 14 - *Regulatory deferral accounts*, paragraph 11 states:

On initial application of this Standard, an entity shall continue to apply its previous GAAP accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances...

Prior to the adoption of IFRS, Hydro followed Canadian Generally Accepted Accounting Principles (CGAAP) as its accounting policies. According to IFRS 14, Hydro must continue to apply the CGAAP standards with respect to regulatory deferrals. With respect to the accounting treatment of regulatory deferral accounts, not all of the financial impacts as a result of the 2013 GRA Order are accounted for in the same manner under CGAAP standards. Specifically, adjustments to Hydro's previously recorded cost deferrals (i.e. reductions to Hydro's net income) must be recorded in 2016 if changes in circumstances indicate that the amount recorded is no longer recoverable.⁴ This is in contrast to regulations regarding new regulatory assets such as the supply deferral accounts (i.e. increases to regulatory assets and Hydro's net income) which can only be recorded if they are probable, or more likely than not.⁵

¹ Letter from Newfoundland Power dated December 15, 2016, Page 3.

² Letter from the Consumer Advocate dated December 16, 2016.

³ Letter from Vale dated December 15, 2016. Letter from the Island Industrial Customers dated December 15, 2016.

⁴ CICA 3063.09

⁵ CICA 3064.21

Hydro submits that net reductions to Hydro's previously approved cost deferrals are required be recorded in 2016 as a result of the 2013 GRA Order. However, as the deferral definitions for the three cost deferral accounts have not yet been finalized and the accounts are still subject to a further order of the Board with respect to recovery, accounting standards do not permit recording of these transactions in 2016. Hydro conferred with a Technical Accounting Consultant on this matter who found Hydro's approach to be reasonable and consistent with accounting standards. This approach is still subject to review by Hydro's external auditors.

The amount requested for deferral in Hydro's application reflects the Board's decision in the 2013 GRA Order which approved the implementation of three supply cost deferral accounts, effective January 1, 2015. Given the concepts of the accounts have been approved by the Board, Hydro submits that it is appropriate to report these amounts in 2016 in a separate deferral account for financial reporting purposes to permit Hydro to earn a reasonable return in 2016.

Hydro also submits that, as is clearly indicated in its Application, this is not an application for recovery of the amounts proposed to be placed in the 2016 Cost Deferral Account. Hydro submits that the amounts proposed to be included in the 2016 Cost Deferral Account were calculated consistent with the Board's direction and orders as provided in the 2013 GRA Order and reflect supply costs that were prudently incurred by Hydro in the provision of service to its customers. However, Hydro would like to clarify that this is an application for the *creation* of a deferral account for 2016 financial reporting purposes with the intent that recovery of the amounts would be dealt with through a further application to the Board.

Approval of this Application will not have any impact on Hydro's rate payers. Further, Hydro submits that it has provided evidence to demonstrate that it will incur financial losses in 2016 without the relief provided by the 2016 Cost Deferral Account. As shown in Appendix A to Hydro's Evidence, Hydro's 2016 Quarterly Financial Report for the period ending September 30, 2016, shows a net loss at the end of that period in the amount of \$2.7 million. Appendix B, which provides Hydro's 2016 Forecast Financial Results, shows that Hydro is anticipating a net loss in the amount of \$14.9 million in the absence of regulatory relief.

4.0 Conclusion

In summary, Hydro respectfully requests that the Board approve the creation of the proposed 2016 Cost Deferral Account provided in Schedule 2 to the 2016 Cost Deferral Application. This will address Hydro's 2016 forecast revenue deficiency, which has resulted from delayed implementation of the rates proposed in its 2013 GRA.

Should you have any questions, please contact the undersigned.

Yours truly,

NEWFOUNDLAND AND LABRADOR HYDRO



Tracey L. Pennell
Senior Counsel, Regulatory

TLP/lb

cc: Gerard Hayes – Newfoundland Power
Paul Coxworthy – Stewart McKelvey Stirling Scales
Thomas J. O'Reilly, Q.C. – Cox & Palmer
Genevieve M. Dawson – Benson Buffett

Dennis Browne, Q.C. – Consumer Advocate
Yvonne Jones, MP Labrador
Senwung Luk – Olthuis, Kleer, Townshend LLP