Office of the Consumer Advocate

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May 7, 2024

Via Email

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

Attention: Jo-Anne Galarneau
Executive Director and Board Secretary

Dear Ms. Galarneau:

Re: Newfoundland Power's 2024 Rate of Return on Rate Base Application - Submission of the Consumer Advocate

On November 23, 2023, Newfoundland Power ("NP") submitted to the Public Utilities Board (the "Board") its 2024 Rate of Return on Rate Base Application ("Application"). A report entitled *2024 Rate of Return on Rate Base* was filed with the Application.

Newfoundland Power filed its Application in accordance with Board Order No. P.U. 3(2022) which (Application, para. 2) "*ordered Newfoundland Power to file an application on or before November 15, 2023 for approval of the 2024 forecast average rate base and rate of return on rate base maintaining the common equity ratio and return on common equity established for ratemaking purposes.*"

In a letter dated April 30, 2024, the Board directed intervenors to file comments on the Application by May 7, 2024. This document presents the Consumer Advocate's comments.

SUMMARY OF APPLICATION

Newfoundland Power's Application seeks Board approval for (Application para. 6) "*an overall average increase in current customer rates of 1.5%, with effect from July 1, 2024, based upon:*

(i) a forecast average rate base for 2024 of $1,360,058,000;
(ii) a rate of return on average rate base for 2024 of 6.85% in a range of 6.67% to 7.03%; and
(iii) forecast revenue requirements from customer rates for 2024 of $711,080,000, representing a $11,835,000 increase to the ratemaking 2023 revenue requirement approved by the

Board in Order No. P.U. 3 (2022) to reflect the revised 2024 forecast average rate base and rate of return on rate base."

Newfoundland Power also proposes (Application, para. 8) "*deferred cost recovery of the 2024 revenue shortfall amount of $6,722,000.*" This deferred cost recovery amount collects the difference between the proposed revenue increase in 2024, and the amount of revenue forecast to be collected in 2024 via the proposed 1.5% rate increase effective July 1, 2024.

The proposed 2024 forecast average rate base of $1,360 million is $72 million more than the $1,288 million forecast average rate base for the 2023 Test Year (2024 Return on Rate Base, page 3 of 8). According to Footnote 14 (2024 Return on Rate Base, page 3 of 8), the forecast increase in average rate base is due to 2023 capital expenditures of $122.9 million approved in Order No. P.U. 38 (2022), 2023 capital expenditures of $1.6 million approved in Order No. P.U. 14 (2023), and 2024 capital expenditures of $115.3 million proposed in the *2024 Capital Budget Application* which at the time of the Application was still under Board review. The Board has since approved an amount of $114,252,000 in Order P.U. 2(2024), $1 million less than proposed by Newfoundland Power in its *2024 Capital Budget Application.*

SYNOPSIS OF THE CONSUMER ADVOCATE'S POSITION

In accordance with Board Order No. P.U. 3(2022), Newfoundland Power has determined a regulated rate of return on rate base for 2024 of 6.85%, which is based on an equity ratio of 45% and an approved rate of return on equity of 8.5%. In comparison, Newfoundland Power provided a 2024 forecast of 6.21% rate of return on rate base together with a 7.08% return on equity. The rate of return on rate base is a weighted average of the rate of return on equity and the rate of return on debt. Newfoundland Power proposes to increase its rate of return on equity to approximately 8.5%, which would have the effect of increasing the rate of return on rate base to the 2024 regulated rate. To achieve that higher rate of return on equity, Newfoundland Power wants an increase in customer rates.

The Consumer Advocate opposes that increase in customer rates. It would be inappropriate to do so outside a General Rate Application process, where all costs, not just debt cost, are scrutinized. Increasing customer rates so that the utility will be assured of earning the approved rate of return on equity would be equivalent to implementing a guaranteed minimum rate equal to the approved rate. While cost of debt is a component of equity earnings, and higher debt costs are at play in Newfoundland Power's 2024 forecast of a low rate of return on equity, other costs have played a bigger role. However, the utility has not addressed them despite their sizable increases over 2023 levels. Also, Newfoundland Power's forecast of 2024 energy sales and, by implication, its revenues, are unduly low. With likely higher sales and by taking actions to reduce the forecast increases in its other costs, Newfoundland Power has a reasonable opportunity to earn a higher return on equity in 2024 at current customer rates. There is no justification for the Application's proposed increase in customer rates.

The remainder of this document elaborates.

PERTINENT ISSUES

1. Resetting Rates Outside the GRA Process

Newfoundland Power is proposing the setting of new customer rates outside of the GRA process and separately from the current institutionalized July 1 adjustments. This is highly questionable.

While the Board's Order P.U. 3(2022) justifies the filing of the Application, Newfoundland Power fails to explain why it is appropriate for it to receive an increase in customer rates outside of a Test Year as requested. In CA-NP-021(e), Newfoundland Power acknowledges that "*The Board did not provide any direction in Order No. P.U. 3 (2022) with respect to customer rates for 2024.*"

Newfoundland Power states (*2024 Rate of Return on Rate Base*, page 2 of 8) "*This 2024 return on rate base application follows the same approach as prior applications approved by the Board for the 2015, 2018 and 2021 forecast years.*" The Board's Orders on these three applications are attached to CA-NP-004, and Newfoundland Power confirms (CA-NP-017) that in none of these previous applications did it request an increase in customer rates, and neither did the Board approve any increase. Newfoundland Power (CA-NP-017) explains that it did not request a rate increase in each of those years because its "*forecast rate of return on rate base was within the ±0.18% range of the regulated rate of return on rate base set out in the respective applications. Accordingly, continuation of existing customer rates provided the Company a reasonable opportunity to earn the regulated rate of return in each of those years.*" It is important to emphasize that without the Application's requested increase in customer rates, Newfoundland Power's 2024 rate of return on rate base is forecast at 6.21%, which is within the 2023 approved range for the rate of return on rate base, namely, 6.21% to 6.57% (NLH-NP-003).

Newfoundland Power states with respect to rate-setting approaches used elsewhere in Canada (PUB-NP-004) "*In each jurisdiction, customer rates are set using the mid-point ROE, in particular when the ROE forms part of the revenue requirement calculation. Between COS reviews, an actual earned ROE is permissible within the respective ranges and mechanisms applicable in each jurisdiction.*" Newfoundland Power concludes "*In the Company's view, these fundamental concepts are consistent with the Board's approach to rate-setting for Newfoundland Power.*" However, the evidence in PUB-NP-004 warrants further analysis.

Newfoundland Power surveyed five jurisdictions, three of which employ performance-based regulation ("PBR") and two of which employ cost of service ("COS") regulation similar to NL. Under PBR, utilities receive incentives to cut costs by allowing them to keep the resulting increase in profits. At the end of the regulation period, the savings due to cost-cutting measures are returned to customers in the form of reduced rates (reduced from what they would otherwise have been) and the regulation cycle begins anew. Under COS regulation, utilities are allowed a return on all prudently incurred costs. A utility is incented to cut costs in order to improve profits (i.e., earn a return closer to the upper end of the approved range on rate of return) in the period leading to the next regulatory cycle, which in this jurisdiction, is generally three years.

In the Application, Newfoundland Power is requesting a rate increase between regulatory cycles to ensure it realizes its approved rate of return on equity regardless of performance; e.g., failure to contain growth in costs. In effect, Newfoundland Power is requesting the Board to "*guarantee*" its rate of return on equity. This is contrary to the widely accepted regulatory premise that a utility is entitled to an "*opportunity*" to earn a fair return; it is not "*guaranteed*" a fair return. Newfoundland Power confirms this in CA-NP-018 stating that in this province, utilities are allowed "*an "opportunity" to earn a fair rate of return*" and that "*there is no legal clause or regulatory principle that "guarantees" Newfoundland Power's return in every year.*"

The two COS jurisdictions included in Newfoundland Power's survey include Nova Scotia Power and Maritime Electric (PEI). The Board asks with respect to practice in other Canadian jurisdictions (PUB-NP-004), "*if rates are reset to meet the mid-point of the targeted return on rate base or to recover the explicit cost increase being incurred by the utility.*" Newfoundland Power responds (page 3 of 4) "*It is Newfoundland Power's understanding that Nova Scotia Power and Maritime Electric both have limited ability to set customer rates, beyond annual supply cost mechanisms, outside of general rate application processes or otherwise directed by their respective regulators.*" In CA-NP-022(e), Newfoundland Power was unable to provide evidence that either of these two jurisdictions re-set customer rates between GRAs. Therefore, contrary to Newfoundland Power's claim that its proposed approach is consistent with practice elsewhere in Canada, it has provided no evidence to suggest that the two jurisdictions in the survey with regulatory mechanisms that are relevant to this jurisdiction allow customer rates to be reset to meet the mid-point of the targeted return on rate base or to recover an explicit cost increase incurred by the utility. Indeed, with respect to this jurisdiction, Newfoundland Power (*2024 Rate of Return on Rate* Base, page 2 of 8) states "*Where the forecast just and reasonable return was within the range of return on rate base previously approved by the Board, the Board ordered continuation of existing approved customer rates.*"

2. Proposed 2024 Regulated Rate of Return on Rate Base

Board Order P.U. 3(2022) set the approved rate of return on rate base for 2023 at 6.39% in a range of 6.21% to 6.57%, with "*a common equity ratio not to exceed 45% and a rate of return on common equity of 8.50%.*" [1] The Application is requesting the Board to approve an increase in the regulated rate of return on rate base for 2024 to 6.85% in a range of 6.67% to 7.03%, while retaining the same conditions with respect to common equity.

Table 1 summarizes the impact of the proposed increase in customer rates on the returns, and rates of return, on rate base and equity.

[1] *2024 Rate of Return on Rate Base*, page 4 of 8.

Table 1

Returns with and without Proposed Increase in Customer Rates[2]

	2024F (no change in customer rates)	2024F (after proposed increase in customer rates)
Return on Equity	$42,653,000	$51,169,000
+ Finance Charges (Debt Cost)	$41,628,000	$41,534,000
= Return on Rate Base	$84,281,000	$92,703,000
Rate of Return on Rate Base	6.21%	6.82%
Rate of Return on Equity	7.08%	8.44%

The table makes it clear that, in effect, all the proposed increase in the return on rate base - from $84,281,000 to $92,703,000 – is to be accomplished through an increase in the Return on Equity. The overriding intent of the Application is to accomplish that increase in the return on equity by raising average customer rates by 1.5%.

Table 1 also reports that those proposed higher customer rates would increase the 2024F rate of return on equity from 7.08% to 8.44%. In tandem, the rate of return on rate base would increase from 6.21% to 6.82%.

The Application seeks to increase the 2024 forecast return on equity from $42,653,000 to $51,169,000, representing an increase of $8,516,000, in order to raise the rate of return on equity from 7.08% to 8.44%. To do so, the Application is seeking an $11,835,000 increase in Newfoundland Power's 2024 revenue requirement. For an explanation of how this increase in the revenue requirement leads to an $8,516,000 increase in the return on equity, see *2024 Rate of Return on Rate Base*, Appendix D, page 1 of 3.

The key question then is why at existing customer rates is Newfoundland Power's 2024 forecast rate of return on equity 7.08%. After all, in 2023, Newfoundland Power earned 8.54% on equity (PUB-NP-019, 1st Revision) at existing customer rates. Table 2 addresses that question. It compares Newfoundland Power's actual 2023 revenues and expenditures with forecasts for 2024 assuming rates remain unchanged.

The return on equity (i.e., earnings applicable to common shares), which is given in the last row of Table 2, is the difference between revenues and expenses. First, consider revenues. As shown, revenues in 2024 are forecast to be higher than in 2023. Specifically, revenue, net of purchased power expense, ("Contribution" in the table) is forecast to increase by $6.935 million and "Other revenue" to increase by $1.813 million when comparing 2024F to 2023. So, it is not a decrease in revenue that is causing a decline in forecast return on equity. On the other hand, the 2024 forecast for "Other expenses," i.e., expenses other than purchased power expense, is $15.592

[2] Source: *2024 Rate of Return on Rate Base*, Appendix D: page 3 of 3 for the first four rows of figures and page 1 of 3 for the final row.

million higher than its 2023 value. That is more than the forecast increase in revenues. That is what leads to a forecast decline in the return on equity in 2024 of $5.434 million, as shown in the last row of the table.

Table 2

Comparison of Return on Common Equity: 2023 Actuals and 2024F ($000)[3] [4]

	2023	2024F Existing Customer Rates	Change from 2023
Revenue	759,464	777,237	17,773
Purchased power expense	511,983	522,821	10,838
Contribution	247,481	254,416	6,935
Other revenue	7,976	9,789	1,813
Other expenses:			
Operating expenses	73,912	78,775	4,863
Employee future benefit costs	2,735	3,010	275
Deferred cost recoveries and amortizations	-814	-240	574
Depreciation	74,536	79,557	5,021
Finance charges	36,842	41,701	4,859
	187,211	202,803	15,592
Income before income taxes	68,246	61,402	-6,844
Income taxes	20,159	18,749	-1,410
Earnings applicable to common shares	48,087	42,653	-5,434

The $15.592 million increase in "other expenses" is largely due to:

(i) a $4.863 million increase in operating expenses,
(ii) a $5.021 million increase in depreciation cost, and
(iii) a $4.859 million increase in finance charges.

All the cost increases are shown in Table 2's column "Change from 2023". Notably, increased finance charges account for just 31.2% (= $4,859/$15,592) of the total increase in other expenses.

[3] Source: PUB-NP-019, Attachment B (1st Revision).

[4] Finance charges in Table 2 for 2024F differ slightly from that given in Table 1 due to $73,000 in interest on security deposits; see *2024 Rate of Return on Rate Base*, Appendix D, page 3 of 3, footnote 1.

Next, a comparison of the 2024F returns on equity (at existing customer rates) with the 2023 Test Year returns on equity yields a similar picture. Table 3 provides the comparison. It shows that the 2024F Contribution and other revenue are both higher relative to the 2023 Test Year. However, the higher revenues are more than offset by increased other expenses. The biggest sources of the higher other expenses are:

(i) operating expenses, up $8.050 million,
(ii) depreciation, up $5.099 million, and
(iii) finance charges, up $8.610 million.

In this comparison, the increase in finance charges relative to the 2023 test year is 38.1% (=$8,610/$22,574) of the increase in other expenses, with the bulk of the remaining 61.9% increase in other expenses due to increased depreciation and operating costs.

Table 3

Comparison of Return on Common Equity: 2023 Test Year and 2024F ($000) [5]

	2023 Test Year	2024F Existing Customer Rates	Change from 2023 Test Year
Revenue	703,826	777,237	73,411
Purchased power expense	459,924	522,821	62,897
Contribution	243,902	254,416	10,514
Other revenue	6,473	9,789	3,316
Other expenses:			
Operating expenses	70,725	78,775	8,050
Employee future benefit costs	2,771	3,010	239
Deferred cost recoveries and amortizations	-816	-240	576
Depreciation	74,458	79,557	5,099
Finance charges	33,091	41,701	8,610
	180,229	202,803	22,574
Income before income taxes	70,146	61,402	-8,744
Income taxes	20,944	18,749	-2,195
Earnings applicable to common shares	49,202	42,653	-6,549

Tables 2 and 3 make it clear that Newfoundland Power's forecast decline in return on equity in 2024 is not due to a single dominant factor, such as an increase in finance charges. Whether

[5] Source: PUB-NP-019, Attachment B (1st Revision).

relative to 2023 Actuals or the 2023 Test Year, the decline in the 2024 return on equity (and associated forecast decline in the rate of return on equity) is due to higher operating expenses, higher depreciation and higher finance charges. With respect to these cost factors, some brief observations follow:

- Operating expenses. Newfoundland Power has more scope to alter operating expenses in the short term than most, if not all, other costs. These expenses are forecast to be much higher in 2024 relative to 2023 Actuals and 2023 Test Year. It is still early in 2024 so presumably Newfoundland Power has scope to reduce the forecast increase in operating expenses. Doing so would increase the return on equity.

- Depreciation cost. Depreciation is largely historically determined and related directly to plant investment, which is the bulk of rate base. The Consumer Advocate warned in the 2024 Capital Budget Application process, and previous ones, about Newfoundland Power's growing rate base. It has been growing much more than the rate of inflation. From 2003 to 2024F, Newfoundland Power's rate base grew by 101% while inflation was 62% (CA-NP-006). Newfoundland Power would surely have been able to predict the implications for depreciation costs as it proceeded with its capital spending and made capital expenditure plans for rate base growth. More disciplined capital spending in recent years would have moderated depreciation cost. While within a one-year period Newfoundland Power has limited scope to reduce its increase in plant capital, it is not likely to be zero. Any reduction would reduce depreciation and raise the return on equity, even if slightly.

- Finance charges. While interest rates have risen, Newfoundland Power does not appear to have moderated capital spending accordingly. Finance charges tend to rise with interest rates, and Newfoundland Power points to the Bank of Canada's successive increases in interest rates during 2022 to mid-2023 (*2024 Rate of Return on Rate Base*, page 5 of 8). However, interest rates are not the end of the story. The amount borrowed is a substantial determinant of finance charges. Capital spending that grows rate base requires more debt financing. Had Newfoundland Power moderated capital expenditure and the associated increase in rate base, especially during the recent few years of higher interest rates, then 2024F finance charges would be lower and, as a result, the return and rate of return on equity higher.

The preceding considerations were not tested in this Application process. In fact, when asked about measures that it could have taken, other than applying for higher customer rates to increase the return on equity, Newfoundland Power's responses suggested that operating and other costs were not relevant to the Application. Some examples are:

> When asked about what cost reduction measures Newfoundland Power identified to address its revenue shortfall, the response was a general one that did not address this particular application (CA-NP-003(b)). And in response to "*Once Newfoundland Power determined the extent of its revenue shortfall, what specific cost-cutting measures did it*

identify to help address it before deciding to seek a rate increase?" Newfoundland Power (CA-NP-024(b)) stated "*the only proposed changes to the Company's 2023 test year revenue requirement relate to its increased 2024 return on debt and return on equity (and related income tax effects) in compliance with Order No. P.U. 3 (2022). There are no other changes to its 2023 test year revenue requirement related to other cost changes in 2024, such as higher operating costs and depreciation expense*".[6] Yet, increases in operating costs and depreciation are among the major factors that have led to the lower forecast rate of return on equity.

NL Hydro asked Newfoundland Power (NLH-NP-010) to explain "*why Newfoundland Power believes that it is appropriate to request a rate increase at this time for higher costs related to rate base and debt costs but does not consider other financial impacts that may result in the cost savings that led Newfoundland Power to forecast excess earnings in 2023*". Newfoundland Power, citing Order No. P.U. 3(2022), responded "*Newfoundland Power's Application is filed in compliance with the Board's order. The revisions to the Company's 2023 test year revenue requirement required by the order are limited to its return on rate base and associated income tax effects*". That response evades the key issue: what has Newfoundland Power done to contain its growth in costs?

The Board (PUB-NP-014) asked "*Please confirm that the proposed $11.8 million increase in revenue requirement reflects an increase of $8.05 million in operating expenses relative to the 2023 Test Year (i.e., $78.775 million less $70.725 million,...)*". Newfoundland Power responded "*Newfoundland Power is not proposing to increase its 2024 revenue requirement for increased operating costs relative to the 2023 test year. The Company's 2024 Rate of Return on Rate Base Application proposes an $11.8 million increase in revenue requirement from the level in existing customer rates to reflect its 2024 forecast average rate base and rate of return on rate base as required by the Board in Order No. P.U. 3 (2022).*" Again, the answer avoids the key issue of costs. The Application is aimed at increasing the forecast rate of return on equity from 7.08% to 8.44% by increasing customer rates in order to cover Newfoundland Power's substantial increases in costs.

No evidence has been presented to show that Newfoundland Power cannot take actions now to improve on its 2024 forecast rate of return on equity. Also, the Application provides no evidence to justify the increases in Newfoundland Power's operating expenses and other costs in the first place. Moreover, if Newfoundland Power were to be granted an increase in customer rates whenever its rate of return on equity fell below the most recently approved regulated rate then that would amount to a guaranteed floor for that rate of return.

The Consumer Advocate opposes the proposed increase in customer rates. That would be a step too far and set a very troubling precedent. It would amount to providing a guaranteed floor for Newfoundland Power's rate of return on equity and it would diminish the incentive for Newfoundland Power to control growth in its costs. Denying an increase in customer rates

[6] The only specific action identified by Newfoundland Power was a change in the timing of long-term debt issuance to take advantage of lower interest rates, which the utility states reduced forecast 2024 debt cost by $400,000.

appropriately places pressure on Newfoundland Power to do whatever it can to increase its returns.

3. Newfoundland Power's Prospects without the Proposed Increase in Customer Rates

The preceding subsection argued that the proposed increase in customer rates should not be approved. Instead of increasing customer rates, Newfoundland Power should take whatever management actions it can to reduce its cost in order to increase its rate of return on equity. Meanwhile, there is evidence that higher-than-forecast sales will also contribute to a higher rate of return on equity. Newfoundland Power's forecast sales in 2023 and 2024 are shown in Table 4.

Table 4

Comparison of Sales Forecasts for 2023 and 2024

	Sales (GWh)[7]	Increase Over Previous Year	Percentage Increase Over Previous Year
2023F	5,949.2	164.7	2.85%
2024F	5,981.4	32.2	0.54%

The increase in sales for 2024 is forecast to be 32.2 GWh compared to the 2023 forecast. As indicated in the table, that is a little more than a half percent increase from 2023 sales. That is quite modest growth. Three reasons why sales growth may be higher follow.

First, there are on-going efforts by government to support electrification in the province. Such efforts include conversion of public buildings to electric heat and incentives for homeowners to convert from oil furnaces to electric heating. While Newfoundland Power is aware of such programs, it is worth noting that new incentives were put in place since the Application was filed.[8]

A second reason to expect higher sales growth is based on sales from the start of 2024. Table 5 shows sales for the months of January and February for 2023 and 2024. Sales were up in both months in 2024 relative to the corresponding months in 2023. Moreover, sales in the two-month period were up 3.5%, much higher than Newfoundland Power's 0.54% forecast growth rate as given in Table 4. The most relevant fact is that the increase in sales over this two-month period is 47.4 GWh. That is more than the 32.2 GWh growth that Newfoundland was forecasting for the whole of 2024! Surely, the extra revenue associated with this sales growth has increased Newfoundland Power's revenues by more than anticipated for the first two months of 2024.

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[7] Source: Newfoundland Power 2025/2026 General Rate Application, Table 1-1. That source also shows 2022 sales were 5,784.5 GWh.

[8] See https://www.newswire.ca/news-releases/federal-provincial-agreement-allows-newfoundlanders-and-labradorians-to-switch-from-heating-homes-with-oil-to-heat-pumps-and-other-electric-home-heating-systems-858042046.html#:~:text=Governments%20of%20Canada%20and%20Newfoundland,of%20an%20average%20heat%20pump.

Table 5

Newfoundland Power Sales (GWh) in January and February, 2023 and 2024[9]

	2023	2024	Change	Percent Change
January	693.2	725.8	32.6	4.7%
February	656.7	671.5	14.8	2.3%
Two-month total	1,349.9	1,397.3	47.4	3.5%

The Board's consultant, The Brattle Group, provides a third reason for expecting higher-than-forecast sales. In its recent report of April 17, 2024 entitled *Review of Newfoundland Power Load Forecasting Methodology*, Brattle expresses concerns over Newfoundland Power's under-forecasting of sales. At one point, it states (page 24) "*The Company has under-forecasted its domestic load four out of five times during the last five-year period, which implies that the Company was able to collect more revenues from the domestic class as a result of under forecasting domestic sales.*"

These three reasons for expecting more growth in sales and, hence, revenue, reinforce the Consumer Advocate's argument that there is no justifiable case for Newfoundland Power to increase its customer rates.

Next, consider Table 6. It shows that for every year of the 26 years from 1998 to 2023, Newfoundland Power has earned a higher rate of return on equity than the approved rate. This indicates how successful Newfoundland Power has been in managing its business so as to ensure that year after year it earns more than its approved rate of return on equity. That success is consistent with the Consumer Advocate's contention that for 2024, Newfoundland Power can and should be expected to make management decisions so it will earn more than the Application's forecast return on equity. Such actions combined with likely higher sales growth will probably enable the utility to come close to earning its approved rate of return on equity or even surpassing it as it has done every year for the past quarter century.

Table 6

Newfoundland Power's Approved and Actual
Rates of Return on Equity: 1998 -2023[10]

Year	Approved	Actual
1998	9.25%	9.58%
1999	9.25%	9.81%
2000	9.59%	10.80%
2001	9.59%	11.35%

[9] Source: Responses to CA-NP-020 and CA-NP-079 with respect to Newfoundland Power's 2025/2026 General Rate Application.

[10] Source: Table 1 in response to CA-NP-079 with respect to Newfoundland Power's 2025/2056 General Rate Application.

2002	9.05%	10.65%
2003	9.75%	10.22%
2004	9.75%	10.12%
2005	9.24%	9.60%
2006	9.24%	9.46%
2007	8.60%	8.66%
2008	8.95%	9.13%
2009	8.95%	8.96%
2010	9.00%	9.21%
2011	8.38%	9.00%
2012	8.80%	8.98%
2013	8.80%	9.16%
2014	8.80%	9.15%
2015	8.80%	8.98%
2016	8.50%	8.90%
2017	8.50%	8.93%
2018	8.50%	8.76%
2019	8.50%	8.79%
2020	8.50%	8.93%
2021	8.50%	8.88%
2022	8.50%	8.95%
2023	8.50%	8.54%

4. <u>2023 Excess Earnings</u>

Newfoundland Power over-earned in 2023. In CA-NP-013, Newfoundland Power states *"Newfoundland Power is forecasting a rate of return on rate base of 6.85% in 2023, which is above the 6.21% to 6.57% range of return on rate base established by the Board. Any return on rate base in excess of the range approved by the Board (i.e., above 6.57% for 2023) will be credited to the Company's Excess Earnings Account.*" In CA-NP-023 (1st Revision) Newfoundland Power provides updated 2023 figures showing excess earnings of $3.7 million (i.e., after-tax earnings above the high end of the range of return on rate base established by the Board), and $6.0 million above the mid-point of the range of return on rate base established by the Board. Also, Newfoundland Power earned an 8.54% rate of return on equity in 2023, which would have been higher in the absence of the provision with respect to excess earnings.

The Board (PUB-NP-007) asks if Newfoundland Power considered "*using the 2023 Excess Earnings to partially offset the proposed 1.5% increase for July 1, 2024.*" Newfoundland Power's response is that the disposition of its 2023 excess earnings will be determined by the Board following its transfer to Newfoundland Power's Excess Earnings Account on December 31, 2023. Newfoundland Power identifies "*two practical options*" for the disposition of the balance, including: *"(i) using the balance to partially offset the proposed July 1, 2024 rate increase through a transfer to the Company's Rate Stabilization Account ("RSA"); and (ii) using the balance to offset the 2024 revenue shortfall amount to be recovered as part of its 2025/2026 GRA."*

The Consumer Advocate supports applying the 2023 excess earnings to the Rate Stabilization Account but not for partially offsetting the proposed July 1, 2024 rate increase or to offset the proposed deferred cost recovery of any revenue shortfall associated with the Application. That proposed rate increase should not be approved by the Board. The disposition of the 2023 Excess Earnings should be decided by the Board separately from the Application.

THE APPLICATION IN THE BROADER CONTEXT

Massive spending is proposed on the province's electricity system. As noted in the Consumer Advocate's submission on Newfoundland Power's 2024 Capital Budget Application (see "Newfoundland Power Inc. 2024 Capital Budget Application - Submission of the Consumer Advocate," November 27, 2023), total expenditures in the electricity sector are forecast to be $16.5 billion.[11] The provincial government's rate mitigation plan associated with the integration Muskrat Falls into the island system has yet to be defined[12] but, regardless, ratepayers will pay a substantial portion of this enormous cost. Newfoundland Power is not responsible for the bulk of this cost but this background provides context in which to assess Newfoundland Power's request for an increase in customer rates.

In NLH-NP-008, Newfoundland Power states that in addition to the 1.5% rate increase proposed in the Application, it "*is anticipating an additional customer rate increase on July 1, 2024 associated with the annual July 1st rate adjustment. The current estimate of the annual July 1st rate adjustments, which is largely the result of higher supply costs, is in the range of 6.7% to 7.5%. The total estimated customer rate increase on July 1, 2024 is therefore in the range of 8.2% to 9.0%%.*" Further, Newfoundland Power is proposing an additional rate increase of 5.5% effective July 1, 2025 in its 2025-2026 General Rate Application (see Newfoundland Power's 2025/2026 GRA, cover letter, pages 2 of 4 and 3 of 4). Therefore, the total estimated rate increase that customers will be facing by July 1, 2025 is in the range of 14.2% to 15.0%, and this does not include any additional rate adjustment that might result from higher supply costs incorporated in the July 1, 2025 rate adjustment.

As stated in Board Order No. P.U. 36(2021)-Reasons for Decision, the Board "*acknowledges the rate pressures which are expected in association with the commissioning of the Muskrat Falls Project. The Board believes that, given the circumstances, both Newfoundland Power and Hydro should renew their efforts to provide evidence which demonstrates that every effort is being made to reduce costs for customers while ensuring the continued provision of reliable service*." The rate pressures anticipated by the Board are now being realized, and reinforce the Board's statement that the two utilities must take every effort to reduce costs for customers while ensuring continued reliability. On the contrary, the information in the Application shows that Newfoundland Power's costs are increasing.

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[11] Total excludes $99.0 million for Holyrood TGS capital projects that are presumably accounted for in both the Reliability and Resource Adequacy Study – 2022 Update and the 2024 CBA (see Hydro's 2024 CBA, Five-Year Capital Plan (2024-2028), page 2).

[12] Reference September 29, 2023 Quarterly Update – Items Impacting the Delay of Hydro's Next General Rate Application Hydro indicates that it cannot submit its next GRA until the details of the government's rate mitigation plan are finalized (CA-NLH-016 from Hydro's 2023 Capital Budget Application).

This Application with its proposed increase in customer rates follows a year when Newfoundland Power earned 8.54% on equity. Further, although Newfoundland Power has incorporated the costs of the 2023 and 2024 Capital Budget Applications in its proposed rate increase, it has either ignored any resultant efficiency savings to customers deriving from these capital projects or there were no efficiency gains. Where are the reductions in operating expenses that might be expected from such high capital expenditures? Newfoundland Power is proposing that customers bear 100% of the cost of raising its 2024 rate of return on equity to 8.44%; Newfoundland Power does not propose to take any action on costs, debt and capital management in order to do it. That is unjustifiable and would be unfair to customers especially where the utility has not provided evidence that it lacks a reasonable opportunity to earn a fair return at current customer rates.

CONCLUSION AND RECOMMENDATIONS

Three main conclusions follow from the preceding.

First, changing customer rates outside the GRA process is not appropriate. It is contrary to the practice of regulatory boards in Canada that use COS regulation. Moreover, revenue and cost forecasts should be fully assessed whenever there is a request to change customer rates. The Application does not involve such an assessment. Approving an increase in customer rates to increase a utility's rate of return on equity outside of a GRA process would be a troubling precedent. It would effectively guarantee a floor for the rate of return on equity.

Secondly, Newfoundland Power's forecast for 2024 shows a set of circumstances that, other than for higher interest rates, is largely of its own making. Higher finance charges reflect an increase in debt, not just higher interest rates. Newfoundland Power has taken on debt to support its capital expenditures that are growing its rate base at a rate greater than the inflation rate. And growth in the rate base, particularly capital plant investment, leads to higher depreciation cost and debt cost. Operating costs are also forecast to increase in 2024 but Newfoundland Power does not offer any plan to reduce their growth. Newfoundland Power's solution is simply to request that customers pay more. Rather than approve an increase in customer rates, Newfoundland Power would be well advised to manage its costs.

Thirdly, consistent with the Board order P.U. 3(2022), Newfoundland Power has calculated its 2024 regulated rate of return on rate base, namely, 6.85% in a range of 6.67% to 7.03%, based on an 8.5% return on common equity and a common equity ratio not exceeding 45%. However, there should be no further revenue entitlement. There should be no increase in customer rates.

Consequently, the Consumer Advocate recommends that the Board:

1) deny the Application's proposed July 1, 2024 increase in customer rates;

2) by implication, deny the proposed deferred cost recovery of the 2024 revenue shortfall amount of $6,722,000;

3) order that Newfoundland Power revise its forecast 2024 average rate base to conform to Order P.U. 2 (2024); and

4) deal with the disposition of the 2023 excess earnings separately from the Application.

Please contact the undersigned if you have any questions on this submission.

Yours truly,

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/jm

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