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April 13, 2017

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 – 2013 General Rate Application – Order No. P.U. 49(2016) Compliance Application - Reply

Following is Hydro's reply with respect to the above noted Application.

1.0 Application Background

In Order No. P.U. 49(2016) (the GRA Order), the Board of Commissioners of Public Utilities (the Board) made a number of determinations on proposals contained in, and matters arising from, Hydro's 2013 Amended General Rate Application (the Amended GRA). On January 27, 2017, Newfoundland and Labrador Hydro's (Hydro) filed an Application in compliance with the GRA Order (the GRA Compliance Application).

2.0 Board Schedule and Process

On March 15, 2017, the Board's Financial Consultants, Grant Thornton, issued a report outlining the results of their review of Hydro's GRA Compliance Application (the Grant Thornton Compliance Report). The detailed scope of this financial review included Hydro's compliance with the GRA Order with respect to average rate base, revenue requirement, rate of return on average rate base, recovery of revenue deficiencies, the Rate Stabilization Plan (RSP), and other determinations of the Board.

Newfoundland Power Inc. (Newfoundland Power), the Island Industrial Customers, and the Consumer Advocate, submitted Requests for Information (RFIs) on March 23, March 24, and March 27, 2017, respectively. Hydro filed responses to those RFIs on March 30, 2017.

Newfoundland Power filed its comments with respect to the Compliance Application on April 7, 2017. Vale Newfoundland and Labrador Limited (Vale) and the Consumer Advocate filed their respective comments on April 10, 2017.The Island Industrial Customer Group, comprised of Corner Brook Pulp and Paper Limited (CBPP) and NARL Refining Limited Partnership (NARL) filed a joint submission on April 10, 2017. CBPP and NARL also filed separate submissions on April 10, 2017. Finally, On April 12, 2017, the Consumer Advocate filed comments with respect to the submissions of the Island Industrial Customers.

3.0 Hydro's Reply to the Grant Thornton Compliance Report

3.1. 2014 Revenue Deficiency Allocation

Grant Thornton identified a discrepancy in the return on rate base used in the 2014 cost of service study which used 7.108% versus 7.18%, which created a mismatch in return on rate base between the Cost of Service and the finance schedules.[1] In response to Grant Thornton's query, Hydro prepared a revised 2014 Cost of Service study which indicated that the impact of the mismatch is a net decrease to the Newfoundland Power revenue requirement of $60,000 and an offsetting increase to the rural Labrador Interconnected revenue requirement of the same amount. Total revenue requirement does not change.

Hydro accepts that the discrepancy causes a mismatch to occur and that the allocation of revenue requirement to Newfoundland Power and rural Labrador Interconnected should be adjusted accordingly. Hydro will file a Compliance Rates Application that will reflect this correction, and any other required changes, as determined by the Board's Order with respect to Hydro's GRA Compliance Application (the Compliance Order).

3.2. 2017 Revenue Deficiency

Grant Thornton noted that Hydro used incorrect compliance base rates in its calculation of the 2017 Revenue Deficiency, which resulted in a revenue deficiency overstatement of $465,000 and $36,000 for Newfoundland Power and Island Industrial Customers, respectively.[2]

Hydro submits that it will correct the above noted error. The 2017 Revenue Deficiency will also be revised in the Compliance Rates Application subsequent to the Compliance Order, to reflect July 1 rate implementation rather than an April 1 rate implementation.

3.3. Operation of the RSP

As a result of the operation of the RSP in accordance with the GRA Order, Grant Thornton noted the following issues that the Board will need to consider before issuing an Order relating to the GRA Compliance Application, including:

a. Fuel Cost in the 2014 Revenue Deficiency
b. Rural Rate Alteration Component of the 2015 RSP
c. 2015 RSP - Fuel Price Used in the RSP for 2015 and 2016
d. RSP Fuel Rider - 2017
e. RSP Recovery Adjustment Rate – April 1, 2017
f. Island Industrial Customers – RSP Surplus Adjustments

[1] Grant Thornton Compliance Report, at page 36.
[2] Grant Thornton Compliance Report, at page 41.

Fuel Cost in the 2014 Revenue Deficiency

On page 64 of the Grant Thornton Compliance Report, Grant Thornton stated:

> *In its Compliance Application, Hydro did not include proposals to update its 2014 revenue deficiency calculation to reflect actual 2014 No. 6 fuel costs or the actual operation of RSP. It is Hydro's position that revising the 2014 Test Year to reflect actual No. 6 fuel costs in 2014, within the context of the RSP, would result in a misrepresentation of the revenue deficiency as this cost difference has already been dealt with through the 2014 RSP balance disposition in 2015.*

Hydro submits that the approach found in the GRA Compliance Application is appropriate given the complexities of the RSP. As noted in Hydro's response to IC-NLH-011 Rev 1, variances from 2014 Test Year No. 6 fuel costs sheltered by the RSP have already been passed on to customers. To include them in the calculation of the 2014 Revenue Deficiency is, in Hydro's opinion, not appropriate.

Rural Rate Alteration Component of the 2015 RSP

With respect to Hydro's treatment of the new interim rates as new base rates and the discontinuation of the Rural Rate Alternation (RRA) credits that had continued since 2007, Grant Thornton stated that it:

> *[C]onsider[s] Hydro's assumption to be appropriate. The Board will need to consider if Hydro's assumption that the interim base rates that were effective July 1, 2015 were the new base rates (cost of service rate) for the purposes of calculating the RRA component of the RSP.*[3]

Hydro submits that Grant Thornton supports Hydro's interpretation that resulted in Hydro discontinuing RRA adjustments in the RSP relative to the new Test Year. If Hydro had continued applying RRA adjustments relative to the 2007 Test Year for the period July 1, 2015 to present, the RSP rate adjustment in July 2016 would have resulted in a larger decrease to retail customers. However, continuing to use the 2007 Test Year for purposes of monthly RRA adjustments post-July 1, 2015 would have also required a larger RSP credit reversal in 2017 to recover the RRA amounts that would have been temporarily credited to customers in the RSP balances in the second half of 2015 and for all of 2016. As such, Hydro submits that the approach it followed is reasonable.

2015 RSP - Fuel Price Used in the RSP for 2015 and 2016

In the GRA Order, the Board directed Hydro to file a revised 2015 Test Year Revenue Requirement for the purpose of determining the 2015 Revenue Deficiency, using a 2015 Test Year No. 6 fuel price of $64.41 per barrel. When Hydro recalculated the RSP for 2015 and 2016, using the inputs as approved and directed by the Board in the GRA Order, Hydro did not use the

[3] Grant Thornton Compliance Report, at page 54.

2015 Test Year cost of $64.41 per barrel of No.6 fuel, but instead continued to use the 2007 Test Year cost of $55.40 per barrel.[4] Grant Thornton notes that:

> *As explained by Hydro, the fuel price variances have already been dealt with through the operation of the RSP and therefore do not impact the determination of revenue requirement from base rates for 2015 and 2016.*
>
> *According to Hydro, if the calculation of the 2015 or 2016 revenue requirement for revenue deficiency was updated using a No. 6 fuel price of $64.41 per barrel compared to the 2007 Test Year price of $55.40, the total revenue requirement would increase by approximately $23.2 million for each year (2,577,657 barrels x $9.01($64.41-$55.40)). This would effectively reflect a fuel cost variance in revenue requirement which would have already been dealt with through the operation of the RSP. Therefore, calculating the revenue deficiency for 2015 and 2016 using $64.41 per barrel would result in an overstatement of revenue deficiency to be recovered from customers.*[5]

Grant Thornton did not take a position on Hydro's approach.

As stated in Hydro's GRA Compliance Application, using $64.41 per barrel fuel price would result in an overstatement of revenue deficiency for 2015 and 2016.[6] As noted in the Grant Thornton Compliance Report, reflecting the $64.41 per barrel fuel price on a historical basis in the RSP would require Hydro to retroactively determine what rates would have been in place for 2015 and 2016 using the new fuel, which Hydro submits is not consistent with rate setting on a prospective basis. Hydro submits that the proposed revision reflects the Board's findings and results in the most accurate computation of revenue deficiencies with respect to the operation of the RSP.

RSP Fuel Rider – 2017

According to Grant Thornton, the Board needs to consider if Hydro has interpreted Rule 1.3 in Section B of the RSP Rules correctly.[7] In determining the fuel rider proposed in Exhibit 4, Hydro "used the Cdn$/US$ Noon Exchange rate of 1.3267, which agrees to the monthly average of the Bank of Canada Cdn$/US$ Noon Exchange rate for the month of September 2015. This calculation results in a forecast fuel price of $68.50."[8] Grant Thornton has stated that the rule could also be interpreted such that the "more current fuel forecast" would be "$67.65, calculated using the Cdn$/US$ Noon Exchange rate for the month of September 2016, and the reference "new test year values" is the 2015 Test Year fuel price of $64.41."[9]

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[4] Ibid., at page 65.
[5] Ibid.
[6] GRA Compliance Application, Exhibit 2, at page 27.
[7] Grant Thornton Compliance Report, at page 65.
[8] Ibid.
[9] Ibid., at pages 65-66.

Section C.2 of the RSP rules deals with the calculation of the Fuel Price Projection to be implemented each July 1. The formula for calculating the Fuel Price Projection treats the US$ to Can$ exchange rate as separate variable from the fuel price forecast in the calculation. The fuel price premium is also a separate variable in determining the price per barrel ($Can) for use in computing the fuel rider. Section D of the RSP rules sets forth the requirement for a new fuel rider when implementing new base rates when "a fuel rider forecast is more current than the test year forecast". Section D requires the new fuel rider reflect "the more current fuel forecast and the new test year values."

Hydro's GRA Compliance Application used the most current fuel forecast as provided by PIRA as required in the formula in both Section C and Section D of the RSP Rules. However, Section D indicates test year values are required for the other inputs in calculating the new fuel price projection. Because the exchange rate is defined separately in Section C and is not a component of the fuel forecast, Hydro used the same values as used in its Test Year in determining the exchange rate. The exchange rate used in determining the Test Year cost per barrel of $64.41 ($Can.) is 1.3267. Hydro considers its approach consistent with the RSP Rules.

Hydro submits that Grant Thornton did not state that Hydro's interpretation of Rule 1.3 is incorrect. However, Hydro acknowledges that the RSP Rules could be interpreted in the manner put forward by Grant Thornton. As such, Hydro agrees with proceeding with the alternate interpretation presented by Grant Thornton and will reflect that interpretation in its Compliance Rates Application.

Hydro notes that ultimately customers will only pay for the actual price of No. 6 fuel through the RSP.

RSP Recovery Adjustment Rate - April 1, 2017

The GRA Order approved Hydro's proposed amendments to the RSP Rules. This included the removal of Section D (2.2), which suspended the Island Industrial Customers RSP adjustment Rate. As such, Hydro determined that the removal of this section requires an RSP adjustment to be implemented for 2017 to provide disposition of the current year balance as of December 31, 2016. In its Compliance Report, Grant Thornton has indicated that there are other options that could be considered. One such option is that the rate could be calculated based on the forecast balance as of March 31, 2017, with the balance fully recovered by December 31, 2017. However, as noted by Grant Thornton, this option would require a change to the RSP Rules.[10]

Hydro submits that the use of the December 31, 2016 Current Plan balance to determine an RSP Recovery Adjustment Rate for Island Industrial Customers contributes to a lower customer rate increase in 2017. Hydro also submits that its calculation of the RSP Recovery Adjustment Rate based on the December 31, 2016 Current Plan balance is consistent with the RSP rules.

[10] Ibid., at page 66.

<u>*Island Industrial Customers – RSP Surplus Adjustments*</u>
The GRA Order required that Hydro file a proposal for the finalization of Island Industrial Customer rates. In the GRA Compliance Application, Hydro indicated that as of March 31, 2017, the Island Industrial Customers RSP Surplus balance will be depleted by the RSP Surplus adjustments and is now forecast to have a RSP surplus balance of approximately $500,000 owing to Hydro. In its report, Grant Thornton stated that *"[d]epending on the timing for the implementation of the final rates, the Board will need to consider if Hydro should file an application to revise rates for Industrial Customers or allow the balance to continue to increase and determine recovery of this balance in a future order."*[11]

Hydro has proposed to use the RSP Current Plan balance at the end of 2016 for determining an Island Industrial Customer RSP Recovery Rider to apply in 2017. Any balances that have accrued in 2017 as a result of the continued application of the continued use of the RSP Surplus Adjustments for the first half of 2017 would be reflected in a revised RSP Recovery Rider to become effective January 1, 2018.

Hydro submits that its proposal is consistent with the current RSP rules and also gives consideration to customer impacts.

3.4. Deferral and Recovery Mechanisms
<u>*Isolated Systems Supply Cost Variance Deferral Account*</u>
Grant Thornton stated that the revised definition for the Isolated Systems Supply Cost Variance Deferral Account filed in Hydro's GRA Compliance Application is consistent with the GRA Order. However, Grant Thornton has recommended that the term *"proceeding year"* as used by Hydro to define Hydro's requirement to describe its efforts to minimize costs be changed to *"during the year"* so that it is clear that the reporting for Hydro's effort is for the reporting year, rather than prospectively.[12]

Hydro submits that this change is appropriate and will update the definition of the Isolated Systems Supply Cost Variance Deferral Account to reflect this change.

<u>*Energy Supply Cost Variance Deferral Account*</u>
In its review of the revised definition for this account, Grant Thornton noted that the formula to determine the Energy Supply Cost Variance Deferral was incorrect in relation to the fuel cost or savings resulting from the variance in generation at the Holyrood Thermal generating facility in that the Energy Supply Cost Variance Deferral account is being added back but instead should be subtracted. Grant Thornton therefore suggested that the formula be modified.[13]

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[11] Ibid., at page 66.
[12] Ibid., at page 67.
[13] Ibid., at page 68.

Hydro agrees that this error needs to be corrected and submits that part “F” of the formula be modified to be calculated as test year less actual, presented as option two by Grant Thornton. Specifically, Hydro proposes the following revised formula for “F”:

> F = [(Test Year kWh Thermal Generation + Test Year kWh Power Purchases) – (Actual kWh Thermal Generation + Actual kWh Power Purchases)] for all defined sources.

Hydro notes that this revision to F is consistent with the calculation of the Energy Supply Cost Variance Deferral as presented in the 2016 Cost Deferral Application.

4.0 Hydro’s Reply to Newfoundland Power and the Consumer Advocate[14]

Newfoundland Power provided comments with respect to costs to be included in Hydro’s rates and issues arising from the implementation of rates on July 1, 2017. The Consumer Advocate, in his letter dated April 10, 2017, essentially agreed with the submission of Newfoundland Power.

Hydro submits that Newfoundland Power’s comments contain several incorrect assumptions and mischaracterizations with respect to the GRA Compliance Application, which are further detailed below.

4.1. 2014 Test Year Depreciation

Newfoundland Power submits that Hydro has incorrectly included depreciation expenses associated with $146 million in disallowed 2014 Test Year capital expenditures in its 2014 and 2015 revenue deficiency calculations. Newfoundland Power states that this requires a reduction of $0.4 million in depreciation associated with the disallowed $146 million 2014 Test Year capital expenditure from Hydro's 2014 Revenue Deficiency calculation and a reduction of depreciation associated with disallowed capital expenditures from Hydro's 2015 Revenue Deficiency calculation.

Hydro submits that the remedies suggested by Newfoundland Power are not supported by the GRA Order and would result in a misstatement of Hydro’s revenue requirement. In Hydro’s reply to NP-NLH-003, Hydro stated:

> *The reduction in capital additions of $146.3 million for GRA adjustments would have resulted in <u>a net increase in depreciation expense of approximately $0.1 million.</u> Hydro did not increase revenue requirement for this change in depreciation expense.*[15] [emphasis added]

Newfoundland Power’s suggestion that the GRA Compliance Application overstates depreciation expense by $0.4 million is incorrect. As indicated in Hydro’s response to NP-NLH-003, Hydro’s depreciation expense in the 2014 Revenue Deficiency is in fact currently understated by $0.1 million.

[14] Submission of the Consumer Advocate dated April 10, 2017.
[15] NLH-NP-003, lines 9 through 12.

The suggested remedy highlights Newfoundland Power's failure to take into account the Board's direction in the GRA Order. As noted in the GRA Order:

> *The Board agrees with Hydro's proposed adjustment to the 2014 average rate base to reflect the actual plant additions, particularly in light of the impact of these delayed in-service additions on the average rate base and revenue requirement for 2014. The Board also notes that the 2014 rate base will have to be adjusted to reflect the prudence review findings and the impacts of the Board's finding in this Decision and Order.*[16] [emphasis added]

Hydro has adjusted its 2014 average rate base to reflect the *actual plant additions* as directed by the Board. However, the remainder of Section 13.3 of the GRA Order is silent on how the related depreciation expense should be adjusted to reflect this requirement. Were Hydro to adjust depreciation expense to be consistent with actual plant additions, it would have resulted in an increase in revenue requirement reflected in the GRA Compliance Application of $0.1 million. Given that there was no specific direction in the GRA Order on this issue and the fact that the resulting adjustment results in a relatively immaterial increase in Hydro's revenue requirement, Hydro elected to forego the $0.1 million adjustment. Hydro's proposal benefits Hydro's customers, including Newfoundland Power. To further reduce depreciation expense as suggested by Newfoundland Power would result in an understatement of Hydro's 2014 Test Year depreciation expense of $0.5 million.

Hydro submits that Newfoundland Power's assertion that the 2014 Test Year should reflect actual additions to rate base combined with only downward forecast adjustments to depreciation expense is inconsistent and is not supported by the GRA Order.

4.2. 2014 Revenue Deficiency

Newfoundland Power submits that the inclusion of the 2014 Revenue Deficiency in the calculation of test year rates is inappropriate. Hydro respectfully disagrees.

In Order No. P.U. 58(2014), the Board approved a deferral account for the 2014 Revenue Deficiency. However, the Board did not approve the proposed use of the credit balance in the RSP Hydraulic Variation Account balance to provide recovery of the forecast 2014 Revenue Deficiency. The Asset Rate Base Method approved by the Board in determining rate base in rate-setting for both Hydro and Newfoundland Power includes approved deferral account balances.

Average rate base is used for rate setting purposes. Therefore, the amount included in 2015 Test Year average rate base for rate setting purposes is $19.1 million, or 50% of the $38.1 million for the 2014 Revenue Deficiency reflecting the GRA Order. The $19.1 million inclusion in average rate base reflects the fact that the full $38.1 million was in a deferral account balance

[16] Order No. P.U. 49(2016), at page 82, lines 36 through 40.

at year-end 2016 (prior to the rate implementation year) and that the full balance would be disposed of in 2017.

Hydro's approach in treatment of the 2014 Revenue Deficiency deferral account balance in determining rate base for rate setting purposes is consistent with the Board approved treatment of deferral account balances in accordance with the Asset Rate Base Method.

Hydro submits that Newfoundland Power's position is not supported by the facts and circumstances surrounding this issue, and is contrary to the Asset Rate Base Method approved by the Board. [17]

Newfoundland Power submits that by the end of 2016, the 2014 Revenue Deficiency is offset by revenue surpluses in 2015 and 2016 for the purposes of setting customer rates. However, footnote 8 in Newfoundland Power's submission states:

> *<u>This would exclude the net impacts associated with recomputing the RSP for 2015 and 2016 of $76.4 million</u> and a 2016 cost deferral associated with 2015 and 2016 supply costs of $38.8 million.* [emphasis added]

Exclusion of the $76.4 million RSP balance to be reversed after approval of new customer rates is a material omission in considering the cost of financing the 2014 Revenue Deficiency for 2017. For the first six months of 2017, the rate setting year, $76.4 million of Hydro's revenue surplus will continue to reside inside the RSP to be financed by Hydro. Therefore, Hydro will not have an opportunity to recover the financing cost for the first 6 months of 2017 related to the 2014 Revenue Deficiency unless the 2014 Revenue Deficiency is included in the rate base opening balance for the purpose of setting customer rates (as reflected in Hydro's Compliance Application).

Hydro submits that its inclusion of the 2014 Cost Deferral in rate base as reflected in the GRA Compliance Application is appropriate and consistent with the Asset Rate Base Method approved by the Board.

4.3. Cost Allocation

Newfoundland Power submits that Hydro should correct the error indicated by Grant Thornton with respect to the discrepancy in the return on rate base used in the 2014 Cost of Service study. As noted in Section 3.1, Hydro will be filing a Compliance Rates Application to reflect this,

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[17] Order No. P.U. 19(2003), page 71, the Board approved the Asset Rate Base Method for NP, consistent with Hydro:

> *The Board finds that the Asset Rate Base method should replace the Invested Capital approach currently used to calculate NP's rate base. <u>The move to the Asset Rate Base method will begin in 2003 by incorporating deferred charges in rate base.</u>* [emphasis added]

and any other required changes, as determined by the Board's Order with respect to Hydro's GRA Compliance Application.

4.4. July 1, 2017 Rate Implementation

Newfoundland Power and the Consumer Advocate have stated that before the Board can approve final rates arising from the GRA, that a revised compliance application reflecting a July 1, 2017 implementation date is required.

Hydro will be filing a Compliance Rates Application to reflect any required changes in accordance with the Board's Compliance Order and to propose customer rates for implementation on July 1, 2017.

5.0 Hydro's Reply to the Island Industrial Customers

5.1. Submission of the Island Industrial Customers (Jointly) and Vale

The Island Industrial Customers, jointly, identified six issues with respect to Hydro's GRA Compliance Application. In its submission dated April 10, 2017, Vale indicated that it supports the submission of the Island Industrial Customers with respect to amendments required to the Compliance Application.

Inclusion of 2014 Revenue Deficiency in 2014 Rate Base

The Island Industrial Customers submit that Hydro's inclusion of the 2014 Revenue Deficiency in the 2014 Rate Base inappropriately seeks to charge interest on the 2014 Revenue Deficiency.[18]

With respect to the Island Industrial Customers, Hydro's entitlement to financing costs on rate base is inherent in the Asset Rate Base Method approved by the Board.[19] Hydro's approved method for the calculation of average rate base is the average of opening and closing balances. What the Island Industrial Customers are effectively proposing is a departure from this well-established method in this particular instance as it is in their best interest. However, Hydro submits that there are examples in the 2013 Amended General Rate Application where the average rate base method has benefited the Island Industrial Customers. For example, the Holyrood Combustion Turbine was not included in Hydro's opening rate base in 2015 in the GRA Compliance Application as it was not placed in-service until mid-February 2015. Practically, this means that Hydro did not begin to earn return on this $119.0 million asset until July 1, 2015, even though it was used and useful in the provision of service to customers some four months earlier. Hydro submits this is an example of the 'give-and-take' as offered by the use of average rate base. Hydro notes that the Island Industrial Customers were silent with respect to this example, where the methodology they appear to oppose (with respect to the 2014 Revenue Deficiency) actually results in a benefit to them.

[18] Joint submission of the Island Industrial Customers dated April 10, 2017, at page 2.
[19] Order No. P.U.19(2003) at page 7.

As previously stated, Hydro submits that its approach to the treatment of the 2014 Revenue Deficiency deferral account balance in determining rate base for rate setting purposes is consistent with the Board approved treatment of deferral account balances in accordance with the Asset Rate Base Method. Further, Hydro submits that the remedy suggested by the Island Industrial Customers is not consistent with the approved inclusion of deferred charges in rate base in accordance with the Asset Rate Base Method.

2014 Revenue Deficiency Balance

The Island Industrial Customers submit that it appears that Hydro, for the purposes of calculating the rate base asset related to the uncollected 2014 Revenue Deficiency, has used a 2014 revenue deficiency of $44.2 million, which is inappropriate given that Hydro's 2014 Revenue Deficiency was $38.1 million.

With respect, Hydro submits that the Island Industrial Customers are mistaken. As noted in Hydro's response to NP-NLH-004, Attachment 1, the $44.2 million was not included in rate base. $44.2 million is noted in NP-NLH-004 as "Total Before Prudence." The $44.2 million was reduced by $6.1 million, which results in the $38.1 million net amount that is included in the computation of average rate base.

2017 Revenue Deficiency

The Island Industrial Customers submit that the error identified by Grant Thornton described in Section 3.2 of this Reply be corrected. As stated above, Hydro submits that it will correct the error in its Compliance Rates Application.

USD/CAD Exchange Rate of RSP Rate Setting

With respect to the USD exchange rate to be used to calculate the fuel price to be used for the fuel rider to be in place for 2017, the Island Industrial Customers submit that the correct interpretation of the RSP Rules is to use the latest exchange rate value, i.e., September 2016, as presented by Grant Thornton (please refer to Section 3.3 *2015 RSP - Fuel Price Used in the RSP for 2015 and* 2016).

As stated in Section 3.3, Hydro acknowledges that the RSP Rules could be interpreted in the manner put forward by Grant Thornton. As such, Hydro agrees with proceeding with the alternate interpretation presented by Grant Thornton and will reflect that interpretation in its Compliance Rates Application.

2016 Regulatory Costs

The Island Industrial Customers submit that Hydro's proposal to include $1.0 million for regulatory studies and filings should not be approved.

Hydro submits that, in its Prudence Compliance Application, Hydro specifically stated that although the Board excluded the $1.0 million included for regulatory studies and filings that were attributable to the Board's investigations from Hydro's calculation of Hydro's 2015

Revenue Deficiency, it had included the amount for future years, *e.g.*, 2016 and 2017. Hydro further specifically stated that the $1.0 million budgeted for future years represents future anticipated studies and hearings are required to be completed and did not relate to the disallowance in question. As a result, Hydro submitted that the $1.0 million should not be disallowed for rate setting purposes in 2016.

Hydro submits that the issue was clearly before the Board in Hydro's Prudence Compliance Application. That application was reviewed by Grant Thornton who confirmed that the adjustments proposed in the application by Hydro were in accordance with the Board's Prudence Order[20] and subsequent direction. In the GRA Order, the Board stated it noted "that no intervenor commented or raised any issues with respect to Hydro's Prudence Compliance Application or Grant Thornton's findings."[21] As such, the Board accepted Hydro's Prudence Compliance Application as being in accordance with the Prudence Order.

Hydro submits that its treatment of this issue is consistent with the findings of the Board in both the Prudence Order and the GRA Order.

5.2. Separate Submissions of NARL, CBPP, and Vale – Recovery of Revenue Deficiencies from the Load Variation of Component of the RSP

The Island Industrial Customers are not in agreement on Hydro's proposed use of the credit balance in the RSP Load Variation Component to provide recovery of the revenue deficiencies allocated to the Island Industrial Customer class. The issue is not whether Hydro is entitled to recovery, but the manner of recovery.

NARL submits that the impact of specifically assigned charges as they relate to Hydro's revenue deficiency and Hydro's approach for recovery are not transparent and clear and does not present the impacts of increases of the specifically assigned charges by all customers except NARL, as a component of Hydro's revenue deficiency. NARL submits that Hydro's proposal for recovery has disparate impacts among the Island Industrial Customers and does not reflect specifically assigned charges actually paid (or not paid) by the Island Industrial Customers during the applicable period. In NARL's opinion, a distinction between the sources of revenue deficiency is necessary, specifically between specifically assigned charges and Energy sales. NARL submits that when the past revenue deficiencies are disaggregated in this manner, significant disparities between members of the customer group are evident.

Vale and CBPP support Hydro's proposal to recover the balance by a transfer of approximately $1.6 million from the Island Industrial Customer segregated load variation component of the RSP. In its submission, Vale submits that the recovery of the revenue deficiencies from the balance available in the RSP is equitable and is consistent with Hydro's evidence and past practice of collecting past balances on a class, as opposed to individual customer, basis. CBPP

[20] Order No. P.U.13(2016).
[21] Order No. P.U.49(2016) at page 20.

submits Hydro's approach is reasoned, reasonable, and meets the standard for acceptance by the Board. CBPP also submits that the use of the RSP balances to address deficiency was always contemplated, including any part related to any specifically assigned charges. In disagreeing with NARL's position, CBPP stated:

> *CBPPL understands that other industrial customers (including NARL) may object to the use of RSP funds to pay shortfalls that relate to Specifically Assigned Charges, on the premise that this leaves the specific customers in question with a lower balance in "their" RSP to pay for future costs. CBPPL submits that this is an incorrect view of the RSP. The RSP, and in particular positive RSP balances, reflect a collective benefit to the industrial class, not an entitlement of any given customer. In this regard, the objecting customers are not being prejudiced by having "their" RSP balance used to transition SAC charges, as there are no customer-specific RSP balances. This would be akin to saying the customers in question unfairly benefitted from having Teck Resources Limited drop their load levels, leaving behind a ''Teck RSP share", or that Teck Resources Limited could somehow submit a request for a payout of "their" share of the RSP upon its closure; this, of course, they could not, as it would reflect a similarly erroneous view of the RSP balances.*[22]

Hydro submits that NARL is effectively proposing a cost of service approach by individual customer in determining the allocation of revenue deficiency. Hydro does not support this proposed approach and submits that NARL has chosen a single cost component to demonstrate cost differences in an attempt to prove it is being treated unfairly.

The credit balance in the RSP Load Variation component has resulted from fuel savings from load variations relative to the 2007 Test Year, primarily in the Island Industrial Customer class. Most of the load reduction relative to the 2007 Test Year resulted from reduced load requirements to serve the pulp and paper industry (i.e., Abitibi and Corner Brook Pulp and Paper). Other Island Industrial Customers, such as NARL, did not pay additional fuel costs through the RSP even though the No. 6 fuel cost increased from $55 per barrel in the 2007 Test Year to a price in excess of $100 per barrel in 2014. Rather, NARL experienced material savings as a result of the RSP over this period even though the individual cost to serve NARL may have increased materially with respect to fuel costs.

Given that Island Industrial Customer rates did not increase over the period 2007 to July 2015 due to savings that were provided from the RSP, it is challenging to engage in a pure cost of service argument when assessing if the credit balance in the RSP Load Variation Component should be broken down on an individual customer basis when considering the approach to provide Hydro recovery of its revenue deficiency.

[22] CBPP reply submission dated April 10, 2017, page 2, lines 8 through 20.

Hydro agrees with the submission of CBPP that the RSP credit balance reflects a collective benefit to the Island Industrial Class and not an entitlement of any given customer. Increased usage of a single Island Industrial Customer can result in a debit balance to be recovered from the full class. At the same time, there can be decreased usage by another Island Industrial Customer that provides an offsetting savings to all Island Industrial Customers.

Hydro submits the use of the RSP credit balance to offset the revenue deficiency on a class basis is reasonable and is consistent with the historical treatment of the RSP balance as being a class balance.

6.0 Hydro's Reply to the Consumer Advocate's Submission of April 12, 2017

Hydro submits that the issues raised by the Consumer Advocate are not relevant to the proceeding currently before the Board.

7.0 Conclusion

Hydro submits that, with the exception of the items noted above to be changed to reflect Grant Thornton's Compliance Report, Hydro's GRA Compliance Application is consistent with the determinations of the Board in the GRA Order. Subsequent to the Board releasing its Compliance Order, Hydro plans to file a Compliance Rates Application reflecting the Board's Compliance Order and proposing customer rates to become effective July 1, 2017.

Yours truly,

NEWFOUNDLAND AND LABRADOR HYDRO

Tracey Pennell

Tracey L. Pennell
Senior Counsel, Regulatory

TPL/bds

cc: Gerard Hayes – Newfoundland Power
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