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Board of Commissioners of Public Utilities
120 Torbay Road
Prince Charles Building
St. John's, NL
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Attention: Ms. Cheryl Blundon

October 26, 2018

Dear Ms. Blundon,

Re: Newfoundland and Labrador Hydro – Sale of the Corner Brook Frequency Converter to Corner Brook Pulp and Paper

As requested by the Board of Commissioners of Public Utilities (the “Board”) in a letter dated August 10, 2018, we have completed our review relating to the accounting treatment associated with the asset retirement and disposal of the Corner Brook Frequency Converter.

Background

On June 18, 2018, Newfoundland and Labrador Hydro (the “Company” or “Hydro”) filed its application (the “Application”) for approval of the sale of the Corner Brook Frequency Converter to Corner Brook Pulp and Paper Limited (CBPP) and of amendments to its Service Agreement.

On July 16, 2018 Newfoundland Power filed its submission which expressed concern that in NP-NLH-006 Hydro stated that “\$4.1 million of loss on retirement would be deferred in accumulated amortization and used to develop depreciation rates in Hydro’s next depreciation study”. Newfoundland Power stated that “this appears to contemplate that certain of the amortized costs of the retirement of the Frequency Converter may ultimately be borne by Newfoundland Power’s customers”. Newfoundland Power further clarified it did not object to the Application provided that none of the costs associated with the retirement of the Corner Brook Frequency Converter are borne by Newfoundland Power customers now or in the future.

On July 23, 2018 the Company’s revised reply noted Newfoundland Power’s position:

- was contrary to the settlement agreement (“Settlement Agreement”) relating to certain matters for the Company’s 2017 General Rate Application signed April 11, 2018;
- was contrary to the depreciation practice of Newfoundland Power in dealing with retirement of specifically assigned assets; and,

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- does not reflect the historical benefits provided to the system by the frequency converter as a common asset.

Observations and Findings

We have reviewed the Company's Application and Order No. P.U. 26 (2018) and offer the following comments for your consideration.

- The approval of the sale of the Corner Brook Frequency Converter in P.U. 26 (2018) for \$1 results in a loss of \$4,959,000 for Hydro, with \$790,000 related to unit of property account F05 and \$4,170,000 related to various other units of property accounts as illustrated in NP-NLH-007.
- Under Hydro's existing depreciation methodology for disposals included in the Gannett Fleming Depreciation Study dated November 2012 as approved in Order No. P.U. 40 (2012), the loss on disposal of \$4.9 million would be recorded as a loss of disposal in the year of retirement on the income statement. Previous general rate applications included loss on disposals as a component of revenue requirement in the test years when applying the existing depreciation methodology.
- Under Hydro's proposed methodology included in the Company's 2017 General Rate Application currently under review by the Board, the loss (or gains) on disposals are recorded through accumulated amortization and would be used to develop depreciation rates in the Company's next depreciation study. The loss (or gain) is not recorded on the income statement or in revenue requirement for a test year. For the 2018 and 2019 revenue requirement, no cost of disposals are included as a result of applying the proposed depreciation methodology. This proposed methodology is consistent with item 9(d) of the Settlement Agreement.
- Hydro has identified that \$790,000 relates to unit of property F05 which solely relates to the Corner Brook Converter Frequency asset. As no active assets remain in this unit of property when the disposal is recorded, Hydro would not recover these costs through a future depreciation study. Instead this loss would be recorded as a loss on disposal on the income statement and would not be recovered through customer rates as this loss is not included in the 2018 or 2019 revenue requirement.
- For the remaining net book value of \$4,170,000 Hydro has asserted that it is comprised of assets in actively used units of property. Under the proposed group accounting depreciation methodology the \$4,170,000 loss on retirement is recorded through accumulated amortization and would be used to develop depreciation rates in the various units of property to which it relates. This methodology is consistent with item 9(d) of the Settlement Agreement.
- Certain amortized costs of the \$4,170,000 which may be associated with units of property included in the Island Interconnected System would ultimately be borne by Newfoundland Power customers through the determination of depreciation rates in the next depreciation study. We did not request a quantification from Hydro on which units of property costs would be included in the Island Interconnected System.

- If the Board decides that all or certain of the costs should not be borne by Newfoundland Power customers, an exception in applying the settled depreciation methodology would be required from the Board.

Based upon our review of the Company's Application and Order No. P.U. 26 (2018) we conclude that applying the methodology agreed to by parties to the Settlement Agreement dated April 18, 2018 would result in costs of \$4,170,000 related to the disposal of Corner Brook Converter Frequency recorded through accumulated amortization and would be used to develop depreciation rates in the Company's next depreciation study.

I trust this is the information you requested. If you have any questions, please contact me.

Yours sincerely,
Grant Thornton LLP



Steve Power, CPA, CA
Partner