P. U. 44 (2006)

IN THE MATTER OF the *Public Utilities Act*, RSNL 1990, c. P-47, as amended (the "*Act*")

AND

IN THE MATTER OF an application by Newfoundland & Labrador Hydro ("Hydro") for approval of deferral of expenses associated with the repair of the Unit 2 Boiler at the Holyrood Thermal Generating Station as a Major Extraordinary Repair, pursuant to Sections 69, 78 and 80 of the *Act* (the "Application").

Application

On July 24, 2006 Hydro applied to the Board for an Order approving the amortization of costs associated with repairs of the Unit 2 Boiler conducted in 2006 at the Holyrood Thermal Generating Station (the "Application").

On September 5, 2006 the Board's Financial Consultants Grant Thornton filed a report in relation to the Application.

On September 26, 2006 the Industrial Customers filed a written submission with the Board indicating that an oral hearing is not requested or necessary in the circumstances. On October 4, 2006 Hydro filed a submission replying to the comments of the Industrial Customers.

On October 26, 2006 the Board sent requests for information to Hydro. Hydro responded to these information requests on December 7, 2006.

Decision

Hydro owns and operates a 466 MW heavy oil-fired thermal generating station situated at Holyrood which, in January 2006, suffered a failure of a boiler tube causing an outage to the 175 MW generating Unit 2, requiring repair before it could be brought back into operation. Hydro, with the assistance of the boiler manufacturer, investigated the failure and the required repair, and determined that the repair is non-capital in nature, and that it was not a foreseeable or expected failure. The estimated cost for the boiler tube repairs necessary to ensure the long-term reliability of Unit 2 is $2,223,060.

Hydro has applied for amortization of the estimated costs of $2,223,060 plus related financing costs on the basis that the repair work constitutes a major extraordinary repair. The Application states that expensing the estimated costs as incurred in 2006 would have a significant adverse affect on Hydro's earnings. Hydro proposes that the total estimated costs of the repairs of $2,666,000, including financing costs, be amortized over a five-year period and that the unamortized balances be included in rate base.

The Industrial Customers oppose the Application, stating that the Board should dismiss the Application and require this expense to be treated as a normal operating expense for 2006. The Industrial Customers argue:

> *"…(a) that the proposal is contrary to generally accepted accounting principles; (b) that an increase in the level of Hydro's net loss in 2006 will not jeopardize the financial viability of Hydro; and (c) that the result is the imposition of additional costs on the consumer…."*

The Industrial Customers point out that companies that are not public utilities would have no choice but to record these expenses in the year incurred in accordance with generally accepted accounting principles (GAAP). They argue that it is only in the case of a "shock" to Hydro's earnings, which would potentially jeopardize its financial viability, that deferral is justified.

In its submission Hydro says:

> *"Hydro would point out that as a regulated public utility, it is subject to specialized rules of accounting that, in appropriate circumstances, provide for different accounting rules than would apply under GAAP. The policy pertaining to extraordinary expenses is one such circumstance."*

Grant Thornton, in its report, agreed that the costs are not capital in nature and that GAAP would require that the costs be expensed in the year incurred unless alternative accounting treatment is approved. After reviewing the matter Grant Thornton concluded:

> *"We concur with Hydro that recognition of the estimated costs of the repair in accordance with GAAP would have a significant negative impact on Hydro's earnings for 2006. The total cost of repairs to the Unit 2 boiler of $2.2 million represents 71% of the forecast net loss for 2006 of $3.1 million. To expense the entire repair cost in the year it occurred would result in a forecast overall net loss to Hydro for 2006 of $5.4 million."*

It is agreed that GAAP would require that these operating costs be recognized as expenses in the fiscal year in which they are incurred unless an alternative treatment is approved by Board. The Board has in the past acknowledged that it is appropriate in some circumstances to adopt a different accounting treatment than required by GAAP for major extraordinary repairs. As noted by Grant Thornton, the Board has in the past given regulatory approval for the deferral and amortization of significant or extraordinary costs. In its report dated April 13, 1992 the Board recommended that the accounting treatment for extraordinary repairs, as set out in a July 1991 Peat Marwick report "Accounting for Major Plant Replacement and Repairs" completed for Hydro, be adopted and implemented with a $500,000 threshold minimum amount. The Board has accepted that an expense may be considered an extraordinary repair if it meets the minimum threshold of $500,000 and would cause a rate shock or a shock in Hydro's earnings that is considered unreasonably high.

The Board is satisfied having reviewed the record that expensing the cost of these repairs in 2006 would have a significant negative impact on Hydro's earnings. The costs if expensed would almost double Hydro's forecast loss for 2006. The Board finds that, in the current circumstances, these costs would cause a significant shock to Hydro's earnings if they were to be recognized in 2006 and should be deferred over a period of time. The Board is satisfied that the five-year amortization proposal set out by Hydro in its Application is reasonable and should be approved. The Board rejects the suggestion of the Industrial Customers that deferral should only be ordered if it is found that the shock to Hydro's earnings would jeopardize its financial viability. This is not the approach that has been taken in the past and the Board is not prepared to adopt such a standard at this time. It is noted that Grant Thornton has suggested in its report that it may be timely to review this matter in the near future. The Board also acknowledges that the deferral of such costs may result in additional costs for the consumer. The ultimate test for the Board is to balance the interests of the utility and its stakeholders. In this circumstance the Board is satisfied these additional costs are reasonable and necessary to ensure a just and reasonable return for Hydro to ensure the continued provision of safe and reliable service in the Province.

<u>IT IS THEREFORE ORDERED THAT:</u>

1. The Board hereby approves:
   (i) treatment of the costs associated with the Unit 2 boiler tube repairs at the Holyrood Thermal Generating Station as a Major Extraordinary Repair;
   (ii) the amortization of the actual expenses for the repairs together with interest, estimated to be $2,666,000, over a five-year period beginning in 2006; and
   (iii) the inclusion in the rate base of the unamortized balance of the deferred costs of the repairs.

2. Hydro shall pay the expenses of the Board arising from this Application.

DATED at St. John's, Newfoundland and Labrador, this 21st day of December 2006.

Robert Noseworthy
Chair & Chief Executive Officer

Darlene Whalen, P. Eng.
Vice-Chair

G. Cheryl Blundon
Board Secretary