

**NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES**

AN ORDER OF THE BOARD

NO. P.U. 38(2019)

1 **IN THE MATTER OF** the *Electrical Power*
2 *Control Act, 1994*, SNL 1994, Chapter E-5.1 (the
3 "EPCA") and the *Public Utilities Act*, RSNL 1990,
4 Chapter P-47 (the "Act"), as amended, and regulations
5 thereunder; and

6
7 **IN THE MATTER OF** Order No. P.U. 26(2018)
8 relating to the sale of the Corner Brook frequency
9 converter by Newfoundland and Labrador Hydro
10 to Corner Brook Pulp and Paper Limited; and

11
12 **IN THE MATTER OF** the recovery of retirement
13 costs associated with the sale of the frequency
14 converter to Corner Brook Pulp and Paper Limited,
15 in the amount of approximately \$4.25 million.

16
17
Background

18
19
20 On August 9, 2018 the Board issued Order No. P.U. 26(2018) approving an application from
21 Newfoundland and Labrador Hydro ("Hydro") for the sale of the Corner Brook frequency
22 converter to Corner Brook Pulp and Paper Limited for a nominal value of \$1. In this proceeding
23 Newfoundland Power Inc. ("Newfoundland Power") raised an issue in relation to Hydro's
24 position that, in accordance with the depreciation policy proposed in the 2017 general rate
25 application, the estimated \$4.1 million loss on the sale of the frequency converter would be
26 deferred in accumulated amortization and used to develop depreciation rates in Hydro's next
27 depreciation study.¹ The Board stated that there was insufficient information on the record to
28 address the issue of which customers should bear the costs associated with the retirement of the
29 frequency converter and deferred the matter pending further inquiry by the Board.

30
31 Newfoundland Power again raised the issue of which customers should bear the costs associated
32 with the sale of the frequency converter during an application filed by Hydro for, *inter alia*, a
33 2018 cost deferral account related to the depreciation methodology changes agreed in the 2017
34 general rate application. Newfoundland Power stated that the amount in the deferral account may
35 reflect the loss on retirement incurred as a result of the sale of the frequency converter and that its
36 acceptance of the account should not be taken as a concession that its customers should bear any
37 portion of those costs. In Order No. P.U. 48(2018) approving the 2018 cost deferral account the

¹ In a letter dated December 7, 2018 Hydro updated the estimate of the loss to \$4.25 million.

1 Board noted that a separate process had been established by the Board to review this matter and
2 that the issues related to the balance in the account and disposition of this balance would be
3 addressed in a subsequent order of the Board. In Order Nos. P.U. 16(2019) and P.U. 30(2019) the
4 Board set out its findings with respect to Hydro's 2017 general rate application and approved rates
5 to be effective October 1, 2019. The Board also approved the agreement of the parties that the
6 frequency converter would continue to be specifically assigned to Corner Brook Pulp and Paper
7 Limited but did not address the recovery of the loss on the sale of the frequency converter.
8

9 **Review Process**

10 The Board engaged Grant Thornton LLP to review the accounting treatment associated with the
11 retirement and disposal of the frequency converter. Grant Thornton filed a report ("Grant
12 Thornton Report") on October 26, 2018 which concluded:
13

14 Based upon our review of the Company's Application and Order No. P.U. 26(2018) we
15 conclude that applying the methodology agreed to by parties to the Settlement
16 Agreement dated April 18, 2018 would result in costs of \$4,170,000 related to the
17 disposal of Corner Brook Converter Frequency recorded through accumulated
18 amortization and would be used to develop depreciation rates in the Company's next
19 depreciation study.²
20

21 Grant Thornton stated that if the costs related to the disposal of the frequency converter are not to
22 be borne by Newfoundland Power customers an exception to the application of the depreciation
23 policy would be required.
24

25 The Grant Thornton Report was circulated to: Newfoundland Power; the Consumer Advocate,
26 Dennis Browne, Q.C. (the "Consumer Advocate"); a group of Island Industrial customers: Corner
27 Brook Pulp and Paper Limited, NARL Refining Limited Partnership, Vale Newfoundland and
28 Labrador Limited (the "Industrial Customer Group"); Teck Resources Limited; and Praxair
29 Canada Inc.
30

31 The Board, Hydro and Newfoundland Power filed requests for information (RFIs) which were
32 answered by Hydro and Newfoundland Power on November 30, 2018.
33

34 On December 5, 2018 submissions were received from Newfoundland Power and the Industrial
35 Customer Group. Corner Brook Pulp and Paper Limited also filed a supplementary submission in
36 addition to being a party to the Industrial Customer Group's submission. The Consumer Advocate
37 did not file a submission.
38

39 On December 7, 2018 Newfoundland and Labrador Hydro filed a reply to the submissions.
40

41 **Submissions**

42 Newfoundland Power submitted that the depreciation policies and practices of both Hydro and
43 Newfoundland Power are not relevant to the question of whether Newfoundland Power's
44 customers should bear any unrecovered costs of the frequency converter. Newfoundland Power
45

² Grant Thornton Report, October 26, 2018, page 3

1 submitted that depreciation accounting allocates the costs of an asset over its useful life and is
2 concerned with the timing of those costs but does not address which customers should pay the
3 costs of a specific asset. Newfoundland Power stated that the determination of which customers
4 should pay the costs is determined through the ratemaking process which allocates costs to
5 various classes of service according to which customers cause the costs to be incurred.

6
7 Newfoundland Power also submitted that specifically assigned charges are a significant element
8 of the rates Hydro charges its large industrial customers and that, in its ratemaking process, Hydro
9 allocates the costs associated with specifically assigned assets for recovery from the specific
10 customer served by the asset. Newfoundland Power noted that the Service Agreement
11 contemplates that costs associated with the specifically assigned asset are to be recovered from
12 Corner Brook Pulp and Paper Limited and also provides that, should Corner Brook Pulp and
13 Paper Limited cease operations, it would be required to pay Hydro a lump sum including any
14 remaining net book value of the specifically assigned plant less its salvage value. In
15 Newfoundland Power's view, given the long history of the frequency convertor as a specifically
16 assigned asset and the significant capital expenditures that were incurred during that period, the
17 history of the frequency converter as a common asset should not be a material consideration to the
18 recovery of any remaining costs. Newfoundland Power noted that its practice is to recover the
19 costs of specifically assigned assets that are not recovered through average rates through
20 contributions in aid of construction. Newfoundland Power submitted that the sale of the frequency
21 converter does not benefit Newfoundland Power's customers and it is not appropriate that its
22 customers bear any associated costs.

23
24 The Industrial Customer Group stated that Hydro's proposal relating to the loss on disposal is
25 consistent with Hydro's current depreciation methodology and the depreciation methodology as
26 agreed in Hydro's 2017 general rate application. The Industrial Customer Group noted that there
27 was no expert evidence to support any divergence from Hydro's proposed application of the
28 depreciation methodology to this loss on disposal and that the impact of treating this loss on
29 disposal in accordance with the settled depreciation methodology is not sufficiently material to
30 warrant revisiting the depreciation methodology. The Industrial Customer Group stated that, if the
31 Board decided upon an alternative accounting treatment, it should be supported by other expert
32 evidence and that the parties be provided an opportunity to comment.

33
34 Corner Brook Pulp and Paper Limited submitted that treatment of the loss on disposal in a manner
35 which would result in Corner Brook Pulp and Paper Limited bearing financial consequences
36 beyond those that were agreed to upon the transfer of the asset would be contrary to the intention
37 of the parties. Corner Brook Pulp and Paper Limited also clarified that the section of the Service
38 Agreement referred to by Newfoundland Power only applies in a situation where Corner Brook
39 Pulp and Paper Limited "ceases operations" and is not applicable to the transfer of the frequency
40 convertor. Corner Brook Pulp and Paper Limited further stated that, if the Board found it
41 inappropriate to allocate the loss on disposal as proposed by Hydro, the only fair and reasonable
42 result in light of the agreement between Corner Brook Pulp and Paper Limited and Hydro would
43 be that Hydro not be permitted to recover the loss from any customer.

44
45 In its submission Hydro noted that the Industrial Customer Group and Corner Brook Pulp and
46 Paper Limited supported Hydro's position in relation to the loss on disposal. Hydro also noted
47 Grant Thornton's conclusion that its proposal was consistent with the depreciation methodology

1 agreed to by the parties in the settlement agreement relating to Hydro's 2017 general rate
 2 application. Hydro stated that the depreciation methodology agreed to by the parties resulted in a
 3 decrease to Hydro's test year revenue requirement, primarily to the benefit of Newfoundland
 4 Power's customers. Hydro further stated that, under the proposed methodology, when assets
 5 which are specifically assigned to Newfoundland Power are retired, disposal costs will be
 6 recovered from all customers through future depreciation rates, not just Newfoundland Power.
 7

8 Hydro submitted that Newfoundland Power's position that Hydro's depreciation methodology is
 9 not relevant is without merit and stated:

10
 11 While the concept of depreciation, whereby the original cost of capital assets are
 12 recognized over their useful lives, has its roots in an accounting concept, Hydro firmly
 13 disagrees that the depreciation methodology approved for use by a utility is not a
 14 relevant consideration in how depreciation expense is recovered from customers.³
 15

16 Hydro noted that its depreciation expert, Concentric Advisors, confirmed that the depreciation
 17 methodology relating to the disposal of assets is the same for both specifically assigned and
 18 common assets and is consistent with generally accepted regulatory accounting principles. Hydro
 19 further submitted that the depreciation rules for the retirement of assets should be applied
 20 consistently among the utilities regulated by the Board. Hydro also submitted that Newfoundland
 21 Power's submission that the frequency converter provides no benefit to Newfoundland Power's
 22 customers is only true for the period 2002 to 2018, as from 1967 to 2001 the frequency converter
 23 was a common asset and supported generation to the Island Interconnected system.

24
 25 In reply to Corner Brook Pulp and Paper Limited's submission that Hydro should bear the
 26 financial loss associated with the sale of the frequency converter if a deviation from Hydro's
 27 depreciation methodology is approved, Hydro stated that it should not be subject to a financial
 28 penalty for undertaking a least cost action in the best interest of customers with respect to
 29 prudently incurred costs. Hydro requested that the Board approve the Application as submitted.

31 **Board Findings**

32
 33 When the Board approved the sale of the frequency converter to Corner Brook Pulp and Paper
 34 Limited in 2018 it reserved its determination as to which customers should be responsible for the
 35 retirement costs associated with this sale and stated that this issue would be determined following
 36 a further inquiry.⁴ Later in 2018, when the issue of the recovery of these costs was again raised in
 37 the context of a separate application filed by Hydro for approval of a cost deferral account related
 38 to depreciation methodology changes, the Board reiterated that this issue was being reviewed in a
 39 separate process.⁵ In Hydro's general rate application the Board approved the continued specific
 40 assignment of the frequency converter but did not address the issues related to the recovery of the
 41 frequency converter retirement costs. The Board also approved the proposed depreciation policy
 42 changes and the adjustment to effect the conclusion of the 2018 cost deferral account.⁶ While it
 43 was not clear on the record whether the \$4.25 million loss associated with the sale was reflected in

³ Hydro Submission, December 7, 2018, page 3

⁴ Order No. P.U. 26(2018)

⁵ Order No. P.U. 48(2018)

⁶ Order Nos. P.U. 16(2019) and P.U. 30(2019)

1 2018 cost deferral account the Board notes that Hydro had clearly stated in its submission that the
 2 approval of the proposed disposition of the balance in the cost deferral account would have no
 3 impact on Hydro's customers or customer rates.⁷ The Board has now reviewed the record with
 4 respect to the issue of who should bear the costs associated with the sale of the frequency
 5 converter.

6
 7 The frequency converter was specifically assigned to Corner Brook Pulp and Paper Limited in
 8 2002, having previously been considered a common asset. Based on the evidence Hydro incurred
 9 approximately \$6.7 million in capital expenditures in relation to this asset since 2002.⁸ These
 10 costs were incurred to the benefit of a single customer, Corner Brook Pulp and Paper Limited, and
 11 the annual specifically assigned charge paid by this customer largely reflected these costs.⁹
 12 Following the sale of the frequency converter the specifically assigned charge paid by Corner
 13 Brook Pulp and Paper Limited was reduced from \$870,898 to \$11,458 per year.¹⁰ The amount
 14 which is the subject of this proceeding of approximately \$4.25 million reflects the net book value
 15 of the frequency converter at the time of sale.¹¹

16
 17 According to Hydro and the Industrial Customer Group Hydro's depreciation methodology
 18 requires that the net book value of the frequency converter be charged to the accumulated
 19 depreciation account regardless of whether the asset is specifically assigned or common.
 20 Newfoundland Power on the other hand submitted that the depreciation methodology applied to
 21 allocate costs associated with the frequency converter over its useful life is separate from the
 22 question of which customers should pay for specific costs. According to Newfoundland Power the
 23 recovery of any of the costs associated with Hydro's specifically assigned assets, including the
 24 frequency converter, from Newfoundland Power customers is not contemplated by Hydro's
 25 current rates or its service agreements. In Newfoundland Power's view its customers should not
 26 bear any of the costs associated with the sale of the frequency converter.

27
 28 If the loss of approximately \$4.25 million associated with the sale of the frequency converter is
 29 recorded in accumulated depreciation as proposed by Hydro these costs will ultimately be borne
 30 by all Hydro customers.¹² While the majority of the costs would be recovered from customers on
 31 the Island Interconnected system, some of the costs would also be recovered from the customers
 32 on other systems, including the Labrador Interconnected system and Hydro's isolated systems on
 33 the island and in Labrador. Given that the costs were incurred for the benefit of Corner Brook
 34 Pulp and Paper Limited the Board believes that this result would raise a substantive issue of
 35 fairness. While the Board acknowledges that the resulting impact on rates may be small and will
 36 be spread out over a number of years, the Board does not accept that the proposed treatment of
 37 these costs is fair.

38
 39 Under Hydro's approved cost of service methodology the costs associated with capital assets that
 40 are used solely for the provision of service to a single customer are functionalized as specifically

⁷ Hydro Submission, 2017 General Rate Application Compliance Application, July 11, 2019, page 2

⁸ NP-NLH-002

⁹ PUB-NLH-007

¹⁰ Order Nos. P.U. 31(2017) and P.U. 48(2018)

¹¹ According to NP-NLH-007 the net book value at June 30, 2018 was \$4.9 million and \$0.8 million was required to be recorded as a loss. Hydro's December 7, 2018 correspondence set out an updated estimate of \$4.25 million.

¹² PUB-NLH-011

1 assigned and are recovered from that customer through the specifically assigned charge. This is
2 consistent with fundamental cost of service principles which provide that costs are generally
3 passed on to the customers who caused the costs. Since the frequency converter was an asset
4 which was maintained and operated only to the benefit of Corner Brook Pulp and Paper Limited it
5 would be inconsistent with Hydro's approved cost of service methodology and cost of service
6 principles to recover the costs associated with the sale from other customers. The Board does not
7 accept that the historical treatment of this asset as common is relevant given the nominal net book
8 value at the time that it was specifically assigned to Corner Brook Pulp and Paper Limited and the
9 fact that most of the costs were incurred following this assignment.¹³

10
11 The Board agrees with Newfoundland Power that in general the depreciation policy is intended to
12 allocate the costs of an asset over its useful life and that the determination of which customer will
13 bear the costs is determined through the ratemaking process in accordance with cost of service
14 principles. While the depreciation policy can, to a limited degree, impact how capital costs flow to
15 different customer groups, cost of service principles should be applied in the ratemaking process
16 so that costs are appropriately assigned. The Board believes that, in the absence of an express
17 provision in the depreciation policy addressing specifically assigned assets, the changes in the
18 approved depreciation methodology should not be taken to override fundamental cost of service
19 principles. In light of this it is not clear based on the record that it is necessary for the Board to
20 approve an exception to Hydro's depreciation policy as suggested by Grant Thornton. Further the
21 Board does not believe that comparisons to Newfoundland Power's depreciation practices and
22 policies are helpful given that, unlike Hydro, it does not have any large industrial customers with
23 significant specifically assigned assets, the costs of which are recovered through a specifically
24 assigned charge in rates.

25
26 The Board also notes that Hydro's Service Agreement with Corner Brook Pulp and Paper Limited
27 contemplates the recovery of the costs of specifically assigned assets and expressly provides for
28 the recovery of the remaining net book value of specifically assigned plant if the customer
29 abandons its operations, goes bankrupt or liquidates its assets.¹⁴ While the Service Agreement
30 does not address the sale of a specifically assigned asset to the customer the Board would expect
31 that the recovery of the net book value of the frequency converter would be recovered in the sale,
32 given the provisions of this agreement, Hydro's approved cost of service methodology and cost of
33 service principles. Hydro agreed to sell the frequency converter for \$1 without recovery of an
34 amount to reflect the costs which had not, up to the time of the sale, been recovered through the
35 specifically assigned charge. Hydro explained that in negotiations Corner Brook Pulp and Paper
36 Limited had rejected its proposal to recover the net book value and that the avoidance of the risks
37 and costs associated with future liabilities justified the transaction.¹⁵ While Hydro submitted that
38 it should not be subject to a financial penalty for undertaking a least cost action in the best interest
39 of customers with respect to prudently incurred costs, the Board believes that Hydro's other
40 customers who did not benefit from these costs should not be held responsible for these costs.

¹³ NP-NLH-002, Attachment 1

¹⁴ Order No. P.U. 26(2018), Service Agreement, Clauses 1.01, 3.04, and 15.04

¹⁵ PUB-NLH-010

1 The Board finds that the loss associated with the sale of the frequency converter to Corner Brook
2 Pulp and Paper Limited should not be borne by other customers on the Island Interconnected
3 system and the Labrador Interconnected system and the isolated systems.

4

5

6 **IT IS THEREFORE ORDERED THAT:**

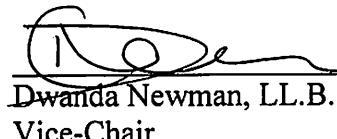
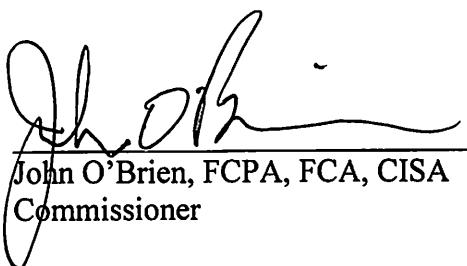
7

- 8 1. The loss on the sale of the frequency converter to its customer, Corner Brook Pulp and Paper
9 Limited, of approximately \$4.25 million shall not be recovered from Hydro's other
10 customers.
- 11
- 12 2. Hydro shall pay all expenses of the Board arising from this Application.

DATED at St. John's, Newfoundland and Labrador this 9th day of December 2019.



Darlene Whalen, P. Eng., FEC
Chair and Chief Executive Officer


Dwanda Newman, LL.B.
Vice-Chair
John O'Brien, FCPA, FCA, CISA
Commissioner
Sara Kean
Assistant Board Secretary