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*Newfoundland & Labrador*

**BOARD OF COMMISSIONERS OF PUBLIC UTILITIES**

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**ORDER NO. P.U. 40(2012)**

**IN THE MATTER OF**

the *Electrical Power Control Act, 1994*, SNL 1994, Chapter E-5.1  
(the "*EPCA*") and the *Public Utilities Act, RSNL 1990*,  
Chapter P-47 (the "*Act*") and regulations thereunder;

**AND IN THE MATTER OF**

an application from Newfoundland and Labrador Hydro for approval  
of changes in depreciation methodology and asset service lives  
pursuant to Section 68 of the *Act*.

**BEFORE:**

**Andy Wells**  
**Chair and Chief Executive Officer**

**Darlene Whalen, P.Eng.**  
**Vice-Chair**

**Dwanda Newman, LL.B.**  
**Commissioner**

**James Oxford**  
**Commissioner**

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1 **I. APPLICATION AND PROCEEDING**

2  
3 **Application**

4  
5 Newfoundland and Labrador Hydro ("Hydro") filed an application (the "Application")  
6 with the Board of Commissioners of Public Utilities (the "Board") on December 22, 2011  
7 for approval of changes in depreciation methodology and asset service lives. In the  
8 Application Hydro is proposing that:

- 9  
10 1. depreciation be applied using the straight line method for all of its assets;  
11 2. depreciation be calculated with group accounting methods using the average service  
12 life procedure and applied on a remaining life basis; and  
13 3. any financial effects of these changes be included in customers' rates following  
14 Hydro's next General Rate Application.

15  
16 **Background**

17  
18 In its 2006 General Rate Application Hydro requested approval in principle to adopt the  
19 recommendations of the depreciation study, which had been filed by Hydro in December  
20 2005 in compliance with Order No. P.U. 7(2002-2003), with implementation of the  
21 methodology to be deferred. In Order No. P.U. 28(2006) the Board directed that Hydro's  
22 request for approval in principle of the straight line and equal life group depreciation  
23 methodology be addressed in a separate process.

24  
25 In April 2009 Hydro filed an updated depreciation study. Hydro also advised the Board  
26 at that time that the new International Financial Reporting Standards ("IFRS") were to be  
27 adopted by January 2011 and that it was uncertain that all the recommendations  
28 contained in the updated depreciation study were compliant with IFRS. This uncertainty  
29 resulted in a delay in the filing of this Application.

30  
31 In Order No. P.U. 13(2012) the Board approved the adoption by Hydro of IFRS for  
32 regulatory purposes effective January 1, 2012.

33  
34 **Proceeding**

35  
36 The intervenors in this proceeding were the Consumer Advocate, Mr. Thomas Johnson,  
37 the Island Industrial Customers (the "Industrial Customers"), represented by Mr. Paul  
38 Coxworthy, and Newfoundland Power Inc. ("Newfoundland Power"), represented by Mr.  
39 Gerard Hayes. Hydro was represented by Mr. Geoff Young and Mr. Colin Feltham.

40  
41 The Board was assisted throughout the proceeding by Ms. Maureen Greene, Q.C., who  
42 acted as Board Hearing Counsel, and Ms. Jacqueline Glynn, Board Counsel.

1 Expert evidence was filed by Hydro, the Consumer Advocate and the Industrial  
2 Customers as follows:

- 3 (i) Larry E. Kennedy, Gannett Fleming, Inc., December 22, 2011(Hydro);  
4 (ii) Jacob Pous, Diversified Utility Consultants Inc., October 3, 2012 (Consumer  
5 Advocate); and  
6 (iii) Patricia Lee, BCRI Valuation Services, October 3, 2012 (Industrial Customers).

7  
8 Hydro responded to 368 requests for information, the Consumer Advocate responded to  
9 84 and the Industrial Customers responded to 47.

10  
11 A technical conference was held on August 23, 2012. All parties participated in the  
12 technical conference.

### 13 14 **Settlement Agreement**

15  
16 After the filing of expert evidence, Hydro, the Consumer Advocate and the Industrial  
17 Customers agreed to hold settlement discussions. Newfoundland Power was advised of  
18 the settlement discussions but did not participate. On October 26, 2012 settlement  
19 discussions were facilitated by Board Hearing Counsel. On November 14, 2012 a  
20 settlement agreement (the "Settlement Agreement") was executed and filed with the  
21 Board for consideration.

22  
23 The Settlement Agreement, as agreed to by Hydro, the Consumer Advocate and the  
24 Industrial Customers, is set out in Schedule 1.

### 25 26 **Hearing**

27  
28 A hearing was held on November 15, 2012. At the hearing the Settlement Agreement  
29 was entered on the record. The Consumer Advocate and the Industrial Customers were  
30 present at the hearing and indicated their consent to the terms of the Settlement  
31 Agreement. Newfoundland Power did not attend the hearing but filed correspondence  
32 indicating that Newfoundland Power had no objection to the Settlement Agreement.  
33 Hydro has requested that the Board accept the Settlement Agreement as a full and final  
34 resolution of all matters relating to depreciation.

### 35 36 **Updated Depreciation Study**

37  
38 On December 3, 2012 Hydro filed an updated Depreciation Study incorporating the terms  
39 of the Settlement Agreement. On December 12, 2012 the Consumer Advocate and the  
40 Industrial Customers advised that they did not have any comments on the updated study.  
41 On December 17, 2012 Hydro filed an amended letter from Gannett Fleming outlining a  
42 number of issues from the Settlement Agreement on which the parties agreed and which  
43 affect Hydro's application of group depreciation to its assets.

1 **III. BOARD DECISION**

2  
3 The Settlement Agreement outlines the depreciation methodology and changes to asset  
4 service lives to be applied by Hydro with effect from January 1, 2011 to determine  
5 depreciation expense from January 1, 2012 on a go-forward basis with the corresponding  
6 adjustment for 2011 to be made to opening retained earnings. The calculated annual  
7 depreciation accrual rates are applicable to plant in service as of December 31, 2009. The  
8 estimated 2011 impacts on depreciation expense are set out in Table 2 of the Settlement  
9 Agreement.

10  
11 The proposed changes will not impact current customer rates as Hydro proposes that the  
12 financial effects of the changes be included in customer rates established in its next  
13 general rate application. Hydro filed a rate impact analysis on November 14, 2012,  
14 showing what the estimated impact of the proposals would be on the parties' 2011  
15 revenue requirement levels. This analysis shows that there would be minimal rate  
16 impacts for Newfoundland Power, a decrease of approximately 12% for Rural Labrador  
17 Interconnected customers, and an increase of approximately 2% for Industrial customers.

18  
19 Hydro provided evidence that the sinking fund method places an unfair burden on current  
20 ratepayers to the benefit of past ratepayers and that it is generally not used by regulated  
21 companies. The Board notes that to be IFRS compliant Hydro must change to the straight  
22 line method of depreciation as the sinking fund method is no longer an acceptable method  
23 under IFRS. The Board is satisfied that Hydro should adopt the straight line method of  
24 depreciation. The Board accepts the agreement of the parties with respect to Hydro's  
25 depreciation methodology and asset service lives, including Hydro's modified sinking  
26 fund formula and Hydro's historical calculation of sinking fund depreciation.

27  
28 In accordance with the terms of the Settlement Agreement Hydro has agreed to provide,  
29 at the time of its next depreciation study, a report, on a limited number of groups of  
30 property, comparing the agreed methodology to the application of depreciation on a pure  
31 group basis. The Board notes that the findings of this report would not be applied  
32 retroactively but rather would provide information for future rate making purposes. In the  
33 Board's view this is a reasonable approach to resolve what appears to have been a  
34 difference in expert opinion on this specific issue. The Board will accept this  
35 recommendation.

36  
37 The Settlement Agreement also recommends that the parties participate in a consultation  
38 process to be established by the Board in relation to the filing requirements for future  
39 depreciation studies. The Board accepts this recommendation on the basis that it should  
40 provide for a more effective and efficient consideration of depreciation matters for both  
41 Hydro and Newfoundland Power in the future.

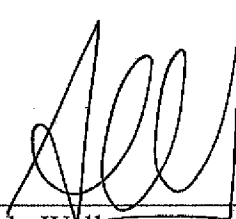
42  
43 The Board also notes that Hydro agrees to pay costs of the Industrial Customers in this  
44 matter in the amount of \$55,000.

1 **IV. BOARD ORDER**

2  
3 **IT IS THEREFORE ORDERED THAT:**

- 4
- 5 1. **Hydro shall adopt the straight line method of depreciation for all its assets, with**  
6 **group accounting methods using average service life procedure and applied on a**  
7 **remaining life basis, as outlined in the Gannett Fleming study filed with the**  
8 **Board on December 3, 2012 and December 17, 2012.**
  - 9  
10 2. **Hydro shall provide, at the time of its next depreciation study, a report on group**  
11 **accounting for selected groups of property as outlined in Schedule 1.**
  - 12  
13 3. **Hydro shall pay the costs of the Industrial Customers in the amount of \$55,000.**
  - 14  
15 4. **Hydro shall pay all costs and expenses of the Board incurred in connection with**  
16 **the Application.**

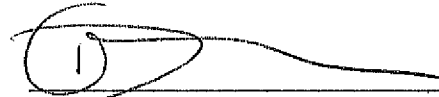
DATED at St. John's, Newfoundland and Labrador this 31<sup>st</sup> day of December, 2012.



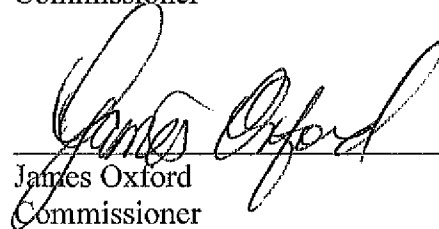
Andy Wells  
Chair and Chief Executive Officer



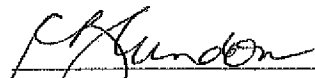
Darlene Whalen, P.Eng  
Vice-Chair



Dwanda Newman, L.L.B.  
Commissioner



James Oxford  
Commissioner



Cheryl Blundon  
Board Secretary

IN THE MATTER OF the *Electrical Power Control Act*, SNL 1994, Chapter E-5.1 (the *EPCA*) and the *Public Utilities Act*, RSNL 1990, Chapter P-47 (the *Act*) as amended, and their subordinate regulations; and

IN THE MATTER OF an Application by Newfoundland and Labrador Hydro, pursuant to Section 68 of the Act, for the approval of changes in depreciation methodology and asset service lives.

### SETTLEMENT AGREEMENT

Whereas Newfoundland and Labrador Hydro ("Hydro") has applied to the Board of Commissioners of Public Utilities (the "Board") for an Order, Inter alia, approving a change in its depreciation methodology to straight line for all its assets and changes in the service lives of certain assets;

And Whereas the Consumer Advocate, the Industrial Customers and Newfoundland Power Inc. have registered as Intervenors (the "Intervenors") in this proceeding;

And Whereas Hydro, the Consumer Advocate and the Industrial Customers (the "Parties"), with participation by Board hearing counsel, have engaged in negotiations;

And Whereas the Parties have agreed to make joint recommendations to the Board for the resolution of the issues arising out of the Application.



**Terms of Agreement**

1. The Parties jointly advise the Board that the issues arising from the Application have been settled by negotiation. Save as expressly agreed, this Agreement does not preclude or prejudice the rights of the Parties to pursue any issues that are of concern to them at any future hearing.
  
2. The Parties consent to the admission in the record of this Application of all pre-filed testimony and exhibits pertaining hereto without the calling of witnesses for the purpose of cross-examination.
  
3. The Parties recommend that the Board implement the agreement of the Parties as stated in this Agreement in its Order on the present matter.
  
4. This Agreement represents a reasoned consensus on the overall application and the individual agreements of the Parties are not intended to be severable.

**Methodology Issues Agreed Upon**

5. The undersigned Parties have reached agreement on all the issues raised by the application of Newfoundland and Labrador Hydro ("Hydro") and, in particular, have agreed as follows:
  - a. Hydro's proposal to switch from sinking fund depreciation methodology to straight line for all its assets is appropriate.

- b. Hydro's modified sinking fund formula and Hydro's historical calculation of sinking fund depreciation will not be made subject to examination or re-examination before the Board, and they are being adopted as the only available bases to move forward to straight line depreciation, in light of the jurisdictional issues raised by Newfoundland Power and Hydro in response to the expert evidence filed by the Consumer Advocate and the Island Industrial Customers.
  
- c. Hydro's proposal to use the average life group procedure applied on a remaining life basis with effect from January 1, 2011 is appropriate to determine depreciation expense from January 1, 2012 on a go forward basis with the corresponding adjustment for 2011 to be made to opening retained earnings.
  
- d. Hydro's proposed 136 groups for depreciation purposes are acceptable until varied by further Order of the Board.
  
- e. Hydro's proposal to use net book value as the base for the calculation of depreciation expense under the straight line method is acceptable due to the conversion to the International Financial Reporting Standards.
  
- f. Hydro's proposal to apply group depreciation rates to individual assets, rather than to total group investment, is acceptable. At the time of its next depreciation study filing, Hydro shall provide a report, on a limited number of groups of property,

showing the results of the methodology hereby agreed compared to the application of depreciation on a pure group basis for the years from 2013 to the end of the calendar year immediately preceding the date of that report. The specific groups of property and the process for calculating depreciation on a group basis are set out in Schedule A attached.

- g. Hydro's current practice and proposal for the future to stop accruing depreciation once an asset is fully accrued is acceptable until varied by further Order of the Board.
- h. Hydro's current practice and proposal to continue to book, to its income statement, gains and losses related to asset retirements is acceptable until varied by further Order of the Board.

**Service Lives Agreed Upon**

- 6. The Parties have agreed with the service lives for the units of property as proposed by Hydro with the modifications set out in Table 1 below.

**Table 1**

Units of Property	Whole Life	
	Original Proposal	Settlement Proposal
Battery and Power Systems	15 years	20 years
Foundations	50 years	57 years
Generators	60 years	65 years
Penstocks	70 years	77 years
Powerhouses	75 years	80 years
Right-of-Ways	55 years	60 years
Roads	50 years	57 years
Software	7 years	10 years
Water Regulating Structures	55 years	70 years

**Future Depreciation Studies**

7. The Parties recommend that the Board establish a consultation process, which will include the Parties, on the determination of filing requirements for future depreciation studies.

**Estimated Results**

8. The estimated 2011 impacts on depreciation expense, resulting from the preceding agreement, are shown in Tables 2 below.

**Table 2**

Service Lives Changes Resulting from Negotiations						
Estimated Changes based on 2011 Test Data						
A	B	C	D	E	F	G
Account	Future Accruals December 31 2010	Hydro Proposed ARL 2009	Depreciation Expense	Settlement ARL 2012	Depreciation Expense	Difference
B01-Battery and Power Systems	\$ 5,637,043	8.4	\$ 563,179.22	14.4	\$ 328,792.03	-\$ 234,387.19
F04- Foundations	\$ 9,294,956	26.8	\$ 347,382.90	34.6	\$ 269,890.18	-\$ 77,492.72
G03- Generators	\$ 45,279,954	36.0	\$ 1,151,033.58	41.4	\$ 1,000,496.22	-\$ 150,537.36
P03-Penstock	\$ 48,764,807	42.4	\$ 1,102,510.07	49.5	\$ 944,743.57	-\$ 157,766.50
P10-Powerhouses	\$ 80,329,410	51.6	\$ 1,559,389.63	56.7	\$ 1,420,270.99	-\$ 139,118.64
R12-Right-of-Ways	\$ 11,686,882	29.2	\$ 398,219.19	34.5	\$ 336,659.15	-\$ 61,560.04
R13-Roads	\$ 78,294,760	26.2	\$ 2,960,458.34	33.1	\$ 2,341,523.30	-\$ 618,935.04
S05-Software	\$ 5,722,799	4.6	\$ 738,358.35	7.7	\$ 441,410.07	-\$ 296,948.28
S16-Studies	\$ 1,255,553	3.7	\$ 342,423.57	3.7	\$ 342,423.60	\$ 0.03
W01-Water Regulating Structures	\$ 19,447,829	35.2	\$ 546,293.85	52.2	\$ 368,268.29	-\$ 178,025.56
			\$ 9,709,248.70		\$ 7,794,477.41	-\$ 1,914,771

**Costs**

9. Hydro agrees to pay costs of the Industrial Customers in this matter in the amount of \$55,000.

Agreed to this 15<sup>th</sup> day of November, 2012.

For Industrial Customers: Paul Bennett

For the Consumer Advocate: Thomas John

For Newfoundland & Labrador Hydro: Geoffrey J.

For the Board's hearing counsel: Maurice P. Greene

NEWFOUNDLAND AND LABRADOR HYDRO

REPORT ON GROUP ACCOUNTING FOR SELECTED GROUPS OF PROPERTY

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**Background:** Hydro will implement group depreciation effective January 1, 2011. In order to comply with International Financial Reporting Standards Hydro will vary the accounting of group depreciation in the following manner:

- (i) Individual assets will be depreciated to a maximum of their net depreciable cost; and
- (ii) Gains or losses on retirement of assets will be accounted for on the income statement and not in the accumulated reserve.

**Purpose for report on group accounting for selected groups of property:** Hydro will track the difference between the application of group depreciation outlined in (i) and (ii) above and pure group depreciation in order to determine the financial effect, on a limited number of units of property, of varying the application of group depreciation in order to comply with IFRS. Results are to be presented at the time of Hydro's next depreciation study for information purposes. It is not intended that the findings would be applied retroactively in any manner whatsoever. It is intended that the findings would provide the Board and all parties with information that might aid in the determination of potential future modification to items (i) and (ii) noted above, for ratemaking purposes.

**Tracking accounts:** It is agreed among the Parties that, at the time of filing its next depreciation study with the Board, Hydro will report on the results of applying pure group depreciation for the following groups of property:

- C11 Computers
- R14 Routers & LAN
- S03 Servers
- S05 Software
- V04 Vehicles - 3/4 Ton & Under
- V06 Vehicles - Cars, Station Wagons & Van

At Hydro's discretion, additional units of property may be tracked and reported on.

**Process:** Effective January 2013, Hydro will calculate depreciation expense on a group basis, using Excel, for the groups of property outlined above and applying the depreciation rates as determined in the Gannett Fleming depreciation study, or in the circumstances of Account S05 – Software, as agreed to in this negotiated settlement process.

The original cost and accumulated depreciation balances will be extracted by group of property from Hydro's Fixed Asset System.

Individual assets which remain in service beyond their estimated service lives will continue to accumulate depreciation expense.

Any asset retirements will result in a reduction in the original cost and an equal reduction in the accumulated depreciation accounts therefore there will be no gains or losses on retirements recorded on the income statement.