

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

AN ORDER OF THE BOARD

NO. P.U. 30(2026)

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**”), as amended, and regulations thereunder; and

IN THE MATTER OF an application filed by Newfoundland and Labrador Hydro for approval of a deferral account for an allowance for funds used during construction, pursuant to section 58 of the **Act**.

1. Decision Summary

The Board does not approve the application filed by Newfoundland and Labrador Hydro to establish a deferral account to allow the inclusion of return on equity in its capitalized financing costs for capital projects requiring extended periods to complete. Hydro’s proposed approach is more aligned with the regulatory accounting policies of investor-owned utilities than crown-owned utilities in Canada. The Board does not accept that Hydro’s proposal reflects generally accepted utility practice for crown-owned utilities in Canada.

Approval of the proposed change in methodology would increase Hydro’s return on equity and return on rate base resulting in increased costs to be recovered from customers or through increased rate mitigation funding. The Board is uncertain whether approval of the application, which could result in increased rate mitigation funding and higher Muskrat Falls Project costs, would be consistent with the Government’s rate mitigation plan.

2. The Application

On April 14, 2026 Newfoundland and Labrador Hydro (“Hydro”) filed an application seeking approval to create a deferral account to enable the deferral and recovery of variances between using Interest During Construction (“IDC”) and Allowance for Funds Used During Construction (“AFUDC”) to calculate capitalized borrowing costs (“Application”).

Prior to adoption of International Financial Reporting Standards (“IFRS”) on January 1, 2012,¹ Hydro capitalized borrowing costs directly attributable to extended construction periods for capital projects using AFUDC, which reflected its approved weighted average cost of capital (“WACC”). Hydro stated that under IFRS,² public utilities are required to capitalize borrowing costs for active construction projects using IDC, which is based strictly on the utility's embedded cost of debt. IFRS does not recognize the cost of equity in determining the financing rate in capitalizing borrowing costs for qualifying capital projects.

Hydro stated that since adopting IFRS, the differences between the capitalization of borrowing costs using IDC versus AFUDC have been relatively small. Starting in 2026, Hydro anticipates significant increases in the differences between the two approaches due to a number of longer-term, higher cost construction projects, combined with a decreasing embedded cost of debt. The difference between AFUDC and IDC is forecast at approximately \$2.1 million for 2026 and \$3.8 million for 2027.³

The Application included a report from Christensen Associates Energy Consulting, LLC (“CA Consulting”) who were engaged to review the methods for recovering financing costs on capital projects. The CA Consulting report indicated that AFUDC better reflects the full cost of capital because it recognizes both debt and equity risk during the construction period and is consistent with the Fair Return Standard.⁴

Hydro proposed that the deferral account balance be amortized using the composite depreciation rate from the most recently approved depreciation study, commencing in the year after the variance transfers to the account. With approval of the Application, Hydro would continue to use IDC for IFRS reporting and AFUDC for regulatory reporting.⁵

2.1 Application Process

The Application was copied to Newfoundland Power Inc. (“Newfoundland Power”); the Consumer Advocate, Ms. Adrienne Ding (“Consumer Advocate”); the Island Industrial Customer Group;⁶ the Labrador Interconnected Group;⁷ Teck Resources Limited; and Linde Canada Inc.

On June 24, 2026 requests for information were filed by the Board, Newfoundland Power and the Consumer Advocate, which were answered by Hydro on July 6, 2026. On July 17, 2026 party comments were filed. On July 23, 2026 Hydro filed its reply.

¹ In Order No. P.U. 2(2012) the Board approved, amongst other items, Hydro’s capital expenditure methodology to incorporate the requirements of IFRS and apply IDC rather than AFUDC. The remainder of the transition to IFRS was approved in Order No. P.U. 13(2012).

² International Accounting Standard 23.

³ Response to PUB-NLH-006.

⁴ Application, Schedule 1, Section 2.1.; Application, Schedule 1, Appendix A.

⁵ Response to PUB-NLH-004.

⁶ The members of the Island Industrial Customer Group are Corner Brook Pulp and Paper Limited, Braya Renewable Fuels (Newfoundland) GP Inc., and Vale Newfoundland and Labrador Limited.

⁷ The members of the Labrador Interconnected Group are the communities of Sheshatshiu, Happy Valley-Goose Bay, Wabush, and Labrador City.

2.2 Submissions

Newfoundland Power did not object to the Application. Newfoundland Power noted that approval of the Application will improve Hydro's return on equity by 29 basis points in 2026, that the Board has approved deferral of other costs for Hydro outside of a general rate application, and that the use of AFUDC to recover capital financing costs is consistent with Canadian regulatory practice, though variations exist amongst crown utilities.

The Consumer Advocate did not support the Application and recommended that the proposal to use AFUDC be reviewed as part of Hydro's 2026 General Rate Application ("2026 GRA"). The Consumer Advocate questioned return on equity for a crown-owned utility and noted that the use of AFUDC was not universal for crown-owned utilities. The Consumer Advocate submitted that the request for an AFUDC deferral account seemed counterintuitive and contradictory to government directives on rate mitigation. The Consumer Advocate also noted that the International Accounting Standards Board issued a new directive with significant changes for regulatory accounting, the impacts of which are not yet known and that approval of AFUDC will not have a material impact on Hydro's financial earnings for 2026.

The Island Industrial Customer Group stated that the Consumer Advocate's submission raised sufficient questions about the deferral account to justify deferring it to the 2026 GRA.

Hydro noted that Newfoundland Power did not object to the Application. Hydro submitted that the Application was consistent with section 80 of the Public Utilities Act, prior orders of the Board, and established regulatory practice, and that the concerns raised by the Consumer Advocate and the Island Industrial Customer Group did not provide a sufficient basis to reject the Application or to defer its consideration to the 2026 GRA.

3. Board Decision

The Board approved Hydro's capital expenditure policy to incorporate the requirements of IFRS and apply IDC rather than AFUDC in Order No. P.U. 2(2012). The Application proposed to transition back to the use of AFUDC for regulatory reporting to include its allowed return on equity in determining its capitalized borrowing costs attributable to completing capital projects with extended construction periods. Hydro indicated historical differences between IDC and AFUDC have been small but are projected to increase due to a number of longer-term, higher cost construction projects, combined with the embedded cost of debt decreasing.

To enable the proposed transition and continue to comply with IFRS, Hydro proposed to create a deferral account to include the difference between using IDC and AFUDC and amortize the balance over the useful life of capital assets.

3.1 Regulatory Practice in Canada

Hydro stated that the use of AFUDC is consistent with Canadian regulatory practice, including within this province, where Newfoundland Power recovers capital financing costs using AFUDC

calculated using its rate of return on average rate base. CA Consulting stated that the adoption of AFUDC will align regulatory practice in the province more closely with industry practice.⁸

The Board notes that the survey conducted by CA Consulting indicated that AFUDC for regulatory reporting appears to be common for most investor-owned utilities in Canada⁹ but does not establish that either AFUDC or IDC is used consistently by Canadian crown-owned utilities. Of the five crown-owned utilities surveyed, BC Hydro and SaskPower responded that they use IDC for regulatory accounting while Hydro Quebec is permitted to use AFUDC for regulatory reporting, but is required to use IDC for non-regulated generation projects.¹⁰ The survey did not provide information on Manitoba Hydro. However, the Consumer Advocate stated that notes to Manitoba Hydro's March 2025 financial statements indicated that Manitoba Hydro follows the IDC approach for regulatory accounting.¹¹

The Board does not accept that the use of AFUDC reflects generally accepted utility practice for crown-owned utilities in Canada. It appears each regulator considers the utility's individual circumstances to determine the appropriate approach.

3.2 Investor-owned vs. Crown-owned Utility

Hydro stated that its status as a crown utility and the method of determining its return on equity should not result in treatment different from an investor-owned utility regarding the capitalization of interest during the construction of an asset.¹²

Hydro's return on equity and capital structure is established pursuant to direction from Government. In 2009, Government directed that the return on equity to be used in establishing Hydro's rates was to be the same as that approved for Newfoundland Power and that Hydro's capital structure was permitted to have a maximum proportion of equity as approved for Newfoundland Power.¹³

The issue of treating Hydro as an investor-owned utility was previously addressed by the Board. In Order No. P.U. 14(2004), the Board stated:

The Board concludes there continue to be more differences than similarities between NLH and an investor owned utility. These differences remain exemplified in NLH's operations in respect of the provincial guarantee, capital structure, dividend policy, public policy direction and tax-exempt status. The Board notes these differences between NLH and an investor owned utility will continue to apply with no evidence of change occurring in the foreseeable future.¹⁴

⁸ Response to PUB-NLH-009(b).

⁹ Enbridge Gas, an investor-owned utility in Ontario is required to use IDC.

¹⁰ Application, Schedule 1, Appendix A, page 12, Table 4.3. The survey response for New Brunswick Power indicated the use of IDC and AFUDC but was unclear on the approach being followed.

¹¹ Consumer Advocate submission, page 3.

¹² Response to PUB-NLH-005.

¹³ OC2009-063.

¹⁴ Order No. P.U. 14(2004), page 36.

The Board decided to continue to recognize Hydro as a crown-owned utility afforded the benefit of a debt guarantee provided by the Government, which sustains Hydro's access to the capital markets.¹⁵

In its 2020 report to Government in relation to its Reference on rate mitigation, the Board reviewed the appropriateness of continuing to set Hydro's return on equity to equal that approved for Newfoundland Power.¹⁶ The Board advised that it believed the attributes of Hydro as a crown-owned utility should be used in setting its return on equity and capital structure and recommended returning the regulatory oversight of Hydro's rate of return and capital structure to the Board.

The differences between Hydro and an investor-owned utility noted in Order No. P.U 14(2004) continue to exist and are relevant in assessing whether Hydro should be permitted to transition from the use of IDC to AFUDC in its capital expenditure policy. The Board notes that Government's rate mitigation plan announced in 2024 demonstrates a continued link of government policy to Hydro's financial position and provides additional evidence of why Hydro should be viewed differently than an investor-owned utility. The Board finds no basis to change its previous determination that Hydro should be treated as a crown-owned utility.

3.3 Regulated Equity Impacts of Adopting AFUDC

Hydro stated that adopting AFUDC will help prevent erosion of equity during construction of major projects.¹⁷ Table 1 provides Hydro's forecast regulated equity for the period 2026 to 2032 using both AFUDC and IDC.

Table 1: Forecast Equity 2026-2032 (AFUDC vs. IDC) \$millions ¹⁸							
	2026	2027	2028	2029	2030	2031	2032
AFUDC	714.9	779.1	836.1	901.6	969.5	1,049.2	1,132.9
IDC	<u>712.8</u>	<u>773.2</u>	<u>824.5</u>	<u>879.3</u>	<u>940.1</u>	<u>1,011.0</u>	<u>1,094.3</u>
Equity Increase	2.1	5.9	11.6	22.3	29.5	38.2	38.7

Table 1 indicates that Hydro's equity component is projected to increase by \$38.7 million by 2032 when using AFUDC compared to IDC. However, it does not demonstrate any significant negative impacts on Hydro's equity position with the continued use of IDC. Table 1 shows that even with the continued use of IDC, Hydro's total regulated equity is projected to increase from \$712.8 million in 2026 to \$1,094.3 million in 2032. The Board finds that Hydro has not provided sufficient evidence to show that its equity position would be significantly impacted by the continued use of IDC.

¹⁵ Order No. P.U. 14(2004), page 37.

¹⁶ Final Report, Rate Mitigation Options and Impacts of Muskrat Falls Project, February 7, 2020, page 91.

¹⁷ Application, Schedule 1, page 5.

¹⁸ Response to PUB-NLH-007. Numbers may not add due to rounding.

3.4 Shareholder Compensation

The Board believes that Hydro's regulated compensation to its shareholders should be considered in aggregate which includes Hydro's allowed return on equity, debt guarantee fee and funding of the rural deficit.

Hydro stated that the IDC methodology recovers financing costs on the cost of debt only, even though capital projects impose a risk on both debt and equity holders. Hydro submitted that this may result in uncompensated risk by the shareholder. CA Consulting stated:

A revenue requirement that relies only on the cost of debt to recover capital financing costs is likely to under-recover the true cost of capital and, therefore, impose uncompensated risks on equity shareholders.¹⁹

The Board notes that the shareholder is currently compensated through the rate setting process with Hydro being provided an opportunity to earn an 8.6% return on equity consistent with Newfoundland Power. The direction on Hydro's return on equity provided by Government did not direct the Board on other aspects of shareholder risk that require compensation to the shareholder.

Hydro currently pays a debt guarantee fee to the Government of Newfoundland and Labrador. CA Consulting commented that the debt guarantee fee does not compensate the Government for its equity risk. CA Consulting further noted that the full amount of the debt guarantee fee is not recovered from customers which arguably increases the extent to which Government's equity risk goes uncompensated.²⁰

In establishing customer rates, the Board determined it was reasonable to recover a portion of the debt guarantee fee from customers, based on a review of the benefits of the debt guarantee provided by Government. The Board notes that approval of recovery of the full debt guarantee would have provided an equity benefit to the shareholder that was not demonstrated to be reasonable.²¹

With respect to whether shareholder risk was impacted by the recovery from Hydro's other customer classes of its revenue shortfall from serving its rural customers ("Rural Deficit"), CA Consulting stated that the Rural Deficit primarily reflects a transfer of cost recovery from Hydro's customers to Newfoundland Power's customers and does not alter the risk of cost recovery of new capital projects.²² However, the Board notes that CA Consulting did not address that the Rural Deficit²³ was previously funded by Government and that the transfer of this responsibility to the ratepayer from the taxpayer effectively resulted in an additional annual dividend payment

¹⁹ Application, Schedule 1, Appendix A, page 13.

²⁰ Response to PUB-NLH-009.

²¹ Order No. P.U. 16(2019), page 42. The Board did not approve recovery of the debt guarantee fee paid for borrowings directly from Government as no debt guarantee was reflected in those borrowings and there was uncertainty of the requirement for the payment from Hydro to Government.

²² Response to PUB-NLH-009.

²³ In Hydro's 2019 Test Year, the Rural Deficit reflected in customer rates was approximately \$64 million.

1 to Government and that Government policy on customer rates materially impacts the amount of
2 the Rural deficit.

3
4 The Board finds that Hydro has not presented evidence that Government seeks further
5 compensation of its equity position. In fact, the shareholder has directed Hydro to fund a rate
6 mitigation policy that requires an average of approximately \$500 million in funds to be
7 contributed annually to manage increases in customer rates on the Island Interconnected system.
8 The Board notes that the adoption of AFUDC would increase costs to be funded by customers or
9 through rate mitigation and is uncertain whether approving the use of AFUDC would be
10 consistent with the Government's rate mitigation plan.

11
12 The Board also finds that no evidence was presented to demonstrate that an increase in Hydro's
13 equity is required or that its equity position has contributed to Hydro or the Government
14 encountering difficulty in raising funds in capital markets for capital projects. The Board is not
15 convinced sufficient evidence has been presented that further regulated compensation for
16 Government's equity risk is appropriate given the current compensation provided through
17 Hydro's allowed return on equity, debt guarantee fee and funding of the rural deficit by
18 ratepayers.

19 20 **3.5 Conclusion**

21
22 Hydro has not demonstrated that its proposal to transition to AFUDC is generally accepted utility
23 practice in Canada for crown-owned utilities. While the use of AFUDC is more common among
24 Canadian investor-owned utilities, the Board does not accept that Hydro, a crown-owned utility,
25 should be treated the same as an investor-owned utility for its capital expenditure policy.

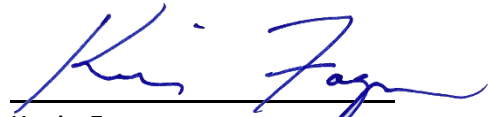
26
27 Approval of the Application to use AFUDC for regulatory reporting would increase Hydro's capital
28 expenditures, rate base and its revenue requirement through a regulatory deferral account
29 reflecting the capitalized financing cost difference between its approved WACC and its embedded
30 cost of debt. The Board finds that Hydro's equity position would not be significantly impacted
31 without the transition to AFUDC and the shareholder will not bear any additional risk if Hydro
32 continues to use IDC.

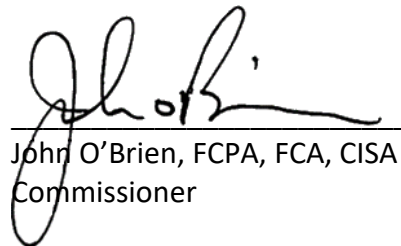
33
34 The Board does not approve the application filed by Hydro for approval to create a regulatory
35 deferral account to enable the deferral and recovery of variances between using Interest During
36 Construction and Allowance for Funds Used During Construction to calculate capitalized
37 borrowing costs.

IT IS THEREFORE ORDERED THAT:

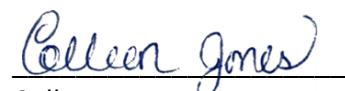
1. The proposal to establish a deferral account to recover the variances between using the Interest During Construction and Allowance for Funds Used During Construction to calculate capitalized borrowing costs is not approved.
2. Hydro shall pay all expenses of the Board arising from this Application.

DATED at St. John's, Newfoundland and Labrador, this 25th day of September 2026.


 Kevin Fagan
 Chair and Chief Executive Officer


 John O'Brien, FCPA, FCA, CISA
 Commissioner


 Jo-Anne Galarneau, LL.B, ICD.D
 Commissioner


 Colleen Jones
 Assistant Board Secretary