The Consumer Advocate

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Hand Delivered

September 20, 2019

The Board of Commissioners of Public Utilities
Prince Charles Building
120 Torbay Road, P.O. Box 21040
St. John's, NL
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Attention: Ms. Cheryl Blundon
Director Corporate Services & Board Secretary

Dear Ms. Blundon:

Re: Reference to Board on Rate Mitigation Options and Impacts

The Board has been requested by Government to undertake a review of electricity rate mitigation options and impacts in relation to the Muskrat Falls Project ("MFP") in accordance with the reference from the Lieutenant-Governor in Council under section 5 of the *Electrical Power Control Act* issued on September 5, 2018. The Board has been directed to review and report on:

1) Options to reduce the impact of the Muskrat Falls Project costs on electricity rates;
2) The amount of required and surplus energy and capacity from the project; and
3) The rate impacts of the identified options based on the most recent project cost estimates.

The Board filed an interim report to Government identifying preliminary findings on February 15, 2019. The Board has received Phase Two reports from its experts, The Liberty Consulting Group ("Liberty") and Synapse Energy Economics ("Synapse").

The Board has indicated that "*expert and non-expert evidence*" can be filed by the parties by September 20, 2019 in advance of public hearings scheduled to begin October 3, 2019. This submission documents the non-expert evidence filing of the Consumer Advocate. This document does not reflect the Consumer Advocate's final submission on the Reference. Our final submissions will follow the public hearings and be filed by the November 4, 2019 deadline established by the Board.

In the interim, the Consumer Advocate will be relying on any additional information from Nalcor and Newfoundland Power as requested in preparation for the hearings and for the Consumer Advocate's final submission. It is understood that our submissions will be considered by the Board for inclusion in its final report to be submitted to Government by the January 31, 2020, deadline.

BACKGROUND

In its June 23rd, 2017 Muskrat Falls Project Update, Nalcor indicated that the capital cost and during-construction financing costs of the Muskrat Falls project had risen to $12.7 billion. OC2013-343 places the financial burden of Muskrat Falls on Island Interconnected Customers. Under current pricing arrangements the price of electricity to be borne by residential customers on the Island Interconnected System would rise to 22.9 cents per kilowatt hour in 2021 and there would be "further" modest increases beyond this.

The enormous cost escalation in the Muskrat Falls Project and its resultant burden on Island Interconnected Customers dictates that it is in the best interest of the Province that energy policy and the complete process of electricity supply and delivery be examined and adjusted accordingly.

It is the Consumer Advocate's position that the primary focus of this Reference is to identify the ways and means for ensuring Island Interconnected Customers will have affordable electricity in compliance with Section 3.1 (b) of the EPCA which requires that all sources and facilities for the production, transmission and distribution of power in the province be managed and operated in a manner that would result in power being delivered to consumers in the Province at the lowest possible cost consistent with reliable service. The issue is how this can best be achieved in the circumstances.

CONSULTANTS' REPORTS

The Board has divided the work to be completed with respect to the Reference Questions between its two consultants, Synapse and Liberty. The Consultants filed their Phase Two reports with the Board on September 3, 2019. A brief summary of the findings in the reports follows.

- Liberty notes that there are continuing discussions between the Provincial and Federal Governments on sinking fund and other financial requirements relating to the federal loan guarantees for MFP financing. Liberty was asked by the Board not to study this further owing to ongoing negotiations. However, it is understood that the funds available for rate mitigation could be substantial if a favourable outcome to the negotiations is achieved. Any evidence Liberty uncovered prior to the Board's direction not to further study this issue is relevant and should be provided by Liberty during the hearing.

- Liberty indicates that the main source of potential rate mitigation funds is equity returns from the MFP. Returning the Province's share of equity returns would result in revenue requirement reductions ranging from $90 million in 2021 to $569 million in 2039 (roughly equivalent to Hydro's current revenue requirement). This finding by Liberty requires a more fulsome explanation.

- The second biggest source of funds for rate mitigation is net revenues from export sales. Liberty estimates a range of net revenues form exports of $35 to $45 million annually "*subject to detailed work*" conducted by Synapse. The Liberty estimate came from Nalcor. Synapse estimates export sales and net revenues from exports using Nalcor's Plexos model. Estimates of exports range from about 3 TWh to 4.5 TWh depending on assumptions relating to the load forecast and the impacts of energy efficiency/demand management and electrification programs. The net revenues from exports estimated by Synapse range from $113 million to $213 million. There is significant disparity in the Synapse and Nalcor estimates. Explanations are required.

- Liberty notes that Hydro's return on equity includes a portion that goes to Government that is about $35 million over and above what Hydro needs to remain financially self-sufficient. The Government could put this toward rate mitigation.

- Liberty estimates that reducing Hydro's equity target from 25% to 20% would make about $110 million available for rate mitigation annually between 2021 and 2025, and about $20 million annually thereafter.

- Liberty identifies some smaller but worthwhile opportunities to reduce revenue requirements, including:

    - $22 million in water-related costs imposed by Government for use of water at Churchill Falls and Muskrat Falls
    - About $6 million in preferred dividends available from Government ownership of Churchill Falls

- The cumulative funds from these sources (excluding those arising from the federal-provincial negotiations and based on the Nalcor estimate of net revenues from export sales) is about $175 million in 2021 increasing to about $700 million in 2039.

- There may also be a reduction in revenue requirement by combining the electricity component of Nalcor with Hydro following completion of Muskrat Falls construction. Liberty estimates savings at $17.6 million annually.

- Liberty estimates that O&M costs associated with Muskrat Falls generation and the LIL could be reduced by about $12 million annually.

- Liberty found "*striking*" the nearly $0.5 billion dollars in five-year capital spending that has been identified by Hydro and Newfoundland Power. Liberty did not do a comparative analysis of these costs relative to other utilities, but indicated that it would not take very large reductions in these costs to generate rate reductions in the range of the operational savings that they found possible.

- Synapse shows that electrification in the Province (e.g., heat pumps and electric vehicles) combined with incentives and appropriate rate designs is preferable to selling the excess power in the export market. Some electrification is already taking place in the Province. Incentives are likely to be necessary to achieve sustainability of such programs.

CONSUMER ADVOCATE'S RESPONSE

The Consultants have identified several promising areas for rate mitigation, but the question of who pays and who receives the benefits, taxpayers or ratepayers, will play a key part. If Government is agreeable to giving up the revenues, rate mitigation funds are available to significantly reduce Island Interconnected Customer rate increases brought on by the Muskrat Falls Project. However, as noted by Liberty, the larger portion of the savings occurs later, so the challenge is finding a way to reduce rate increases in the near term. Effective rate mitigation requires that Government, the Board and Nalcor/Hydro taking appropriate action.

The Consumer Advocate identifies a number of areas of importance that require further clarification and discussion which will hopefully be addressed during the public hearings in October, as follows:

1) There has been no mention of the rural rate subsidy which places a significant burden on the customers forced to pay the subsidy, specifically Island and Labrador Interconnected Customers (excluding Industrial Customers who are exempt). If the Government is to provide rate mitigation funds for Island Customers, the first order of priority should be to put the funds toward payment of this subsidy which should be borne by Government in any regard since it is effectively a Government social initiative.

2) There is a significant difference between the net revenues from exports estimated by Nalcor (ranging from \$35 to \$45 million) and Synapse (ranging from \$113 to \$213 million). In response to a question from the Consumer Advocate, Synapse indicates the source of disparity ***is likely*** because Synapse includes all export sales from the combined output of all resources in the Province, not Muskrat Falls only. Liberty identifies net revenues from exports as the second largest source of mitigation funds, so gaining further clarification of the disparity between the two estimates is important. It is not clear if the Synapse results take into consideration the ponding ability of the Province's hydro reservoirs. The experts should be ready to address these issues at the public hearing.

3) As noted, Liberty states that moderate reductions in capital spending by Hydro and Newfoundland Power would produce revenue requirement reductions equal to or greater than savings from combinations between the two companies. For many years the Consumer Advocate has been concerned about the substantial level of capital spending by Newfoundland and Labrador Hydro and Newfoundland Power and has expressed such concerns at Capital Budget and General Rate Applications. The rate based system needs study and revision. Some of the concerns of the Consumer Advocate relating to capital spending budgets include, but are not limited to:

   a) Is the appropriate amount of labor being capitalized versus expensed as an annual operating cost?

   b) For example, is the approach to transmission line maintenance/repair appropriate; i.e., is the approach to replace/repair only the components of a transmission line that require replacement, rather than the entire line, thus optimizing value to consumers? What are the practices generally of both utilities re repair versus replacement and do these utilities have consistent practices?

c) Should programs to improve reliability be undertaken regardless of the cost and the desire of consumers to pay for improved reliability?

d) Capital budget expenditures generally and the changes necessary to these in a performance-based system.

The Consumer Advocate believes that if utility spending is to be controlled, the introduction of performance-based regulation should be explored. The Consumer Advocate supports performance-based regulation for Newfoundland Power which is a profit-driven organization and an important part of Fortis, Inc., its parent company, and is prone to over-capitalization. We are less supportive of performance-based regulation for Newfoundland and Labrador Hydro because it is a Crown Corporation with social responsibilities, and thus less driven by a profit motive. Any performance-based regulatory mechanism should be reviewed and approved by the Public Utilities Board as it has the necessary expertise, information and processes in place to decide the appropriate mechanism for the Province.

4) The Consumer Advocate supports appropriate electrification and energy efficiency/demand management programs in the Province, but notes that such programs must be supported by rate designs with price signals that incent efficient consumption decisions by customers, i.e., charges reflecting marginal costs, while not discriminating among ratepayers within the same customer class, nor in per-kWh rates across classes. We note that Hydro is undertaking discussions with Island Industrial Customers and Newfoundland Power on wholesale rate designs. The Consumer Advocate looks forward to being a part of such discussions, as well as programs promoting electrification and energy efficiency/demand management going forward. The Consumer Advocate notes that evidence provided in the consultants' report indicate that at least during the non-winter months the marginal cost of electricity, as reflected in export prices, is very low and that electrification requires an inducement for ratepayers to choose to consume more electricity; both of these observations suggest that a lower price of electricity is called for during those months.

5) The timing of this undertaking and rate increases brought on by the Muskrat Falls Project is a significant concern of the Consumer Advocate. According to the Board's schedule, the Board's final report will be provided to Government on January 31, 2020. We understand that Hydro's next General Rate Application ("GRA") has been delayed until 2020. Clearly, the next GRA should reflect any rate mitigation measures recommended in the Board's final report and accepted by Government. We do not want Hydro proposing significantly higher rates for Island Interconnected Customers in a GRA before anything materializes on the rate mitigation front. The Consumer Advocate proposes that in the years following the Board Order on the 2017 GRA up to the time when the Government takes action on rate mitigation options that rates for Island Interconnected Customers be frozen. Further, if rate increases post Muskrat Falls are significant, a plan be implemented to spread the burden over a number of years.

6) The Consumer Advocate continues to believe that Hydro's exclusive right to sell power in the Province should be reconsidered and that formation of a Regional Transmission Organization (RTO) such as that used in the United States should be pursued for the Eastern Canadian Provinces. This would increase the value of exports by further integrating the Island Interconnected System into the North American grid.

7) Liberty states "*Nalcor's use of NEM to manage off-system transactions also has "best practice" implications*." The Consumer Advocate agrees and questions if NEM (Nalcor Energy Marketing) provides services and value that are not already available at lower cost or higher value from other power marketers in the region.

8) We recommend that the Legislature overhaul the *Public Utilities Act* and the *Electrical Power (Control) Act* to allow for the implementation of measures which will be required to provide the Board with jurisdiction over all aspects of performance-based regulation.

This submission is indicative of some of the topics which we will pursue in the public hearings.

Yours truly,

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Consumer Advocate

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