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December 21, 2015

VIA COURIER and ELECTRONIC MAIL

Ms. G. Cheryl Blundon, Board Secretary
Board of Commissioners of Public Utilities
120 Torbay Road
P.O. Box 21040
St. John's, NL A1A 5B2

Dear Ms. Blundon:

Re: Amended General Rate Application of Newfoundland and Labrador Hydro

Enclosed are the original and twelve (12) copies of the Final Submissions on the GRA of Vale Newfoundland & Labrador Limited.

We have provided a copy of this correspondence together with enclosures to all concerned parties.

We trust you will find the enclosed satisfactory.

Yours faithfully,

Thomas J. O'Reilly, Q.C.

TJOR/js
Encl.

c.c. Geoffrey P. Young, Newfoundland & Labrador Hydro
Gerard Hayes, Newfoundland Power
Thomas J. Johnson, O'Dea, Earle
Paul Coxworthy, Stewart McKelvey
Dennis Browne, Q.C., Browne Fitzgerald Morgan & Avis
Nancy Kleer, Olthuis, Leer, Townshend LLP
Yvonne Jones, MP Labrador
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Suite 1000 Scotia Centre 235 Water Street St. John's NL A1C 1B6

IN THE MATTER OF the *Electrical Power Control Act, 1994*, S.N.L. 1994, Chapter E-5.1 (the "EPCA") and the *Public Utilities Act*, R.S.N.L. 1990, Chapter P-47 (the "Act"), as amended and regulations thereunder; and

IN THE MATTER OF a General Rate Application filed by Newfoundland and Labrador Hydro on July 30, 2013; and

IN THE MATTER OF an amended general rate application filed by Newfoundland and Labrador Hydro on November 10, 2014; and

FINAL SUBMISSIONS OF VALE NEWFOUNDLAND & LABRADOR LIMITED

Introduction

In the period during which rates from Hydro's 2013 Amended General Rate Application ("GRA") will be in effect, Vale will become the largest Industrial Customers on the Island Interconnected System. It is expected that Vale's annual electrical costs at its Long Harbour nickel processing plant will exceed $20 million per year. As Vale's products are sold in a global market place, it is imperative that its costs allow it to keep its prices at a competitive level. It is also important to Vale that it has cost certainty as fluctuations in price can create budgeting problems that can affect the company's financial strength.

The outcome of Hydro's GRA will have an impact on Vale's competiveness in the global market for nickel. While Hydro seeks rates that will permit it to earn a fair and equitable rate of return, it is imperative that the Board of Commissioners of Public Utilities (the "Board") ensure that the revenue requirement on which Hydro's rate of return is based is set at a level that requires Hydro to focus on efficiency in its operations. Without requiring efficiency from Hydro, the rate of return earned by its industrial customers will be negatively affected. It is also important that fluctuations in rates be kept at a minimum so as to ensure that industrial customers will have cost certainty. In order to ensure rate stability, it is imperative that the Board set a high threshold for Hydro where it is seeking to recover pre-GRA costs through future rates or is seeking to establish deferral and recovery mechanisms.

Vale has intervened in this GRA to ensure that the objectives of least cost and predictable cost power are achieved. These submissions will focus on achieving these two objectives.

The GRA & Hydro's Recent Performance

The evidentiary record before the Board and the number of issues to be addressed in the GRA are more substantial that would normally be expected. The increased scope and complexity of the GRA was partially due to the Application's procedural history. Hydro's original 2013 General Rate Application (the "Original GRA") was filed on July 30, 2013 and calculated rates based on a 2013 test year. In June 2014, approximately one month before the Original GRA's hearing was scheduled to begin, Hydro decided to withdraw the Original GRA. Five months later, Hydro filed the amended GRA based on a 2015 test year. While some of the evidence in the Original GRA was relevant to the GRA, there were a number of significant differences between the test years and the relief sought by Hydro. The decision to amend the original GRA significantly extended the cost and duration of the Application process.

The cost and complexity of the GRA were also affected by the length of time Hydro allowed to elapse between general rate applications. Prior to the filing of the Original GRA, it had been 7 years since Hydro had filed a general rate application. Since it had last filed a general rate application, Hydro had undergone a major reorganization with the creation of Nalcor and the movement of the executive leadership team responsible for Hydro's operations into Nalcor. This structural change resulted in a significant amount of the hearing being focused on the relationship between Hydro and Nalcor in general and more specifically on questions regarding (i) whether Hydro is getting the level of executive management oversight it requires and (ii) whether the test year inter-company executive charges from Nalcor into Hydro are justified.

The length and cost of the GRA hearing was also significantly increased as a result of dramatic increases in Hydro's revenue requirement since the 2007 test year used in Hydro's previous general rate application. In total, the revenue requirement increased $131.8 million between the 2007 and 2014 test years and $231.4 million between the 2007 and 2015 test years.[1] While the largest contributor to Hydro's increasing revenue requirement is fuel costs, gross salaries are up 47% above inflation and operation and maintenance costs have increased 37% above inflation.[2] Hydro's increasing revenue requirement appears to be growing exponentially in recent years. Costs increased $43.3 million between 2007 and 2013 before increasing $87.7 million between 2013 actuals and the 2014 test year and $99.6 million between the 2014 test year and the 2015 test year.[3] As shown in request for information ("RFI") NP-NLH-307, Hydro's operating costs, which increased a total of 9% between 2007 and 2012, increased by 5% from 2012 to 2013, 13% from 2013 to the 2014 test year[4] and a further 10% from 2014 test year to the 2015 test year. Despite these rising costs, customers have seen decreased reliability characterized by two major outages in a twelve month period and a utility that has failed to meet the key performance indicators the Board has required it to report on.[5]

[1] See Grant Thornton Report, Graph 2, p. 40 for a breakdown of the differences between the 2007 and 2015 test years.
[2] RFIS NP-NLH 314, 315, 316 and 317 show a trend of costs increasing above inflation.
[3] Grant Thornton Report p. 41.
[4] Costs actually increased by 18% from 2013 actuals to 2014 actuals.
[5] Amended GRA Application, Exhibit 2, 2013 Annual Report on KPI, Table in Section 2.2

As a new industrial customer, Vale is understandably concerned with the combination of an increasing revenue requirement and with decreasing reliability. Ensuring that this trend is reversed will require a difficult balancing act for the Board and Hydro. It is also critical that Hydro's approved test year costs ensure that rates are equitable as between customers and customer classes. Vale submits that these goals have to be reflected in every aspect of the GRA including cost of service, revenue requirement, deferral mechanisms and Hydro's proposed deferral mechanisms. Vale's submission will deal with each of these categories in turn.

Cost of Service Issues

Calculation of Specifically Assigned Charges

One of the central issues for Vale in the GRA is the Specifically Assigned Charge Hydro is seeking for Vale. As can be seen in Table 1, Vale's Specifically Assigned Charge is approximately $500,000 annually.

Table 1: Vale's Annual Specific Assigned Charges ($)

Operating and maintenance expense	436,715
Depreciation	37,553
Return of debt (interest)	19,281
Return on equity	7,339
Other	(1,367)
Total	**499,522**

Reference: Amended GRA, Exhibit 13, 2015 COS, page 40 of 109, line 21

The $436,715 operating and maintenance expense specifically assigned to Vale represents 87% of the total Specific Assigned Charge. Table 2 breaks down the operating and maintenance expense into its several components.

Table 2: Vale's Annual Specific Assigned Maintenance Charge ($)

Lines	74,839
Terminals	104,837
Other	44,050
Subtotal LTO*	223,726
Administrative and General	212,989
Total	**436,715**

Reference: Amended GRA, Exhibit 13, 2015 COS, page 40 of 109, line 21
*LTO is lines, terminals and other

Of the $436,715 operating and maintenance expense assigned to Vale, $179,676 (or 41%) relates to lines and terminals that are used solely by Vale. The $44,050 in "Other" expenses include costs that are related to both "Lines " and "Terminals" such as vegetation control, helicopter use and fleet vehicle use (see V-NLH-069 Rev 1). The Administrative and General component is the portion of Hydro's overall administrative and general expense that it proposes to allocate to Vale.

The operating and maintenance charges for "Lines", "Terminals" and "Other" are calculated by prorating the original cost of plant in service of the system equipment used by Vale against the total original cost of plant in service for all of Hydro's assets on the system (see V-NLH-066 Rev 1, V-NLH-067 Rev 1 and V-NLH-069 Rev 1). The charge for Administrative and General is largely determined by the same method (see V-NLH-068 Rev 1).

In his testimony, Mr. Ed Martin acknowledged that many of the plant and transmission assets are more than 40 years old and that their replacement cost today would be more than when they were originally purchased[6]. The unchanged pre-filed evidence of Mel Dean, Vale's expert,[7] illustrates that construction costs for transmission terminal plant is more than five times as expensive as it was forty years ago[8]. Thus prorating the operating and maintenance costs using plant in service without accounting for the time value of money results in an inequitable allocation of costs among customers.

Mr. Greneman, Hydro's expert witness agrees that the method Hydro used in the GRA to allocate specific assigned charges has the potential for inequity[9]. Likewise, Hydro's witness Mr. Fagan, Manager of Rates and Regulation, agrees that not taking the time value of money into consideration can lead to results which are inequitable and unreasonable. In his testimony, Mr. Fagan states "..... Hydro recognizes that it's not a fair approach with respect to specifically assigned charge" (see transcript October 6, 2015 page 58, line 20 to page 59, line 1). Mr. Fagan repeated the same in his testimony on October 7, 2016 when asked about the specifically allocated charge in the amended GRA saying that the original charge was not appropriate[10].

Mr. Fagan summarizes Hydro's perspective on this issue in his testimony on October 6, 2015, page 76, lines 3-20:

> So, I think from a principle perspective, starting with this, like if – here's my struggle. Vale doesn't pay a specifically assigned charge right now. So you're starting them out with a $436,000 specifically assigned charge on a methodology which you really can't support because it's based on a presumption that because they've got new assets which are higher costs than the original cost of the assets that are there for 20 or 30 years that they should pay a higher O&M charge, and it's really hard to defend that. I mean, to me, being able to explain the rationale of a rate to a customer and say "okay, this is why this rate makes sense" is an important component of communicating with the customer. If you can't defend your approach to the charge, I'd have a hard time proposing it.

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[6] Reference: Transcript 2015-09-11, page 88, lines 7 to 22

[7] Reference: See pre-filed evidence entitled "Expert's Report on Newfoundland and Labrador Hydro's Amended 2013 General Rate Application", prepared by Mel Dean, June 4, 2015

[8] Reference: Ibid, Appendix A: Restatement of Transmission Terminal Plant in Service. This restatement uses the most common Public Utility index on construction costs which is the Handy-Whitman Index. The base is reset so that 2015 = 100. The index for 1975 is 19, so in forty years, the terminal transmission plant construction costs increased by more than five times.

[9] Reference: Transcript 2015-09-28, page 110, line 10 to page 111, line 1

[10] Reference: Transcript 2015-10-07, page 17, lines 16-20

Mr. Patrick Bowman, expert witness for the Industrial Customers also testified that taking into account the time value of money resulted in an equitable and reasonable way to calculate the specifically allocated charge. The exact exchange was:

O'REILLY, Q.C.:
Q. Okay. And I understood your evidence as well to be that if the spreadsheet method is being used, indexing of the costs that go into the spreadsheet is an equitable and reasonable way to complete the calculation. Is that correct?

MR. PATRICK BOWMAN:
A. Yes.[11]

Failing to take into account the time value of money for the plant in service results in new industrial customers being materially overcharged for operating and maintenance costs. Fair and equitable rates are the foundation of good ratemaking. The method used by Hydro in the amended GRA does not meet this test. More important, the method applied by Hydro contravenes Section 3(2) of the *Electrical Power Control Act, 1994*, S.N.L. 1994, c. E-5.1 which provides:

It is declared to be the policy of the province that:

(a) the rates to be charged, either generally or under specific contracts, for the supply of power within the province

(i) should be reasonable and not unjustly discriminatory,

Based on the evidence and for the reasons stated above, Vale submits that the current method of calculating Specifically Assigned Charges is unjustly discriminatory as it creates inequity for new industrial customers.

In the pre-filed evidence entitled "Expert's Report on Newfoundland and Labrador Hydro's Amended 2013 General Rate Application", prepared by Mel Dean, June 4, 2015, Mr. Dean described a way to eliminate the present inequity by indexing the original plant in service costs to present day dollars and then prorating the operating and maintenance cost using the indexed amounts. Following the filing of Mr. Dean's evidence, Hydro revised its response to RFI V-NLH-083, revision 1. This response fully answered the question that was asked in the RFI and followed a similar approach to that used by Mr. Dean. As Mr. Dean did not have complete information from Hydro, he accepted that the calculations done by Hydro in V-NLH-083, revision 1 were the fair and equitable specifically allocated charges for all customers.

Q. Do you agree with Hydro's recalculation of the O&M charges for the Industrial Customers as set out in that RFI response?

MR. DEAN:
A. I agree entirely. It did differ from mine, but mine were based on a number of assumptions, due to a lack of total information, and when I look at the difference

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[11] Reference: Transcript, October 1, 2015, page 50, lines 9-16

> between ours, it's only in the range of 17 percent, I believe. So, I think that was pretty good. I will accept theirs.[12]

No party submitted evidence suggesting that Mr. Dean's suggested approach or Hydro's revised approach detailed in V-NLH-083 revision 1 is not fair and equitable. Hydro's witness, Mr. Fagan, supports the revised approach to calculating the specifically allocated charge. In his testimony on October 6, 2015, Mr. Fagan stated his support for the revised calculation on three separate occasions:

> *" Mr. Dean's proposal is credible, I think, that's it ....adjusting the numbers to real dollars in calculating the O&M percentage would be fairer."* (page 58, lines 8-11)
>
> *" .... yeah, his recommendation has merit. The Board should consider it and in their final order of the Board"* (page 59, lines 8-11)
>
> *"So what Mr. Dean has presented seems like a reasonable approach ....."* (page 59, lines 12-13)

Mr. Greneman, Hydro's expert, is also in agreement with Hydro's revised approach to calculating the specifically assigned charge. In the September 28, 2015 transcript, page 112, lines 2-11, upon being questioned he agrees:

> O'REILLY, Q.C.:
> Q. Are you in agreement with Hydro's approach to this issue as outlined in its response to that RFI?
>
> MR. GRENEMAN:
> A. Yes.
>
> O'REILLY, Q.C.:
> Q. Pardon me?
>
> MR. GRENEMAN:
> A. Yes, I am.

As stated previously, Mr. Patrick Bowman, expert witness for the Industrial Customers also testified that Hydro's revised approach is an equitable and reasonable way to calculate this charge.

Vale submits that in its final order in the GRA, the Board should direct Hydro to calculate the specifically assigned charge as described in V-NLH-083, revision 1.

In the course of the hearing, it was suggested that to give effect to this revised calculation of specifically assigned charge would represent a major methodology change and should therefore not be considered by the Board until the upcoming cost of service methodology hearing. Vale strongly disagrees. As Mr. Dean points out in his testimony (October 1, 2015, page 65, lines 1-25)., Hydro's revised calculations respect the basic premise that assets

[12] Reference: Transcript, October 1, 2015, page 67, lines 1-11

primarily for the use of a customer should be specifically assigned to that customer. This principle goes back to at least 1978 and is not being changed in this GRA. Second the concept of pro-rating Hydro's operating and maintenance costs based on the cost of the plant in service is also not being changed. The only variance, as pointed out by Mr. Dean, is that the costs are indexed so that the pro-rating is fair and equitable. Vale submits that the change in the way the specifically assigned charge is calculated should be implemented in this GRA.

Mr. Patrick Bowman also agrees that the revised method of calculation should be implemented now and any refinements should be considered at the cost of service methodology hearing. This is evident in his September 30, 2015 testimony, on page 156:

> JOHNSON, Q.C.:
> Q. So it sounds to me that that issue is tailor made for the 2016 review, to get into that sort of level and justification, would you not agree?
>
> MR. PATRICK BOWMAN:
> A. I think the refinements we're talking about could be part of that, but as I said, the current method, Mr. Dean's method I think on the merits, Mr. Dean's approach is better because it addresses one known problem with the current method which is the date of implementation of the costs and inflationary pressures over that period.

Upon question from Mr. O'Brien (NP Counsel) regarding deferring the matter until the cost of service methodology hearing, to allow a further study, Hydro's expert Mr. Greneman replied "I don't think there's any benefit in doing a more comprehensive review"[13].

Even Hydro's witness, Mr. Fagan, believes that the revised approach is a good starting point and that it can be further reviewed at the subsequent cost of service methodology hearing. In his testimony on October 6, 2015, page 70, lines 18-24, Mr. Fagan says, "Hydro believes Mr. Dean's approach would be a good approach to start with until it can be further reviewed in the cost of service methodology hearing, and so change the approach now and use that until it's further reviewed in the cost of service methodology hearing." Similarly, Mr. Henderson, Vice-President of Newfoundland and Labrador Hydro stated "I would think that if there's an issue of fairness or appropriateness in the rate design and it can be resolved in a general rate application, it would make sense to resolve it in a general rate application."[14]

Mr. Fagan agrees that in its present form, the amended application results in Vale paying a specific assigned charge of $291,000 more than is appropriate and that if Vale was required to pay these sums there would be no chance of getting that back. (See transcript October 7, 2015, page 17, lines 4 to 20).

Undertaking U-45.1 illustrates that Hydro is ready to implement the revision to the calculation. Attachment 1 is the cost of service study reflecting the revised calculation of the specific allocated charges. Although fairness and equity should be the main criteria, Hydro

[13] Reference: Transcript September 28, 2015, page 51, lines 17-18
[14] **Reference: Transcript October 8, 2015, page 180, lines 15-20**

has also looked at customer impact. Table 2 of the same undertaking illustrates that such a change would have only a 0.1% effect on Newfoundland Power rates, a very minimal percentage.

Vale submits that unless the revisions now proposed by Hydro are implemented in the Board Order in the present GRA, Vale would be overcharged by $291,000 for a period of up to three years. An overcharge of nearly one million dollars is unjustly discriminatory to a new industrial customer and is therefore a contravention of s. 3(2)(a)(i) of the *Electrical Power Control Act, 1994*. The Board should therefore direct Hydro to calculate the specifically allocated charge as outlined in V-NLH-083 revision 1 in its final order in the GRA.

Vale submits that the Board only needs to answer one question "Is the calculation of the specific allocated charge as presented in V-NLH-083, revision 1 fair and equitable to all parties?"

It was suggested during the hearing by implication that no other utility uses the method proposed by Vale's consultant and accepted and refined by Hydro. Even if no one else is using this method, it still has no bearing on the basic issue. Hydro's response to V-NLH-083 revision 1, table 4 illustrates that more than $600,000 of the equitable amount is allocated to specific assigned charges. The customer affected the most is Vale who is being overcharged $291,000 annually and is being discriminated against because it is the newest industrial customer on the system. However, the same indexed approach is used by Newfoundland Power for the calculation of contributions in aid of construction. Mr. Fagan's testimony on October 6, 2015, page 61, line 15 to page 62, line 16 illustrates this:

> So Newfoundland Power's contribution in aid of construction policy or CIAC policy in determining its charge to customers that pay contributions, it's based on a capital cost but also includes a O&M portion assumed over the life of the asset, and in determining the O&M portion, because actually the approach that Mr. Dean is proposing is consistent with the approach used and approved by the Board for determining the charges for Newfoundland Power that they use. They index the costs upon the Handy-Whitman index to the original cost of distribution index – of the distribution asset, sorry. So, because the approach that Hydro uses now for specifically assigned charges is consistent with what was used in Newfoundland Power's CIAC policy up to I think September of 1997 and there was a change in the policy at that time to move the indexing approach. The O&M percentages were materially higher for the customers paying contributions and it was determined that it should be changed, so it was changed in 1997 for Newfoundland Power.
> So what he's presenting has been dealt with in a different context before but the principle is the same.

In a question from Mr. Johnson, Consumer Advocate, Mr. Henderson confirmed that Hydro's CIAC policy was the same as Newfoundland Power's:

> JOHNSON, Q.C.:
>
> Q. Okay, and are you familiar with whether or not Hydro's CIAC policy is similar to Newfoundland Power's at this point?

MR. HENDERSON:

A. My understanding is our contribution in aid construction policy is the same as Newfoundland Power's.[15]

As for universality of approach, Mr. Patrick Bowman testified that neither Manitoba Hydro nor the Yukon Electric Utility have a specifically assigned operating and maintenance charge for their electrical industrial customers[16].

Though far from being determinative of the primary issue of whether Hydro's proposed method of calculation of the O&M component of specifically assigned charge was inequitable and unreasonable, the implication inherent in the questions by the Consumer Advocate that Vale knew or should have known the magnitude of the specific assigned charge needs to be addressed. There is no evidence on the record indicating that Vale was ever given an estimate of the magnitude of the specifically assigned charge. The relevant evidence is the testimony given by Mr. Dean that Vale could not understand why they would be charged over $500,000 in specifically assigned charges when they had paid for all the assets in question.[17]

Undertaking U-47 is a letter from Hydro to Vale dated August 19, 2011 on the subject of "Industrial Electrical Service Agreement – Long Harbour – Specific Assignment of Assets". The letter is said to explain the specific assignment of assets in a "summary fashion". As it is a summary, much of the necessary information was missing. There is no way that Vale could calculate or even estimate the amount of the specifically assigned charge that it might be required to pay. In particular:

- The letter states that the capital costs have been paid by Vale but in no way indicates to the industrial customer that there would be depreciation and return on rate base charge of over $64,000 a year[18].

- There is no indication in the letter that Vale would be required to pay operating, maintenance and administration expenses for general and administration costs. The amended GRA assigned $213,000 of such charges to Vale[19].

- In the explanation of the assigned operating and maintenance charges for transmission lines, terminal stations and other, there is no indication that 2012 costs were being prorated against the average asset costs which are over forty years old.

In summary, this letter is merely a general indication of the process or in Hydro's words it is only an explanation in a "summary fashion". There is no way that Vale would have understood, nor could it have understood, the calculations involved in the specifically

[15] Reference: Transcript October 8, 2015, page 177, lines 5-12
[16] Reference: Transcript October 1, 2015, page 55
[17] Reference: Transcript October 1, 2015 page 64, lines 12 – 24
[18] Reference: 2015 Amended GRA COS, page 40 of 109, line 21, sum of columns 8, 10, 15 and 16
[19] Reference: 2015 Amended GRA COS, page 40 of 109, line 21, column 5

assigned charge or have an appreciation of the magnitude of the charge from a fair reading of the letter.

Similarly irrelevant is the suggestion that Vale's consultant was not an "expert" in proposing a way to remedy the inequity inherent in Hydro's specifically assigned charge. The issue is not one of perceived expertise but rather is a recognition of the inequity inherent in comparing 2012 costs with 1960s costs without taking into consideration the time value of money. No party submitted evidence contradicting the proposal forwarded by Mr. Dean for calculating the specific assigned operating and maintenance charge as not being fair and equitable. Hydro's own expert acknowledged the inequity in the specifically assigned charge in the amended GRA. Likewise, Hydro accepted the basis proposed by Mr. Dean and revised their response to V-NLH-083. Hydro's response included the information that had not been previously made available to Vale and its response fully supports the use of indexing.

During cross examination, it was also suggested that transmission plant had higher than normal maintenance costs in the early years implying that Hydro's existing calculation was correct and that consequently Vale should be charged the amount set out in the amended GRA. With respect, such a suggestion is not logical as the present calculation would mean that the oldest assets on the system require the least maintenance. Intuitively, less maintenance as an asset ages does not make sense. Aging assets require more maintenance, not less. Hydro's amended GRA evidence dated November 24, 2014 section 1.2 has listed aging assets as a key challenge.

> The Newfoundland and Labrador electrical grids were established principally in the late 1960s with the construction of the Bay d'Espoir Generating Station on the island and the Churchill Falls Generating Station in Labrador during the early 1970s. As such, most of Hydro's generation and transmission assets are now more than 40 years old and require increasing maintenance, refurbishment and replacement. This is the number one challenge faced by Hydro.

In his evidence given on October 8, 2015, Mr. Henderson agreed that as transmission assets age, they require more maintenance[20]:

> I can confirm that there has been no studies. There's just the, I'll say, general experience as assets age, you end up having – you know, that is our experience. As they age, they require additional corrective maintenance until the time that the asset reaches the end of its life and it's replaced.

In addition, Mr. Humphries, Hydro's witness, stated that in general, new transmission lines require less maintenance than old ones as new transmission lines are built to higher standards and that there was nothing about the line feeding Vale that would give rise to higher maintenance[21].

In summary, all of Hydro, Hydro's expert, the IC's expert and Vale's expert agree that the calculation used for specifically assigned charges in the amended GRA results in new

[20] Reference: Transcript October 8, 2015, page 147, lines 7-12
[21] Reference: Transcript October 22, 2015 pages 9-12

industrial customers entering the system being overcharged. The same witnesses all support the concept of indexing original costs to a constant year as proposed by Hydro in V-NLH-083, Revision 1. No party has submitted evidence to the contrary. As the evidence on the record has unequivocally demonstrated, the overcharge to Vale is $291,000 annually which Vale submits is unreasonable and unjustly discriminatory and therefore contravenes the provisions of the *Electrical Power Control Act, 1994*.

Appropriate Load Forecast

One of the issues that did not get resolved through the settlement process was "Should the load forecast be adjusted to reflect Vale's and Praxair's full load once fully operational?" Hydro's position is that the loads reflected in the amended 2015 Test Year properly reflect the rates as load growth may occur. Vale supports Hydro's position. Hydro's best summary evidence is contained in undertaking U-44, Revision 1 where an analysis shows that using a normalized load using 2017 forecast demand and energy would lead to abnormal results.

> From a demand cost perspective, IIC have a higher load factor than Newfoundland Power (NP) and a lower coincidence during peak periods. As a result, their unit demand cost is generally lower than that of NP. Table 1 shows that under the normalized approach the unit demand costs is materially higher for IIC than NP.
>
> The analysis indicates that normalization to reflect higher future loads in the allocation of the 2015 Test Year revenue requirement will result in reflecting the future cost of serving IIC load in current rates. Allocation of a higher proportion of costs to IIC based on the 2017 forecast will have the effect of materially increasing the rates to be charged IIC and result in over-recovering the cost of serving IIC in both the test year and in the future years.

Mr. Fagan was extensively cross-examined on this issue and he adequately defended Hydro's position[22].

Hydro Communication with Industrial Customers

Vale supports Hydro's plan to enhance the communication system with industrial customers in early 2016[23]. Upon questioning as to how information regarding the calculation and magnitude of the specific allocated charge would be communicated to the industrial customers, Ms. Dalley stated that such would be indicated in the new system even though it had not yet been finalized. Ms. Dalley said, "the question you're asking me it's an area of concern, and what Ms. Williams was reflecting to me is that it was, and would there be a solution that we could come up with which would facilitate that process differently within the account management framework, and I suggested that I thought that was worthy of further discussion." Vale submits that in its final order on the Amended GRA, the Board should direct Hydro to improve its communication with the Industrial Customers and in particular to require that it fully explain, with examples, the concept and calculations involved with the specific allocated charge as well as the estimated amount of the specific allocated charge

[22] Reference: Transcript October 6, 2015, pages 105-134
[23] Reference: Transcript November 24, 2015 pages 74-77

both for a new customer and when a significant capital expenditure on a specific asset is made. The annual amount of the specifically assigned charge or change in the amount is especially important to industrial customers.

Revenue Requirement

As discussed above, Hydro's revenue requirement has been increasing significantly recently. For the first time, the Government of Newfoundland and Labrador has removed the Board's jurisdiction to set the return on equity that Hydro's rates are to be based on. As such, the effect of any unjustified amounts being included in the test year revenue requirement are heightened by the fact that Hydro's target return on equity will increase from 4.465% to 8.8%.

Although Vale did not retain a financial expert to provide a report similar to Grant Thornton's June 12, 2015 report (the "Grant Thornton Report"), it did engage in the process of scrutinizing Hydro's 2015 test year revenue requirement through the RFI process and cross examination of Hydro's witnesses. It is Vale's submission that the revenue requirement being put forward by Hydro in its GRA is potentially overstated in a number of aspects including, but not limited to, (i) Hydro's suggested vacancy allowance, (ii) budgeting in day to day costs, (iii) inclusion of the Holyrood CT in rate base, (iv) the inclusion of the Debt Guarantee Fee and (v) intercompany transactions.

(i) Vacancy Rate

Hydro's gross payroll costs have been increasing at a level well above inflation. Payroll costs increased by 7.2% between 2013 and the 2014 test year and a further 7.9% between the 2014 test year and the 2015 test year.[24] While an increase in the number of full time equivalent ("FTE") positions included in Hydro's budgets is a major contributor to the increase, Grant Thornton demonstrated that the net cost per FTE is also increasing over time.[25] Average salary per FTE is estimated to increase by 4.63% between the 2014 test year and 2015 test year (from $80,953 per FTE in the 2014 test year to $84,704 per FTE in the 2015 test year).

Vale submits that the test year payroll costs should be decreased as Hydro has underestimated its vacancy levels resulting in an inadequate vacancy allowance being applied. As illustrated in Table 43 of Grant Thornton's June 12, 2015 report, Hydro's net FTEs (defined as FTEs plus or minus operating and labour recharges from or to other Nalcor lines of business) have increased by 53 from 2013 to 2014 test year (from 807 to 860) and by 30 from 2014 test year to 2015 test year (from 860 to 890). As there were 32 vacancies in 2014, the difference between the 2014 actuals and the 2015 test year is 62.

In its 2014 test year, Hydro has estimated that it will have 40 vacancies. However, testimony during the GRA confirmed that 2015 actuals are expected to include 65 vacancies.[26] While Hydro has stated that 40 vacancies remains a realistic basis on which to set rates as it

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[24] Grant Thornton p. 63 and Table 39
[25] Grant Thornton p. 68 and Tables 46 and 47
[26] GRA Transcript Sept 21 at pp 41-46

expects its vacancies to reduce to this level in 2016, its 2015 actuals contradict this. Hydro's response to NP-NLH-310 shows that Hydro had 40 vacancies in 2011 on 841 FTEs, 52 vacancies in 2012 on 863 FTEs, 41 vacancies in 2013 on 864 FTEs and 52 vacancies in 2014 on 885 FTEs. Based on Hydro's historical vacancy rate a projection of 40 vacancies on 943 FTEs in 2015 (i.e. 12 less vacancies on 58 more FTEs than 2014) is not a reasonable projection.

Hydro's witnesses also testified that an increase in vacancies does not necessarily mean a decrease in costs as a vacancy in a position can result in increased overtime or the requirement to retain outside contractors to complete work that the vacant position would have completed.[27] In its response to Undertaking 146, Hydro demonstrates that the decrease in salaries from the 2015 test year to 2015 forecast is less than the increase in overtime, contract labour and consultants seen from the 2015 test year to 2015 forecast. However, Hydro has not provided any analysis to enable the Board to conclude that there is a direct correlation between increased vacancies/lower salary costs and an increase in overtime, contractor labour and consultants. Further, as the answer to Undertaking 146 was provided after the conclusion of the GRA hearing, the parties were unable to question Hydro on the data presented.

As noted above, the average salary per net FTE included in the 2015 test year is $84,704. If, consistent with 2015 actuals, Hydro's vacancy level is underestimated by 25 vacancies, Hydro's test year costs would be overstated by $1,270,560 (not including the return on that amount). Vale submits that, at a minimum, Hydro's 2015 test year revenue requirement for payroll costs should be decreased by $1 million in addition to the current allowance for vacancies.

(ii) *Budgeting and Efficiency in Day to Day Costs*

The evidence presented by Hydro in support of its rate case demonstrates that Hydro's test year budgeting process results in an overestimation of some of Hydro's test year day to day expenses. For example, Hydro's office supply costs have never been higher than the $2,595,000 actuals seen in 2013 and were $2,392,000 in 2014 notwithstanding a test year budget of $2,629,000. Despite this historical evidence, Hydro's 2015 test year includes $2,804,000 in office supply costs.[28] Vale submits that the test year number is overstated by at least $200,000.

Hydro's test year budget for travel costs is also concerning from both a budgeting and efficiency perspective. Notwithstanding the fact that Hydro's travel expenses have never been higher than the $3,338,000 incurred in 2013 and were $3,208,000 in 2014 despite a forecast of $3,710,000, Hydro has nevertheless included $3,717,000 in travel costs in the 2015 test year.[29] During cross examination, Robert Henderson, then Nalcor's Vice President of Newfoundland and Labrador Hydro, justified the travel budget based on Hydro's "very broad geographic area and the distance between our central offices and where our work is done." However, as the area covered by Hydro's business has not

[27] See transcript Sept 16th for discussion by HR Panel. Also see Operations Panel for discussion on FTEs
[28] Grant Thornton, Tables 73 and 74, p. 85; See GRA Transcript Sept 24 at pp 32-33.
[29] Grant Thornton, Tables 73 and 74, p. 85.

changed, this is no justification for distinguishing 2015 test year costs from past year actuals.[30] Hydro also suggested during its evidence that increased vacancies can reduce travel costs.[31] While the fact that Hydro's current forecast for 2015 travel costs is $3.9 million[32] supports the test year increase over past year actuals, the dramatic increase in the test year is concerning from a budgeting and efficiency perspective.

A further example of a Hydro expense that has increased significantly over time is fees paid to consultants. As outlined in Table 2.7 of Hydro's Company Evidence, 2014 test year consultant fees were $7.2 million, which is $5 million higher than 2007 test year fees and $4 million higher than 2013 actuals. While consultant fees decreased to $5.6 million for 2015 test year, this is still $3.4 million higher than the 2007 test year and $2.6 million higher than 2013 actuals.[33] The difference between 2014 and 2015 is a result of $2M in outage inquiry costs being included in 2014 test year.[34] GRA and Board related costs follow a similar pattern.

Despite increasing costs, Hydro's response to RFI NP-NLH-57 shows that Hydro has not initiated an adequate number of efficiency initiatives. Instead of deploying efficiency initiatives, Hydro's response to RFI NP-NLH-384 states that its:

> budgeting methodology incorporates productivity improvements into its base budgets, not as a specific allowance to be shown separately. Both methods have the same end result.

Both during cross examination and in response to RFIs, Hydro used budgeted overtime as an example of a focus on efficiency being manifested in the budgeting process.[35] However, Hydro's response to RFI NP-NLH-307 shows that Hydro 2015 test year overtime budget of $10,128,000 does not demonstrate efficiency on Hydro's part. Rather, the RFI response demonstrates that overtime was less than $10 million in each year between 2007 and 2012. While overtime increased to $12,282,000 in 2013 and to $16,624,000 in 2014, this would be expected in years that had major outages and, in the case of 2014, a focus on catching up on deferred preventative maintenance. [See GRA Transcript September 23 pp165-170, Transcript November 16, 2015 and Undertakings U-142 and U-143].

As stated in Board Order P.U. 2002 (7), the "onus is on [Hydro] to bring forward performance measures which clearly demonstrate the efficiency of its operations".[36] As was the case in the 2003 GRA, Hydro's evidence fails to demonstrate such efficiencies. Vale submits that rather than dealing with efficiency and budgeting concerns on a line by line basis, the Board should include a productivity allowance in the 2015 test year. As discussed in Board Order P.U. 2002 (7), "Attempting to reduce individual expense categories may impede the ability of

[30] GRA Transcript September 24, pp. 29.
[31] GRA Transcript November 18, pp. 13-14.
[32] Undertaking 55, attachment 2, p. 1; see also GRA Transcript November 18, pp. 13-15.
[33] The difference between 2014 test year and 2015 test year consultant fees is the result of $2 million in outage related inquiry costs being included in the 2014 test yea; see GRA Transcript September 24, pp 23 and 24.
[34] GRA Transcript September 24, pp 23 and 24.
[35] GRA Transcript September 22, pp 88-91.
[36]Board Order P.U. 2002 (7), at p. 73.

[Hydro] management to make decisions on how and where efficiency improvements are best implemented".[37] In contrast, a productivity allowance does not impede management's decision making process while at the same time it requires the utility's management to use its best efforts to identify efficiencies. In Board Order P.U. 2002 (7), the Board ordered a $2,000,000 adjustment to the test year requirement to reflect a productivity allowance. Given the substantial increase in test year costs between 2002 and 2015, Vale submits that the 2015 test year should include a $4 million productivity allowance adjustment.

(iii) *The Holyrood CT*

The 2015 test year includes more than $4 million in depreciation and return on rate base associated with the Holyrood CT. However, while Hydro provided its contractor with a "stretch target"[38] to have the Holyrood CT installed before year end 2014, the Holyrood CT was in fact not in operation until late January 2015. Hydro has acknowledged that it would normally not include an asset in a test year rate base if the asset was not in service at the start of the test year.[39] Because of this, Hydro has removed costs associated with the Holyrood CT from the 2015 revenue deficiency application[40] but argues that the cost should remain in the 2015 test year to allow Hydro to earn an acceptable return on rate base.[41] Vale submits that costs associated with Holyrood CT should be removed from the rate base.

(iv) *The Debt Guarantee Fee*

The 2015 Test Year includes a Debt Guarantee Fee payable to Hydro's sole shareholder, the Government of Newfoundland and Labrador, of $4.4 million.[42] Vale submits that the Debt Guarantee Fee should not be included in Hydro's recoverable revenue requirement.

While Hydro's witnesses testified that it is reasonable for it to continue to pay the Debt Guarantee Fee pointing to the significant reduction in the amount of the fee in support of its position that the current fee is reasonable, Vale disagrees.[43] As acknowledged by Hydro, this is the first GRA in which there is no legislative requirement that Hydro pay the Debt Guarantee Fee.[44]

In RFIs NP-NLH-058 and 254, Newfoundland Power pointed out that section 32 of the *Hydro Corporation Act (1990)*, which required Hydro to "pay annually to the Minister of Finance a fee in respect of loans guaranteed by the Minister of Finance under [the] Act", has been repealed. The new version of the legislation, the *Hydro Corporation Act, 2007*, makes no provision for payment of a Debt Guarantee Fee by Hydro to the Minister of Finance as proposed by Hydro in its 2013 General Rate Application. When asked in RFI PUB-NLH-058 to support a continuing requirement on the part of Hydro to pay the Debt Guarantee Fee,

[37] *Ibid.*
[38] GRA Transcript November 4, p. 14.
[39] GRA Transcripts November 18, p 201 and November 19, p 65.
[40] As set out in Hydro's answer to undertaking 153, the Holyrood CT was the largest of a number of projects that made up a $5.1 million adjustment to the 2015 Cost Recovery Application.
[41] GRA Transcripts October 5, p 111.
[42] Grant Thornton, Table 35, pp 58
[43] Ed Martin Sept 9th, (Nov. 19 at 54..)
[44] (Nov. 19, p 22)

Hydro pointed to Order in Council OC2011-218, which specifically refers to Sections 21 to 25 of the *Hydro Corporation Act, 2007*. When asked in NP-NLH-254 how an Order in Council citing a statute that does not contain a provision similar to section 32 of the *Hydro Corporation Act (1990)* justifies the inclusion of a Debt Guarantee Fee in its test year costs, Hydro responded:

> The payment of the debt guarantee fee is justified on the basis of it being a government policy as stated in an Order in Council (see PUB-NLH-058 Attachment 1) and because it is a reasonable fee for the debt guarantee which has given value to the ratepayers by lowering Hydro's borrowing costs.

Vale submits that Hydro's answer to NP-NLH-254 is not responsive to the question asked. Hydro has not provided evidence that it is required to pay the fee. Rather, the only valid justification for the fee is that it lowers Hydro's borrowing costs.

While lower borrowing costs may have been a valid justification for the Debt Guarantee Fee in past general rate applications, the fact that the Board has been ordered to provide Hydro with the same return on equity as Newfoundland Power, which does not have the benefit of such a guarantee, is support for the Board refusing recovery of the fee in this GRA. Additionally, the 2009 $100 million equity contribution by Government, which has a $5.8 million effect on the revenue requirement,[45] also serves to enhance Hydro's financial stability. The Debt Guarantee Fee, the $100 million equity injection and the increased return are all aimed at ensuring the long term financial viability and creditworthiness of Hydro. While it may be argued that customers should incur the cost of one or even two mechanisms to achieve this result, the costs of all three cannot be justified.

Even if the Board were to decide that the Debt Guarantee Fee should be recovered, the amount of the fee should still have to be justified. In the Grant Thornton Report, Grant Thornton demonstrated that the Scotiabank Guarantee Fee Analysis dated October 2013 does not lead to an equitable result.[46] First, while a fee of 50 basis points on long term debt is significantly lower than the fee that was previously charged to Hydro, it is still above the high end of the range for such a fee.[47] Grant Thornton also recommended that the benefit of the fee be shared between Hydro and the Government.[48]

Vale submits that the Debt Guarantee Fee should be removed from the 2015 test year revenue requirement. As recommended by Grant Thornton, before including recovery of the fee in a future year, Hydro should be required to provide an analysis that accounts for the inadequacies of the Scotiabank report and provides for "an equitable methodology to apportion the benefit".[49] An Example of an equitable apportionment is found in undertaking 139 where Hydro demonstrated that the test year Debt Guarantee Fee would be reduced by

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[45] See PUB-NLH-62

[46] Grant Thornton Report, pp 19 and 20.

[47] Hydro 'defended the inclusion of the Debt Guarantee Fee at GRA Transcript, November 19, 2015, p. 29.

[48] Grant Thornton Report, pp 19 and 20. In undertaking 140, Hydro confirms that providing the Debt Guarantee Fee has not had an effect on the Province's credit rating.

[49] Grant Thornton pp 19 and 20.

$2.6 million if the fee on long term debt was set between 37 and 45 basis points and the benefit of the fee was apportioned 50/50.[50]

(v) *Intercompany Charges*

A significant amount of the GRA hearing focused on intercompany charges between Hydro and its parent/affiliates in general and Nalcor Leadership Team charges to Hydro in particular. As discussed in Liberty Consulting Group's July 6, 2015 Report ("Liberty's Initial Report") filed in the Prudency Review and as demonstrated in RFI PUB-NLH-228 Rev 6, the Nalcor Leadership Team charges to Hydro in the 2014 test year included a significant number of hours linked to actions which were found by Liberty Consulting Group ("Liberty") to be imprudent. However, as the charges included in the 2015 test year are more representative of charges between 2011 and 2013, Vale accepts that the 2015 test year charges are reasonable.

As shown in Hydro's response to Undertaking 151, the 2015 test year costs are overstated as a result of common services not being fully burdened. Vale submits that the 2015 test year costs should be reduced by $114,851 to account for this fact.[51]

Requested Deferral Accounts

Included in Hydro's requested relief in the GRA is Board approval for the creation and recovery of a number of deferral accounts including, but not limited to, (i) costs associated with the Holyrood black start diesel units, (ii) $1.2 million in "extraordinary repairs", (iii) supply costs, (iv) external regulatory costs and (v) recovery of Hydro's stated 2014 revenue deficiency. With the exception of the 2014 revenue deficiency application, which Hydro is proposing to recover from the Rate Stabilization Plan's Hydraulic Variation Account, the revenue requirement impact of each of the proposed deferral accounts is summarized in Table 90 of the Grant Thornton Report.

(i) *Costs Associated with the Holyrood Black Start Diesel Units*

As stated in Hydro's Company Evidence[52] and confirmed during cross examination of the Finance Panel,[53] the 2015 test year includes $1.6 million for a five year amortization of the lease costs for the Holyrood black start diesel generating units installed by Hydro in July 2014. As demonstrated by Liberty,[54] such costs should not be recovered from rate payers. While Hydro may argue that the current plan is to continue to use the diesel generators for black start going forward thereby increasing the units' used and useful lifespan, Hydro based its decision to defer incurring the costs for onsite black start capacity at Holyrood partially on the fact that the new CT would fill this role. Hydro confirmed during cross

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[50] See also Undertaking 178 for another example of a more equitable apportionment of the Debt Guarantee Fee.
[51] See Report of Grant Thronton: Evaluating the Pricing Policy for Affiliate Common Services, Common Expenses and Corporate Expenses dated June 1, 2015, pp. 35-37.
[52] Hydro's Company Evidence for the GRA, Volume 1, p. 3.29.
[53] GRA Transcript November 18, pp. 188-189.
[54] Liberty's Initial Report pp. 48-56.

examination that the new CT would have been used for this purpose in the Winter of 2016 had the black start diesels not been in place.[55] As such, Vale submits that the current plan to continue to use the diesel units for black start at Holyrood is not relevant and all costs associated with the Holyrood black start diesel generating units should be removed from Hydro's revenue requirement.

(ii) *$1.2 Million in Extraordinary Repairs*

In the GRA, Hydro sought the deferral and recovery over five years of $1.2 million in preventive maintenance and repairs of transformers and air blast circuit breakers. As shown in Hydro's response to V-NLH-89 and discussed at length during the Prudency Review, these repairs were required because Hydro repeatedly failed to meet its own preventative maintenance schedules in the years prior to 2014. In Liberty's Initial Report, it found that Hydro's practice of repeatedly deferring preventative maintenance was imprudent.[56] Had these repairs not been imprudently deferred, they would have been completed between GRAs and, therefore, would not have been recoverable. Vale submits that rate payers should not be penalized by Hydro's decision to defer preventative maintenance work by the recovery of expenses that would not have been recoverable had they been prudently completed in a timely manner.

Even if the Board were to permit recovery of these amounts, in response to RFI V-NLH-89 Rev. 1, Hydro confirmed that it currently estimates the cost of these repairs to be $763,000. Therefore, any deferral account should be limited to this amount.

(iii) *Supply Costs*

In Board Order P.U. 56 (2014), the Board ordered deferral of unexpected capacity related costs incurred by Hydro in the first quarter of 2014. Hydro has proposed that, in addition to the recovery of its stated 2014 revenue deficiency, these supply costs be recovered over a five year period. As discussed in Vale's Submission on the Prudency Review, Liberty estimated that $2,189,110 of the $9,650,000 in supply costs actually incurred by Hydro were caused by Hydro's imprudent actions.[57] While Hydro has questioned Liberty's finding on prudence and its $2,189,110 calculation, Vale submits that Hydro's evidence failed to show that Liberty's findings were incorrect. Therefore, any recovery of 2014 supply costs should be limited to $7,460,890 [$9,650,000 - $2,189,110].

(iv) *External Regulatory Costs*

Hydro has requested a deferral and recovery over a three year period of Hydro's GRA costs. While Vale recognizes that Hydro should be entitled to recover internal and external costs associated with the GRA, it submits that it should not be entitled to full indemnification in the current GRA. The costs of this GRA were considerably increased as a result of Hydro's failure to file a GRA in the seven year period between 2006 and 2013. This inordinate delay between GRAs increased both the complexity and cost of this GRA. In addition, Hydro's

[55] Reference: Transcript November 5, 2015, page 99, lines 3-19.
[56] Liberty's Initial Report pp. 38-40.
[57] Liberty's Initial Report pp. 38-40.

decision to amend its GRA and change test years in July 2014 resulted in a significant amount of the time and expense incurred on the original GRA being wasted. Vale submits that any cost recovery awarded to Hydro should account for these factors.

(v) *2014 Revenue Deficiency*

Coincident with the GRA, Hydro is seeking recovery of its stated 2014 revenue deficiency. In P.U. 58 (2014), the Board approved the creation of a deferral account in the requested amount of $45.9 million but denied a request by Hydro that the stated deficiency be recovered on an interim basis from the balance in the Rate Stabilization Plan's Hydraulic Variance Account. In addition to recovery of the stated $45.9 million revenue deficiency, Hydro is seeking recovery of $10 million in 2014 supply costs discussed in subsection (iii) above.

In addition to seeking recovery of $55.9 million in 2014 revenue deficiency and supply costs, Hydro filed a 2015 Revenue Deficiency Application in which it is seeking to defer and recover $60.5 million in 2015 revenue deficiency for a total deferral and recovery of $116.4 million between 2014 and 2015. Hydro has also raised the possibility of filing a further cost deferral application for 2016 depending on the timing of the Board's Order in this GRA.[58] While Hydro has suggested recovering past deficiencies from existing Rate Stabilization Plan balances owing to customers, it has acknowledged that at least part of the amounts to be recovered may have to be recovered through an increase in future rates.[59] During cross examination, Hydro acknowledged that it had not completed an analysis of how recovery of past deficiencies will affect rates.[60]

It is important that the Board set a high threshold for Hydro to meet on this issue as the recovery of prior year revenue deficiencies from current or future customers creates the potential for inequity. If the Island Industrial Customer Class were to remain stable over time, this would not by an issue for Vale. However, the makeup of the Island Industrial Customer Class is changing radically over time with (a) Vale ramping up production in a manner that will make it Hydro's largest industrial customer within a short period of time and (b) to the best of Vale's knowledge, Teck Resources, which benefited from the rates that led to the deficiency, closing its operations in 2015. As such, if past deficiencies are recovered from future customers, there will inevitably be intergeneration inequity in that the changing dynamic within the Island Industrial Customer Group:

(i) will result in a customer [Vale] responsible for contributing only a small percentage to the accumulating deficiency repaying the largest percentage of that deficiency; and

(ii) could result in an industrial customer that benefited from the rates that created the deficiency ceasing operations before its portion of the deficiency is repaid through a rate rider.

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[58] GRA Transcript, November 19, pp 63 and 64.
[59] GRA Transcripts October 5, p 108 and November 19, pp 40 and 41.
[60] GRA Transcript November 19, pp 73-76.

At a minimum, Hydro should be required to establish that the recovery of past revenue deficiencies is consistent with sound electrical regulatory practice. As pointed out by Newfoundland Power in its November 30, 2015 Submission on Hydro's 2015 Cost Deferral Application dated November 12, 2015, Hydro has not provided any evidence that the recovery of past income deficiencies is consistent with generally accepted sound electrical regulatory practice. Newfoundland Power also points out that the requested relief is inconsistent with the principle that the effects of management decisions, such as the decision not to file a GRA in a timely manner, should be borne by the utility as opposed to the customers. An Order permitting the recovery of past deficiencies would also be inconsistent with the guidance provided by the Court of Appeal in *Newfoundland and Labrador Hydro vs. Newfoundland and Labrador (Board of Commissioners of Public Utilities)*[61] that the Board's powers are "regulative and corrective" and do not "contemplate a retroactive recovery of the actions of management."

If the Board finds that a recovery of a 2014 deficiency is appropriate to ensure the financial integrity of Hydro is maintained, Vale submits that the amount requested by Hydro is not reasonable. First, the 2014 revenue deficiency is calculated based on a return on equity of 8.8%, which is almost double Hydro's existing approved rate of return on equity of 4.465%.[62] Almost half of the 2014 revenue deficiency is a result of the increase in return on equity Hydro has used in its revenue deficiency calculation.[63] Hydro's position is that OC2009-063, which directed the Board "**for all future General Rate Applications**" to calculate Hydro's return on equity based on the same target most recently set for Newfoundland Power, entitles Hydro to a rate of return on equity of 8.8%. Vale submits that Hydro's Application to recover its stated 2014 revenue deficiency is brought coincident with its 2013 Amended General Rate Application but is not itself a general rate application. As the revenue deficiency Application is not a general rate application, Vale submits that OC2009-063 does not apply and any interim or final revenue deficiency recovery relief should be based on a return on equity of 4.465%.

That Hydro is not entitled to an 8.8% return on any recoverable 2014 (or 2015) deficiency was recognized by the Board in Order P.U. 39 (2014), wherein the Board stated:

> The Board agrees that Hydro is entitled to earn annually a just and reasonable return on its rate base, as provided for in section 80 of the Act, but notes that Hydro is not guaranteed to earn the established return. The rate of return is, where practicable, established by the Board on a prospective basis and Hydro must manage its business, working within the existing regulatory framework, so as to minimize the risks and maximize its opportunity for a just and reasonable return. The Newfoundland and Labrador Court of Appeal addressed this issue in Section 101 of the *Public Utilities* Act (Newfoundland) (Re) (1998), 164 Nfld. and P.E.I. R.60, stating at paragraph 31:
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>> [31] This leads to another point: because the setting of the rate of return is based on projections one cannot be sure that the rate of return will be achieved in practice. Although the utility is "entitled" by

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[61] [2012] NLCA 38, at para. 38.
[62] GRA RFI IC-NLH-002.
[63] References: RFI V-NLH-085 to V-NLH-087

> s. 80 of the Act to have the Board determine a just and reasonable rate of return based on appropriate predictive techniques and methodologies, it is not "entitled", in the sense of being guaranteed, to that rate of return... The utility therefore takes the risk that it's chosen management techniques and the future economic climate may not yield its expected success. Although some of the activities of the utility are regulated within the framework of the statutory objectives, the utility nevertheless remains subject to business risks and effects of management decisions. To that extent, the financial risks associated with the operation of the utility, just as in the case of any private business, are to be borne by the investors in the enterprise, not the customer of the service.[64]

Hydro's justification for including a target return on equity of 8.8% in the 2014 test year used to calculate Hydro's stated 2014 revenue deficiency is that such a return is required for Hydro to demonstrate that it is financially strong. However, Hydro has not provided sufficient evidence to support this proposition. As shown in Table 9 of the Grant Thornton Report, from 2010 to 2013, Hydro's return on equity fluctuated between 0.06% and 6.69%.[65] While Hydro's actual return on equity assuming a recovery of its 2014 test year costs would be 5.19%, Hydro's suggestion that this is not reasonable is contradicted by the fact that it did not take any steps to obtain a rate adjustment when its return was 2.03% in 2010.

In addition to including a return on equity of 8.8%, the 2014 test year also includes some costs that should not be recovered. In particular, Vale submits that costs caused or contributed to by the imprudent actions of Hydro should be removed from the 2014 test year revenue requirement. These costs are considered in detail in Vale's Prudency Review Submission filed contemporaneously with this submission.

Vale also submits that the $3.5 million included in the 2014 test year for GRA and Board related costs should not be fully recoverable. These costs, which include costs associated with the original GRA and the amended GRA,[66] were significantly increased because Hydro (i) did not file a GRA in 8 years and (ii) chose to amend its GRA shortly before the hearings in the original GRA which were scheduled to commence resulting in a significant delay and increased costs for all parties.

In addition to costs associated with Hydro's imprudent actions and the outage that resulted therefrom, Vale also submits that, for the reasons stated in the previous section, is the difference between the test year vacancy rate of 20 FTEs and the actual vacancy rate of 52 FTEs,[67] costs associated with the Holyrood CT, understatement of common services costs[68]

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[64] P.U. Order 39 (2014) at p. 9.

[65] Grant Thornton pp 22; See also p 3.17 of Hydro's Company Evidence and GRA Transcript November 19 p 50 for evidence and discussion on Hydro return on rate base between 2007 and 2013.

[66] GRA Transcript September 24, pp 23-26.

[67] See Undertaking 145. In its response to Undertaking 146, Hydro demonstrates that the decrease in salaries from the 2014 test year to 2014 actuals are less than the increase in overtime, contract labour and consultants seen from the 2014 test year to 2014 actuals. However, Hydro has not provided an analysis to demonstrate that there is a direct correlation between increased vacancies/lower salary costs and the

and the Debt Guarantee Fee[69] should also be removed from the 2014 test year costs. With respect to the costs associated with the Holyrood Combustion Turbine, as shown in Hydro's response to RFI NP-NLH-308, the 2014 test year includes $261,900 in amortization and $3,906,700 in return on rate base associated with the Holyrood CT. As the Holyrood CT was not installed until late January 2015 and has been removed from the 2015 revenue deficiency calculation, Vale submits that the inclusion of these amounts in the 2014 test year cannot be justified. Following the conclusion of the rate hearing, in answer to Undertaking 148, Hydro confirmed that the Holyrood CT is included in the 2014 test year rate base and acknowledged that it should be removed. Similarly, as noted in PUB-NLH-487 Rev 1 and Hydro's response to Undertaking 150, the 2014 test year should be reduced by $2.1 million on account of the difference between 2014 test year capital expenses and 2014 actuals capital expenses.

<u>Proposed Deferral Mechanisms</u>

In its GRA, Hydro seeks approval for the creation of three new deferral mechanisms: (i) an Energy Supply Cost Variance Deferral Account, (ii) a Holyrood Fuel Conversion Factor Deferral Account and (iii) an Isolated Systems Supply Cost Variance Deferral Account. As mechanism (iii) does not affect Vale, Vale's submissions will be limited to mechanisms (i) and (ii).

(i) *<u>Energy Supply Cost Variance Deferral Account</u>*

Hydro's proposed Energy Supply Costs Deferral Account would include both price and quantity variations from a number of supply sources on the Island Interconnected System. The supply sources covered by the proposed account include power purchases from the Exploits hydroelectric generation station, which is owned by Hydro's shareholder, and the Holyrood CT. The account would not include any costs within $500,000 of the test year costs and Hydro would be required to apply to the Board on an annual basis for the recovery of any balance in the account.

There was a significant amount of testimony at the GRA hearing regarding the appropriateness of deferral mechanisms that protect the utility from variances between actual and test year costs. While Hydro repeatedly denied that such mechanisms would alter the way in which it would conduct its operations, at a minimum, such costs have the potential to remove incentive for the utility to operate its business in the most efficient manner. By insulating the utility from changing conditions, these mechanisms also have the potential to increase the time between GRAs.

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increase in overtime, contractor labour and consultants. Further, as the answer to Undertaking 146 was provided after the end of the GRA hearing, the parties were unable to question Hydro on the data presented.

[68] In its answer to Undertaking 151, Hydro estimated ensuring that common service costs are fully burdened would reduce the test year revenue requirement by $105,820. See Report of Grant Thronton: Evaluating the Pricing Policy for Affiliate Common Services, Common Expenses and Corporate Expenses dated June 1, 2015, pp. 35-37.

[69] Amended GRA, November 24, 2014, page 3.32 lines 9-10 states that the 2015 Test Year debt guarantee fee is $4.4 million.

A further factor militating against the creation of additional deferral mechanisms outside of the Rate Stabilization Plan is that the Board has no ability to reflect the inclusion of such accounts in Hydro's target return on equity. As noted by J.W. Wilson and Associates Inc. in its June 1, 2015 report,[70] the fact that Hydro's target return on equity is now automatically set at Newfoundland Power's allowed equity return, a fact that will increase the test year revenue requirement by $23 million,[71] could result in a "double burden to customers" if this is combined with the creation of an Energy Supply Costs Deferral Account.

While Hydro has presented evidence in response to Undertakings 170 and 171 that the current wording of the deferral account protects customers, the provision of these calculations following the conclusion of the GRA makes it impossible for the parties to test them through cross examination or RFIs. As such, unless the Board establishes that Hydro has indubitably demonstrated that the current wording of the Energy Supply Costs Deferral Account protects customers in all potential scenarios, Vale submits that the Board should refuse Hydro's request for an Energy Supply Costs Deferral Account.

(ii) *Holyrood Fuel Conversion Factor Deferral Account*

In the GRA, Hydro is proposing that its 2005 test year rates be based on a Holyrood fuel conversion factor of 607 kWh per barrel and that the Board create a deferral account for any effects of Hydro failing to meet or exceeding this conversion factor. Hydro has taken the position that the $500,000 threshold proposed for the Energy Supply Costs Deferral Account is not appropriate for this mechanism as it has no control over supply costs.[72] While Hydro has some control over Holyrood efficiency, it takes the position that the creation of this account will not reduce its incentive to maximize efficiency at Holyrood.[73]

As discussed at length by Patrick Bowman of Inter-Group Consultants Ltd. in his June 4, 2015 report, the Holyrood fuel conversion factor may be significantly underestimated by Hydro.[74] During cross examination, Hydro's witnesses acknowledged that Mr. Bowman's analysis was thorough,[75] admitted that the new Holyrood CT will increase the efficiency at Holyrood, admitted that an analysis of the CTs effects had not been completed[76] and admitted that the test year factor does not account for the upgrade to the Holyrood fan motors.[77]

Given the uncertainty of the accuracy of the Holyrood Fuel Conversion Factor, Vale supports the creation of the Holyrood Fuel Conversion Factor Deferral Account.

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[70] At pp. 38 and 39.
[71] PUB-NLH-56 Rev 1, line 22.
[72] See IC-NLH-179.
[73] See NP-NLH-332
[74] At pp. 22-25.
[75] GRA Transcript October 21, p 99; for a discussion of Patrick Bowman's evidence with Hydro's witnesses, see GRA Transcript October 21, pp 98-130.
[76] GRA Transcript October 20, pp 173 and 174 and October 21, pp 103 and 104.
[77] GRA Transcript October 21, 118–121.

Costs

Vale requests that the Board award Vale its costs on both the Original GRA and the Amended GRA on the same basis as any award of costs is made in favor of the Consumer Advocate and/or the Industrial Customer Group. Vale submits that an award of costs in its favor is justified based on the fact that:

1. Vale's energy consumption is steadily increasing with time and, when Vale's Long Harbour processing facility completes production ramp-up, it will be the single largest industrial customer of Hydro. As such, Vale had a significant interest in participating in the within Application; and

2. Vale's interests in the within Application are discreet from the interests of the Industrial Customer Group. In particular, Vale and all members of the Industrial Customer group may not be aligned on the manner of recovering past deficiencies through future rate riders or the calculation of specifically assigned charges.

The within Application was made unnecessarily lengthy and complex because of delays in the general rate application process as Hydro elected to allow seven years between GRAs and amended its rate case one month before the hearing on the Original GRA was scheduled to commence. Further, the filing of answers to Undertakings and revised RFIs containing material information on GRA issues more than two weeks after the conclusion of the hearing has increased the time and cost associated with preparing these submissions. For these reasons, Vale submits that all or a significant percentage of its costs of the within Application should be borne by Hydro and should not be passed on to Hydro's customers.

DATED at St. John's, in the Province of Newfoundland and Labrador, this 21st day of December, 2015.

COX & PALMER

Per: ______________________
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