

July 11, 2014

Ms. G. Cheryl Blundon
Board of Commissioners of Public Utilities
120 Torbay Road, P.O. Box 12040
St. John's, NL A1A 5B2

Dear Ms. Blundon:

Re: Second Application by Newfoundland and Labrador Hydro pursuant to Sections 70 and 75 of the Public Utilities Act for the interim approval of customer electricity rates for 2014 pursuant to Order No. P.U. 13 (2014)

On May 12, 2014 Hydro submitted an Application to the Board requesting interim rates to: i) clearly demonstrate Hydro's requirement for additional revenue in 2014; and ii) provide a proposal for additional revenue in 2014 which balances the objectives of reasonable cost recovery and customer impacts. The evidence also addresses the requirement to phase-in cost based IC rates in accordance with Government directives. Specifically, Hydro is requesting that the Board make an Interim Order pursuant to Section 75 of the Act approving on an interim basis:

- i) A transfer of \$29.4 million from the \$68.6 million credit balance in the Hydraulic Production Variation component of the Rate Stabilization Plan (as of March 31, 2014) to be recognized as revenue by Hydro in 2014 to provide an opportunity to earn a reasonable return on rate base in 2014;
- ii) Approval of an Industrial Customer fuel rider of 1.490 cents/kWh effective January 1, 2014 in accordance with existing RSP rules;
- iii) Approval of a recovery adjustment rider of 0.168 cents/kWh effective July 1, 2014 for disposition of the Industrial Customer Current Plan RSP balance at December 31, 2013;
- iv) Revised RSP rules effective January 1, 2014 to permit the use of the Industrial Customer RSP surplus to permit the phase-in of Island Industrial Customer rates; and
- v) The phase-in of Island Industrial Customer rates as provided in the Schedules 2, 3 and 4 to the Application.

To summarize, in the Second Interim Rates Application Hydro is requesting on an interim basis:

- 1) The opportunity to earn a return on rate base in 2014 that is closer to that directed by Government; and
- 2) Implement IC rates in a manner that achieves the result contemplated in Government directives.

Since the Second Interim Rates Application was submitted, Hydro has advised (on June 6, 2014) that it will be filing an amended GRA in the fall, so a Board decision on the GRA will not be available prior to year-end 2014. This has resulted in a change in the Consumer Advocate's position and recommendations with respect to Hydro's interim rates applications, as described below.

A. The Opportunity to Earn a Return in 2014 Closer to that Directed by Government

As explained in the Application, Hydro's financial position has deteriorated significantly. Hydro now forecasts a shortfall in net income under existing rates relative to rates proposed in the 2013 GRA of approximately \$29.4 million, excluding about \$10 million in additional supply costs incurred in the first quarter of 2014 (page 4 of Second Interim Rates Application Evidence). On page 2 of the Second Interim Rates Application Evidence, Hydro indicates that it forecasts a return on equity under existing rates of 1.1% for 2014. Again, this does not include additional costs arising in the first quarter of 2014, or additional costs deriving from the Board's recommendations relating to the Outage Inquiry. The outages during the past two winters have resulted in severe hardship for the electricity consumers of this Province. The Consumer Advocate supports implementation of the recommendations deriving from the Board's Inquiry into the power outages, and is concerned that in the absence of rate relief, Hydro will cut services to improve its financial position, resulting in a further deterioration in service.

In light of the significantly deteriorated nature of Hydro's financial position, the Consumer Advocate supports Hydro's application for interim rate relief provided there is a full prudence review of 2014 costs during Hydro's amended GRA Application, and rates are adjusted accordingly. Hydro has stated that the actual net income shortfall for 2014 will be determined based upon the Board's testing of Hydro's 2014 test year revenue requirement following the submission of the amended application in the fall of 2014. While, as NP has stated in SIR-NLH-NP-005, the evidence provided in the Second Interim Rate Application "does not indicate *why* the 2014 forecast return on equity of 1.1% deviates from the return approved by the Board in Order No. P.U. 8 (2007). . ." in the view of the Consumer Advocate to insist upon a full record at this stage in order to pinpoint the reasons for or the precise size of the alleged revenue shortfall before entertaining an interim relief application is not necessary so long as the relief ordered is interim pending a full 2014 revenue requirement review. It is the subsequent process to test the legitimacy, reasonableness and prudence of 2014 test year costs that is the regulatory regime's protection mechanism – one that allows for retrospective adjustments to any relief granted on an interim basis

The Consumer Advocate points out that the \$29.4 million proposed transfer figure is based on a target return on equity the same as that set for NP (consistent with OC2009-063). As stated by the Consumer Advocate in the previous Interim Rates Application, a Government Order in Council even though legally binding does not necessarily reflect what constitutes a fair return. The process that determines what is a just and reasonable return is a full review by the Board of evidence filed by all stakeholders under a GRA. The Order-in-Council does not state that Hydro must earn the same target return as NP in the 2014 calendar year or any specific year for that matter as witnessed by the fact that Hydro did not file an application for the higher return in 2009, 2010, 2011, 2012 or 2013 following issuance of OC2009-063. Therefore, the Consumer Advocate supports interim rates relief, but recommends that the transfer amount from the hydraulic balance of the RSP be equivalent to that resulting in the return on equity last approved by the Board at the 2006 GRA; i.e., 4.47% (Board Order P.U. 8(2007)). The Board can, if it finds it reasonable to do so, issue an Order following a full review of the issues in the amended GRA that allows Hydro to earn a return in 2014 that is closer to that directed by Government.

The Consumer Advocate supports the Board's approval on an interim basis of a portion of the RSP credit balance. These are monies that represent an amount due to customers from Hydro. The Consumer Advocate agrees with Mr. Brockman's view (SIR NLH-NP-009) that to use the RSP Hydraulic component credit balance to reduce the amount of shortfall for 2014 that would otherwise be recovered in future rates is preferable to increasing future rates to recover the shortfall.

Finally, the Consumer Advocate notes that Newfoundland Power in its reply to SIR-NLH-NP-006 has stated that there is no provision which governs interim orders approving transfers for deferral accounts. Newfoundland Power also suggests that if Hydro did not file an amended general rate application until 2015, the transfer may for all practical purposes be final. The Consumer Advocate submits that the Court of Appeal's 2012 decision evidences that this Board's power and authority is not so limited as Newfoundland Power appears to suggest. The Consumer Advocate refers to paragraphs 60-65, 116-121 and 128-136 of the Court's judgment as authority for the Board's jurisdiction and power to be able to make an interim

disposition of a portion of the RSP balance. The RSP is a rate making tool. Furthermore, even were Hydro delayed in filing an amended general rate application until 2015 or later, that would not detract from the fact that the Board's order approving a disposition was expressly interim and the Board could therefore subsequently order a transfer into the deferral account for rate setting purposes for the benefit of customers.

B. The Need to Implement IC Rates Consistent with Government Directives

The Consumer Advocate takes no exception to Hydro's proposal with respect to IC rates. It is very important that IC rates be increased to the full cost of service as quickly as possible to eliminate the cross-subsidy that has been provided to the ICs by other customers on the system since 2008. Therefore, the Consumer Advocate supports Hydro's application relating to IC rates provided there is a full review of the costs during the amended GRA to ensure ICs pay the full cost of power by September 1, 2015 as directed in OC2013-089.

C. Recommendation

In conclusion, the Consumer Advocate recommends that the Board approve Hydro's Second Interim Rates Application subject to the conditions identified above.

Please feel free to contact the undersigned if you have any questions.

Yours very truly,



D'DEA, EARLE

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