Office of the Consumer Advocate

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July 17, 2026

Via Email

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

Attention: Mike McNiven (Board Secretary)

Re: Newfoundland and Labrador Hydro - Application for Approval of a Deferral Account for an Allowance for Funds Used During Construction ("AFUDC") – Consumer Advocate Comments

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Please find enclosed the Consumer Advocate's comments on the above noted matter.

Should you have any questions, please contact the undersigned.

Yours truly,

CONSUMER ADVOCATE

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July 17, 2026

The Board of Commissioners of Public Utilities
Prince Charles Building
120 Torbay Road, P.O. Box 21040
St. John's, NL
A1A 5B2 Canada

Attention: Mike McNiven, Board Secretary

Dear Mr. McNiven:

Re: Newfoundland and Labrador Hydro - Application for Approval of a Deferral Account for an Allowance for Funds Used During Construction ("AFUDC") – Consumer Advocate Comments

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On April 14, 2026 Newfoundland and Labrador Hydro ("Hydro") submitted to the Public Utilities Board (the "Board") an Application for Approval of a Deferral Account for an Allowance for Funds Used During Construction (the "Application"). In a letter dated July 8, 2026, the Board requested comments from the parties on the Application by July 17, 2026. This document conveys the comments on the Consumer Advocate.

Summary of Hydro AFUDC Application

Hydro indicates that (Application, para. 7) it currently uses the IFRS methodology for capitalization of borrowing costs, and that this methodology is "*inconsistent with established principles of financial economics and the regulatory principle known as the Fair Return Standard*." Hydro submits that it is appropriate (Application, para. 9):

> *…to capitalize borrowing costs based on its allowed rate of return. Hydro proposes to calculate the capitalization of borrowing costs using the AFUDC methodology which capitalizes directly attributable borrowing costs during asset construction using Hydro's allowed rate of return. This approach will align Hydro more accurately with accepted regulatory treatment of capital borrowing costs." Hydro goes on to say (Application, para. 10) "To facilitate this, Hydro proposes the creation of a new deferral account called the AFUDC Deferral Account, effective January 1, 2026" and "Any variances between the calculation of AFUDC and IDC, which will continue to be used for IFRS reporting purposes, will be captured in the AFUDC Deferral Account on a monthly basis.*

Additionally, Christensen Associates (Application, Schedule 1, Appendix A, p.12 of 14) concluded that its survey of utilities found that "*AFUDC is the most commonly used method for recovering financing costs among respondents*". This survey included 17 electric and gas utilities (6 of which were crown-owned), of which 10 responded (5 of which were crown-owned).

Hydro requests that the Board approve (Application, para. 13):

(i) The proposed AFUDC Deferral Account; and
(ii) Hydro's amortization of the balance in the AFUDC Deferral Account using the composite depreciation rate derived from the most recent depreciation study accepted by the Board, commencing in the year after the variance transfers to the AFUDC Deferral Account.

Hydro was asked (CA-NLH-001) to provide the reasons for submitting this application separately from the 2026 GRA and to explain how this approach supports regulatory efficiency. Hydro responded that it

> *submitted this application separately from the 2026 General Rate Application ("GRA") as Hydro is proposing the deferral account be effective January 1, 2026, given the growing difference between the calculation of allowance for funds used during construction and interest during construction beginning in 2026. Hydro requires approval of the deferral account prior to December 31, 2026 to facilitate the deferral of the 2026 balance; however, Hydro's 2026 GRA proceeding is not expected to conclude prior to this date. Filing this application separately from the GRA allows for timely approval and also reduces the scope and breadth of the GRA.*

The Consumer Advocate's comments on the Application and ultimate recommendation to the Board are provided below.

There is No Material Deleterious Financial Impact on Hydro for 2026 in Absence of AFUDC

The introduction of the proposed AFUDC deferral account to be effective retroactive to January 1, 2026 does not appear to be of great impact or urgency to Hydro. The evidence on the record of this proceeding does not demonstrate a material deleterious financial impact on Hydro for 2026 if the AFUDC deferral account was considered by the Board as part of the 2026 GRA proceeding. The impact on Hydro's net income in 2026 would be $2.1 million and equity would be only 0.3% (PUB-NLH-007, Table 1).

Return on Equity for a Crown-Owned Utility is a Phantom Cost

Despite Hydro's arguments on the entitlement to a return on equity (ROE) for Hydro, crown-owned public utilities do no issue equity shares to investors at large to fund construction work in progress for major capital projects. Rather, the equity in crown-owned public utilities is a mix of government contributions and retained earnings which have been funded by ratepayers over time. Hydro's $8.1 billion of equity at December 31, 2025 (Note 22 to Hydro's Consolidated Financial Statements at December 31, 2025) is a mix of $5.0 billion of government share capital/contributions and $3.1 billion of retained earnings/reserves. In Hydro's case, the Government of Newfoundland and Labrador ("Government") issues debt in the financial markets on Hydro's behalf and then loans these funds to Hydro on cost recovery basis, in order to fund its capital program and operations. As such, a return on equity (ROE) for Hydro is a phantom cost and the requirement for AFUDC deferral account for Hydro to earn a ROE is questionable.

The Use of AFUDC in Canadian Crown-Owned Utilities is Far from Universal

Despite the fact that Hydro's rationale for introducing an AFUDC Deferral Account includes industry research, the adoption of the AFUDC approach is not universal. The most relevant comparators to Hydro are other crown-owned public utilities. The survey by Christensen Associates indicates that Hydro-Quebec, NB Power and NS Power use AFUDC and that BC Hydro and Sask Power use interest during construction (IDC). Manitoba Hydro did not respond to the survey. However, a review of its material accounting policies in its most recent annual report (Notes 3 (a) and 3 (g) of its March 31, 2025 audited financial statements) indicates that Manitoba Hydro does not have an approved regulatory deferral account for AFUDC and that it applies interest at the weighted average cost of debt outstanding to construction work in progress (an IDC approach). As such, for the most relevant crown-owned comparators to Hydro, three use AFUDC and three use IDC. This industry research does not provide solid support for an AFUDC deferral account for Hydro.

Questionable Consistency of AFUDC and Government Directives in the Rate Management Plan

The questionable consistency of Hydro's request for an AFUDC deferral account and Government directives inherent in the Rate Management Plan is another significant concern. Hydro's request for approval of an AFUDC deferral account is premised on the theoretical argument that its shareholder is entitled to a ROE on its equity tied up in construction work in progress related to major capital projects. However, at the same time that Hydro makes this argument on behalf of its shareholder, that same shareholder (Government) has directed a 2.25% rate cap until 2030 and that the funds for the Rate Management Plan are to be sourced from Hydro's own sources. It appears that the Government directives that underpin the Rate Management Plan effectively suspend the very same ROE that Hydro is arguing the Government is entitled to, and which underpin the AFUDC deferral account Application. Hydro has confirmed that its ROE for 2026 would be less than 3.1% (compared to an approved ROE of 8.6%) in absence of the AFUDC deferral account (NP-NLH-001, footnote 1) and Christen Associates admits (PUB-NLH-009 (b)) that *"it is possible that, given the current rate mitigation framework, the Government of Newfoundland and Labrador may continue to bear risk without full compensation."* A Hydro request for an AFUDC deferral account in these circumstances appears to be inherently counterintuitive and contradictory.

The IASB has Recently Issued a Permanent Accounting Standard Related to Regulatory Accounting

On May 27, 2026, the International Accounting Standards Board (IASB) issued IFRS 20 - Regulatory Assets & Regulatory Liabilities as a permanent standard to replace the temporary regulatory accounting standard, IFRS 14 – Regulatory Deferral Accounts, which was issued back in January of 2014. IFRS 20 has an effective date of January 1, 2029, with earlier adoption permitted. The full implications of IFRS 20 are not known at this time, given its recent release date. However, IFRS 20 mandates a significant change as compared to IFRS 14 in that regulatory assets and liabilities will now have to be measured based on expected cash flows that are discounted at a regulatory interest rate. It would not be beneficial for the Board to approve any additional regulatory deferral accounts in advance of understanding the implications of IFRS 20 as part of the Hydro 2026 GRA.

The Proposed AFUDC Deferral Account is Best Reviewed as Part of the Hydro 2026 GRA

The Hydro request for Board approval of an AFUDC deferral account is based on theorical arguments and utility industry research with questionable relevance to the actual circumstances of Hydro.

There are a number of compelling reasons outlined above, such that the Consumer Advocate believes that the AFUDC Application is best reviewed as part of the Hydro 2026 GRA. This recommended approach will improve regulatory effectiveness and efficiency by enabling a wholistic assessment of the Application in conjunction with consideration of the Rate Management Plan, the numerous other deferral accounts (about a dozen) for which Hydro is requesting approvals in the 2026 GRA and recent IASB pronouncements with respect to regulatory accounting.

The Consumer Advocate therefore requests that the Board reject the Application and order a full review of the proposed AFUDC deferral account as part of the 2026 GRA.

Please contact the undersigned if you have any questions relating to this submission.

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