newfoundland labrador hydro

Newfoundland and Labrador Hydro
Hydro Place. 500 Columbus Drive
P.O. Box 12400. St. John's. NL
Canada A1B 4K7
t. 709.737.1400 | f. 709.737.1800
nlhydro.com

July 23, 2026

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

Attention: Mike McNiven
Senior Regulatory Advisor & Board Secretary

Re: Application for Approval of a Deferral Account for an Allowance for Funds Used During Construction – Hydro's Reply

On April 14, 2026, Newfoundland and Labrador Hydro ("Hydro") filed an application with the Board of Commissioners of Public Utilities ("Board") requesting approval of a deferral account for an allowance for funds used during construction ("AFUDC"). The Application addresses Hydro's proposal to capitalize financing costs directly attributable to eligible capital construction projects using an AFUDC approach, which recognizes a return on both debt and equity, in place of Hydro's current Interest During Construction ("IDC") approach, which recognizes debt only. To implement the AFUDC approach under International Financial Reporting Standards ("IFRS"), Hydro requests approval of an AFUDC Deferral Account, effective January 1, 2026, to capture the monthly variance between AFUDC and IDC, with amortization of the deferred amounts to commence the year following the variance transfer to the deferral account.

The Board established a review schedule for the application that provided for the filing of Requests for Information ("RFIs") by the parties. Hydro responded to RFIs issued by the Board, Newfoundland Power Inc. ("Newfoundland Power"), and the Consumer Advocate, with all responses filed with the Board on July 6, 2026. The Island Industrial Customer ("IIC") Group did not file RFIs. An extension was granted for the parties to file their submissions on the application; Newfoundland Power, the Consumer Advocate, and the IIC Group filed their comments on July 17, 2026.

Party Comments

Newfoundland Power

Newfoundland Power advised that it does not object to the Application. Newfoundland Power expressed the view that the Application is generally consistent with section 80 of the *Public Utilities Act*, prior orders of the Board, and Canadian regulatory practice. Newfoundland Power did not propose any alternative treatment or additional conditions.

Consumer Advocate

The Consumer Advocate opposed the Application and raised the following concerns:

(i) There is no material deleterious financial impact on Hydro for 2026 in the absence of the AFUDC deferral account, as the impact on equity would be approximately $2.1 million, or approximately 0.3%;

(ii) A return on equity for a crown-owned utility is a "phantom cost" because such utilities do not issue equity to investors to fund construction work in progress;

(iii) The use of AFUDC among Canadian crown-owned utilities is far from universal;

(iv) Hydro's request is of questionable consistency with the Government directives underlying the Rate Management Plan, including the 2.25% rate cap to 2030; and

(v) The recent issuance of IFRS 20 – Regulatory Assets and Regulatory Liabilities counsels caution before approving any new deferral accounts.

On this basis, the Consumer Advocate requested that the Board reject the Application and instead order a full review of the proposed AFUDC deferral account as part of Hydro's 2026 General Rate Application ("2026 GRA").

Island Industrial Customer Group

The IIC Group advised that it had reviewed the Consumer Advocate's submission and takes the position that the submission raises sufficient questions about the proposed AFUDC deferral account to justify deferral of the issue to Hydro's general rate application.

No comments were received from any other parties.

Hydro's Reply

Hydro has reviewed the submissions of the parties and replies as follows.

Consumer Advocate

<u>No Material Deleterious Financial Impact</u>

The modest nature of the 2026 financial impact shown in Table 1 of Hydro's response to PUB-NLH-007 does not diminish the importance of adopting the correct regulatory accounting treatment. Further, the variance between AFUDC and IDC is cumulative and escalates from approximately $2.1 million (0.3%) in 2026 to approximately $38.7 million (3.4%) by 2032. It was precisely to prevent this ongoing erosion of equity during the construction of eligible capital projects that prompted Hydro to seek an effective date of January 1, 2026.[1] Deferring the matter would allow the variance to continue to compound without the corrective treatment in place. Additionally, the fact that the AFUDC treatment is forecast to improve Hydro's 2026 return on equity by approximately 29 basis points, or roughly 10%, simply confirms that the current IDC approach understates Hydro's cost of capital and depresses its return below the approved level. That corrective effect is precisely what the AFUDC treatment is intended to achieve and is a reason to approve the Application, not to defer it.

<u>Return on Equity is Not a Phantom Cost</u>

Contrary to the Consumer Advocate's submission, Hydro's regulated return on equity is not a phantom cost. Hydro's regulated equity at December 31, 2025 was $686.6 million, including a $100 million equity

[1] Please see Hydro's response to NP-NLH-001.

injection by the Newfoundland and Labrador Government ("Government") as its sole shareholder. Hydro's entitlement to earn a return on equity, equivalent to that of Newfoundland Power, is directed by Order in Council OC2009-063, and Hydro's approved Return on Equity of 8.60% has been approved in Board Order No. P.U. 10(2025) pursuant to that direction.

The Use of AFUDC is Well Established in Canadian Regulatory Practice

The AFUDC approach recognizes the full cost of capital and is well established in Canadian regulatory practice, including within this province, where Newfoundland Power recovers capital financing costs using AFUDC calculated on its rate of return on average rate base.[2] As the Consumer Advocate recognized, Hydro-Quebec, New Brunswick Power, and Nova Scotia Power also use AFUDC. The applicability of AFUDC was also reviewed in Hydro's Review of Capitalization Policies and Guidelines that was submitted on August 14, 2020, and referenced in the evidence to this Application. The capitalization of borrowing costs is one of the differences between accounting and regulatory capitalization highlighted in the JT Browne Consulting report included with that Review. The JT Browne Consulting report noted that the allowed return on rate base that would be avoidable without the capital projects in aggregate should be capitalized and that this return recognizes both debt and equity.
Prior to adopting IFRS, Hydro capitalized borrowing costs directly attributable to capital construction projects with a substantial duration based on its allowed rate of return or AFUDC. In this province, Newfoundland Power reports under US GAAP and uses AFUDC to recover capital financing costs calculated using the rate of return on average rate base.

Consistency with the Rate Management Plan

The policies adopted for regulated Hydro are separate from rate mitigation funding, which is provided from Hydro's other non-regulated lines of business. In this Application, Hydro proposes regulatory accounting policies that best align with current practice, including within this province, independent of rate mitigation.

IFRS 20 Does Not Warrant Delay

While the International Accounting Standards Board issued IFRS 20 – Regulatory Assets and Regulatory Liabilities in May 2026, the Accounting Standards Board of Canada has not yet issued the standard. Hydro expects to adopt IFRS 20 effective January 1, 2029, and will continue to apply the interim IFRS 14 – Regulatory Deferral Accounts until then. Given the Accounting Standards Board of Canada has not yet issued the standard it is unlikely a complete assessment of the impacts of the standard will be complete to fully understand the impact on Hydro in the 2026 GRA. In Hydro's view, there should be no delay in approving deferral accounts on account of a future accounting standard where an existing regulatory deferral standard exists under IFRS.

Conclusion

Hydro submits that the Application is consistent with section 80 of the *Public Utilities Act*, prior orders of the Board, and established regulatory practice, and that the concerns raised by the Consumer Advocate and the IIC Group do not provide a sufficient basis to reject the Application or to defer its consideration to the 2026 GRA.

Accordingly, Hydro respectfully requests that the Application be approved as submitted.

[2] Please see Hydro's response to PUB-NLH-010.

Should you have any questions, please contact the undersigned.

Yours truly,

NEWFOUNDLAND AND LABRADOR HYDRO

Shirley A. Walsh
Senior Legal Counsel, Regulatory
SAW/mc

Encl.

ecc:

Board of Commissioners of Public Utilities
Jacqui H. Glynn
Ryan Oake
Board General

Consumer Advocate
Adrienne H.Y. Ding, O'Dea Earle
Justin W. King, O'Dea Earle
Consumer Advocate General

Linde Canada Inc.
Sheryl E. Nisenbaum
Tina Lahey

Newfoundland Power Inc.
Dominic J. Foley
Douglas W. Wright
Regulatory Email

Teck Resources Limited
Darren Hennessey

Island Industrial Customer Group
Paul L. Coxworthy, Stewart McKelvey
Denis J. Fleming, Cox & Palmer
Glen G. Seaborn, Poole Althouse