

1 Q. **Reference: Volume 1, pages 5.27 and 5.28**

2 Hydro states (pages 5.27, lines 10 to 27 and 5.28, lines 1 to 12) "...the Board ordered that the
3 calculation of financing charges on the existing Supply Cost Variance Deferral Account be
4 calculated based on Hydro's short-term borrowing costs...Hydro's proposal is for the Long-Term
5 Supply Cost Variance Deferral Account to come into effect on January 1, 2027. This account will
6 continue to capture variances between Hydro's incurred supply costs and those included in
7 Hydro's most recently approved test year; however, these variances and the resulting balance in
8 this account are expected to be much lower in comparison to the existing Supply Cost Variance
9 Deferral Account as project costs and rate mitigation funding will be included in Hydro's cost of
10 service and test year revenues, prior to this account becoming effective...balances are not
11 expected to be material and fast-growing...For these reasons, this long-term approach...differs
12 from the existing...Hydro is proposing...using the weighted average cost of capital as approved in
13 Hydro's test year."

14 a) Provided a detailed explanation of why Hydro expects that the balances in the Long-Term
15 SCVDA will be much lower and not as fast as growing when compared to the existing SCVDA,
16 considering that the forecast unrecovered balance at December 31, 2027 appears to be in
17 excess of \$1.75 billion (Schedule D-V) and the annual difference between Muskrat Falls costs (in
18 the order of \$780 million) and rate mitigation (in the order of \$500 million) are in the order of
19 \$280 million per year.

20 b) Confirm (or explain otherwise) that charging financing costs at the proposed weighted average
21 cost of capital instead of at the approved short-term borrowing rate will increase the balance
22 outstanding in the Long-Term SCVDA.

23 c) Provide a calculation of the forecast carrying costs for the Long-Term SCVDA by year from the
24 2027 Test Year to the 2030 Forecast for (i) the weighted average cost of capital, (ii) the short-
25 term borrowing rate and (iii) cumulative difference between (i) and (ii) from the 2027 Test Year
26 to the 2030 Forecast. Exhibit 2 – Review of

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- 1 **A.** **a)** Balances in the Long-Term Supply Cost Variance Deferral Account ("SCVDA") will be lower
2 compared to the existing SCVDA since the existing SCVDA includes variances in actual costs
3 and revenues from the 2019 Test Year. The 2019 Test Year did not include Muskrat Falls
4 Project costs or rate mitigation funding; therefore, the full costs and revenues are being
5 recorded in the SCVDA currently. In the 2027 Test Year, Muskrat Falls Project costs and rate
6 mitigation funding balances are included, and therefore only the variances between
7 Newfoundland and Labrador Hydro's ("Hydro") incurred costs and revenues and those
8 approved in the test year will be recorded in the SCVDA, with the remaining being recorded
9 in the income statement, which will result in less costs being recorded in the Long-Term
10 SCVDA, compared to the existing SCVDA. The \$1.75 billion ending deferral balance
11 referenced in Schedule D-V of Hydro's 2026 General Rate Application ("GRA") is the Power
12 Purchase Expense Recognition Deferral, which is a separate deferral from the SCVDA. The
13 SCVDA is not included in Schedule D-V since it is not included in the rate base.
- 14 **b)** The financing charges recorded in the proposed Long-Term SCVDA are based on Hydro's
15 approved weighted average cost of capital ("WACC"), rather than its short-term borrowing
16 cost. As a result, for a given deferral account balance, financing charges would be higher
17 when the approved WACC exceeds Hydro's short-term borrowing rate and lower when the
18 approved WACC is below the short-term borrowing rate. The impact of using WACC in
19 comparison to short-term borrowing costs also depends on whether the account is in an
20 asset or liability position. Assuming the Long-Term SCVDA is in an asset position, and WACC
21 exceeds short-term borrowing costs, the higher financing charges would increase the
22 outstanding account balance relative to a short-term borrowing cost approach. However, if
23 the Long-Term SCVDA were to move to a liability position and WACC exceeds short-term
24 borrowing costs, the higher financing credit would increase the amount owing to customers
25 relative to a short-term borrowing cost approach.
- 26 **c)** Exhibit 13 of Hydro's 2026 GRA provides an example where variances in the account are
27 approximately \$45.8 million due from customers, a balance which Hydro estimates is a
28 reasonable expectation for the balance in the Long-Term SCVDA in a given year, assuming
29 approval of Hydro's 2027 Test Year as proposed. Using this example as a proxy, and
30 assuming that the balance was outstanding for a full year, Hydro's proposed WACC of 4.88%

1 produces a financing charge of approximately \$2.2 million.¹ Hydro's short-term borrowing
2 rate as of December 31, 2025 applied to its existing SCVDA was 3.35%, which produces an
3 estimated financing charge of approximately \$1.5 million.²

4 It is important to note that the \$45.8 million illustrated in Exhibit 13 represents the assumed
5 year-end balance of the account. In practice, the balance would be expected to accumulate
6 gradually throughout the year rather than remain outstanding at that level for the entire
7 period. For the purpose of this illustrative example, however, it is assumed that the full
8 \$45.8 million balance was outstanding for the entire year. Because interest on the account is
9 calculated and applied monthly, the actual financing costs associated with a balance that
10 accumulates progressively over the year would be expected to be lower than those shown
11 in this example, all else being equal.

12 As Hydro noted in its response to part a) of LAB-NLH-024 of this proceeding, although the
13 short-term borrowing rate is currently lower than Hydro's WACC, short-term interest rates
14 can vary and may not always be lower than Hydro's WACC. For instance, in 2023, the
15 interest rate applied to Hydro's existing SCVDA, based on its short-term borrowing rate, was
16 5.72%, which was higher than the approved WACC of 5.43%.

¹ \$45.8 million × 4.88%.

² \$45.8 million × 3.35%.