

1 **Q. Reference: Responses to CA-NLH-099 and PUB-NLH-095**

2 **a)** In response to CA-NLH-099, Hydro stated that it earns a return on the Muskrat Falls and
3 Labrador Transmission Assets sustaining capital costs that have been included in rate
4 base pursuant to Board Order No. P.U. 33(2021). Confirm that the Board did not
5 approve inclusion of deferral account in rate base and clarify whether or not Hydro has
6 earned a return on rate base since this account was approved in Order No. P.U.
7 33(2021).

8 **b)** Both the Board and the Consumer Advocate requested confirmation on whether Hydro
9 will be earning a return on the Muskrat Falls Sustaining Capital Deferral Account, which
10 represents capital work on assets that are not under the Board's jurisdiction. Explain
11 Hydro's rationale for deciding that it is appropriate for Hydro to be earning a return on
12 these assets when Hydro Regulated has limited control over the approval of the
13 sustaining capital relating to Muskrat Falls and the Labrador Transmission assets.

14 **c)** Has Hydro considered whether a carrying charge would be appropriate for this deferral
15 account instead of including it in rate base? Explain why or why not.

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18 **A. a)** Newfoundland and Labrador Hydro ("Hydro") has not earned a return on the Muskrat Falls
19 Power Purchase Agreement ("PPA") Sustaining Capital Deferral Account since the approval
20 of the account in 2021. Hydro's response to CA-NLH-099 should have read that Hydro is
21 proposing to include the deferral account in rate base in its 2027 Test Year as part of its
22 2026 General Rate Application ("GRA").¹

23 **b)** Hydro's rationale for including the Muskrat Falls Sustaining Capital Deferral Account in rate
24 base is not based on Hydro Regulated's authority to approve individual sustaining capital

¹ As Hydro noted in its response to PUB-NLH-100 of this proceeding, where an approved deferral account has not previously been included in rate base, but Hydro includes the balance in the proposed rate base in a subsequent GRA, Hydro considers that the inclusion of the balance in the proposed rate base constitutes a request for the Board to approve its inclusion in rate base as part of that proceeding.

1 projects. Rather, it reflects the fact that Hydro is contractually obligated to fund its share of
2 sustaining capital expenditures as those expenditures are incurred, together with the
3 regulatory treatment approved by the Board of Commissioners of Public Utilities (“Board”)
4 that defers recovery of those amounts from customers over time.

5 The purpose of the Muskrat Falls Sustaining Capital Deferral Account is to align the recovery
6 of sustaining capital contributions with the period over which customers benefit from the
7 underlying investments. In Order No. P.U. 33(2021), the Board recognized that recovering
8 the full amount of sustaining capital contributions as they are incurred would not match the
9 timing of the benefits provided and could result in rate volatility. The Board therefore
10 approved the deferral account to permit the sustaining capital contributions to be recovered
11 from customers over time, with the approach to recovery to be determined in the next
12 general rate application.

13 The approved deferral treatment means that Hydro Regulated funds the required
14 contributions when they are incurred but does not recover the corresponding amounts from
15 customers until a later period.

16 As a result, Hydro carries an unrecovered balance during the period between funding the
17 contributions and recovering them through rates. Including the unamortized balance in rate
18 base recognizes the financing cost associated with that timing difference.

19 Hydro does not consider the level of control it exercises over the approval of individual
20 sustaining capital projects to be determinative of whether a return should apply to the
21 unrecovered balance. The relevant consideration is that Hydro is contractually obligated to
22 fund the expenditures, the expenditures are required to maintain assets that provide service
23 to Hydro's customers, and recovery is deferred in order to align costs with customer
24 benefits over time.

25 Section 78 of the *Public Utilities Act* gives the Board authority to determine the rate base of
26 a public utility and expressly permits the rate base to include amounts in addition to the
27 value of the utility's property and assets, including other amounts that the Board considers
28 appropriate under the circumstances. Section 78(2)(h) in particular states that the Board

1 may allow the addition to rate base of other fair and reasonable expenses which the Board
2 thinks appropriate and basic to the public utility's operation. The statutory concept of rate
3 base is not confined solely to physical assets owned by the utility.

4 Section 80 of the *Public Utilities Act* provides that a public utility is entitled to earn annually
5 a just and reasonable return, as determined by the Board, on the rate base fixed and
6 determined by the Board. This follows from the Board's determination of the appropriate
7 rate base; section 80 does not prescribe that the amounts comprising rate base must
8 themselves constitute assets owned by the utility.

9 Hydro submits that these provisions support the Board's authority to include the Muskrat
10 Falls Sustaining Capital Deferral Account in rate base and, accordingly, to provide a return
11 on that balance. The balance of that account represents amounts that Hydro Regulated is
12 required to fund pursuant to the Muskrat Falls PPA, for which recovery from customers has
13 been deferred pursuant to the regulatory framework approved by the Board. The resulting
14 regulatory balance represents a financing obligation borne by Hydro during the period
15 between the required funding of the sustaining capital contributions and their recovery
16 from customers. Including the unamortized balance in rate base, and applying the applicable
17 return, recognizes the cost of capital associated with that regulatory timing difference.

18 c) In Order No. P.U. 33(2021), the Board recognized that sustaining capital expenditures should
19 not be recovered from customers in the year incurred and noted that capital costs are
20 normally amortized over the expected life of the asset to match the timing of customer
21 benefits, consistent with intergenerational equity principles.

22 Consistent with those principles, the Muskrat Falls Sustaining Capital Deferral Account
23 represents long-term sustaining capital expenditures that are funded as incurred and
24 recovered over time using a composite depreciation rate. Hydro considered whether a
25 carrying charge could be applied to the account; however, Hydro believes rate base
26 treatment is more appropriate given the nature of the balance. The account is expected to
27 represent a long-term regulatory asset. Unlike deferral accounts that may fluctuate between
28 debit and credit balances over time, the Muskrat Falls Sustaining Capital Deferral Account is

1 not expected to exhibit fluctuations between a balance owing from customers (regulatory
2 asset) and a balance owing to customers (regulatory liability).

3 Accordingly, inclusion in rate base appropriately recognizes the ongoing investment
4 represented by the unrecovered balance and provides treatment that is consistent with the
5 long-term recovery of capital costs over the period in which customers receive the
6 associated benefits.