

**NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES**

AN ORDER OF THE BOARD

NO. P.U. 56(2016)

1 **IN THE MATTER OF** the *Electrical Power*
2 *Control Act, 1994*, SNL 1994, Chapter E-5.1
3 (the “*EPCA*”) and the *Public Utilities Act*, RSNL
4 1990, Chapter P-47, as amended (the “*Act*”), and
5 regulations thereunder; and
6

7 **IN THE MATTER OF** an amended general rate
8 application filed by Newfoundland and Labrador
9 Hydro on November 10, 2014 and Board Order
10 No. P.U. 49(2016); and
11

12 **IN THE MATTER OF** an application filed by
13 Newfoundland and Labrador Hydro for approval of
14 a cost deferral account for 2016.
15
16

17 **The Application**
18

19 On December 1, 2016 the Board issued Order No. P.U. 49(2016) providing its findings and
20 decisions on Hydro’s amended general rate application for 2014 and 2015 test years, and, among
21 other things, directing Hydro to file revised proposals in relation to its revenue requirement, rate
22 base and return on rate base for the test years incorporating the determinations of the Board in
23 Order No. P.U. 49(2016).
24

25 Hydro filed an application on December 9, 2016 for approval of a 2016 cost deferral account (the
26 “2016 Cost Deferral Account”) in the amount of \$38.8 million (the “Application”). The
27 Application stated that the timing of Order No. P.U. 49(2016) and the corresponding compliance
28 filing would not allow for the implementation of the Board’s findings in 2016 and that this will
29 create a material revenue deficiency for Hydro in 2016, impeding Hydro’s ability to earn a
30 reasonable return in 2016. The Application further stated that Hydro’s forecast net loss in 2016
31 of \$14.9 million is primarily as a result of increased fuel expense resulting from Rate
32 Stabilization Plan adjustments and increased supply costs.
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34 The Application noted that in Order No. P.U. 49(2016) the Board approved certain proposed
35 supply cost deferrals to be implemented effective January 1, 2015, specifically the Isolated
36 Systems Supply Cost Variance Deferral, the Energy Supply Cost Variance Deferral, and the
37 Holyrood Conversion Rate Deferral, but directed Hydro to file amended account definitions to
38 reflect the Board’s findings. According to the Application implementation of the supply cost
39 deferral accounts approved by the Board in Order No. P.U. 49(2016) for 2015 and 2016 would
40 provide Hydro with an additional \$38.8 million in cost recovery, resulting in a forecast net

1 income of \$23.9 million in 2016 and a 6.63% return on rate base, which is within the forecast
2 allowed rate of return on rate base calculated to reflect the finding of the Board in Order No.
3 P.U. 49(2016). The Application proposed that the amount of \$38.8 million be deferred in the
4 2016 Cost Deferral Account, which represents the under-recovery of supply costs for the period
5 2015 and 2016.

6 7 **Submissions and Request for Information**

8
9 The Application was circulated to the parties to the amended general rate application:
10 Newfoundland Power Inc. (“Newfoundland Power”); the Consumer Advocate; a group of Island
11 Industrial customers: Corner Brook Pulp and Paper Limited and NARL Refining Limited
12 Partnership (the “Industrial Customer Group”); Teck Resources Limited; Vale Newfoundland
13 and Labrador Limited (“Vale”); the Innu Nation; the Towns of Labrador City, Wabush, Happy
14 Valley-Goose Bay and North West River (the “Towns of Labrador”); Nunatsiavut Government;
15 and Yvonne Jones, MP Labrador.

16
17 Newfoundland Power and the Industrial Customer Group filed submissions on December 15,
18 2016. The Consumer Advocate filed a submission on December 16, 2016. Hydro filed a reply
19 submission on December 16, 2016.

20
21 Newfoundland Power noted that Hydro does not propose to record any other transactions in the
22 2016 Cost Deferral Account associated with Order No. P.U. 49(2016) other than those associated
23 with the supply cost deferral accounts for 2015 and 2016. Newfoundland Power further noted
24 that it appears the forecast net loss for 2016 is due in part to Hydro recording cost disallowances
25 associated with Order No. P.U. 49(2016) based on accounting standards, but that the extent to
26 which the cost disallowances, and other aspects of the Board’s Order, have been recorded is
27 unclear. Newfoundland Power stated:

28
29 It also appears other transactions as a result of the Order have been recorded by Hydro
30 without the requirement of a further order from the Board. According to Hydro, these
31 transactions were recognized based on the accounting standards requiring cost recognition in
32 2016. In its evidence in support of the Application, Hydro does not describe the transactions
33 that were recorded as a result of the accounting standards. Further, Hydro does not provide
34 evidence why the accounting standards require a further order from the Board to record
35 transactions associated with the supply cost deferral accounts.

36
37 It is unclear to Newfoundland Power why an order in respect of the Application is required
38 to record only the expenditures associated with the supply cost deferral accounts in 2016. So,
39 while Newfoundland Power believes it is reasonable that Hydro record the transactions as
40 proposed in the Application, it is equally reasonable that any other transactions that can be
41 estimated as a result of the Order in 2016 also be indicated to provide reasonable context for
42 decision-making on the Application.

43
44 Newfoundland Power also stated that, while it appears that the Hydro has appropriately recorded
45 expenditures associated with supply costs in determining the amount of \$38.8 million related to
46 these accounts, the Application does not provide any meaningful evidence indicating that these
47 expenditures were consistent with the least cost, reliable operation of the power system.
48 Newfoundland Power submitted that, for clarity, the Board should order Hydro to file supporting
49 evidence to this effect with either its annual application for disposition of the balances in the

1 supply cost deferral accounts or as part of its compliance filing arising from Order No. P.U.
2 49(2016).

3
4 The Consumer Advocate's submission referenced the Board's comments in Order No. P.U.
5 49(2016) that, according to Court of Appeal, the setting of a rate of return is to the extent
6 practicable to be done prospectively. The Consumer Advocate also noted the Board's statement
7 that there was no entitlement to a rate of return but rather the management of the utility is
8 responsible to manage its business effectively to earn the return which is approved in a general
9 rate application process. The Consumer Advocate submitted that, in considering the Application,
10 the Board must be satisfied that there will be adherence to these principles.

11
12 The Industrial Customer Group noted the abbreviated time schedule for comments and stated
13 that, as result, they are not in a position to add any substantive comments and are satisfied to
14 have the Board consider the Application based on the submissions of Hydro and Newfoundland
15 Power.

16
17 In its reply submission filed on December 16, 2016 Hydro provided further clarification on the
18 accounting standards relied on to reduce previous cost deferrals to be recorded in 2016. Hydro
19 also explained that, since the deferral definitions for the three cost deferral accounts have not yet
20 been finalized and the accounts are still subject to a further order of the Board, accounting
21 standards do not permit recording of these transactions in 2016. Hydro submitted:

22
23 ...this is not an application for recovery of the amounts proposed to be placed in the 2016
24 Cost Deferral Account. Hydro submits that the amounts proposed to be included in the 2016
25 Cost Deferral Account were calculated consistent with the Board's direction and orders as
26 provided in the 2013 GRA Order and reflect supply costs that were prudently incurred by
27 Hydro in the provision of service to its customers. However, Hydro would like to clarify that
28 that this is an application for the creation of a deferral account for 2016 financial reporting
29 purposes with the intent that recovery of the amounts would be dealt with through a further
30 application to the Board.

31
32 Hydro also stated that approval of this application would not have any impact on ratepayers and
33 also that it has provided evidence to demonstrate that it will incur financial losses in 2016
34 without the relief provided by the 2016 Cost Deferral Account.

35
36 On December 19, 2016 the Board issued a request for information (PUB-NLH-001) to Hydro
37 seeking the following information:

38
39 On page 3 of the Application Hydro states that the increased net loss for 2016 of \$14.9
40 million reflects the recognition of certain items outlined in the Board's 2013 GRA Order
41 which are required to be recorded in 2016. Please provide specific details of the items
42 recorded including the amounts and basis of calculation. In your response please provide
43 details regarding any reductions in the 2014 and 2015 cost deferral accounts.

44
45 Hydro provided a reply to this information request on December 19, 2016, which was circulated
46 to the parties for comment. In its response Hydro stated that accounting standards require
47 adjustments to the 2014 cost deferral on the basis of disallowances ordered by the Board in the
48 prudence review and general rate application [Order Nos. P.U. 13(2016) and P.U. 49(2016)].

1 Hydro provided details of the calculation of the financial statement adjustments required in
2 relation to 2014 in the amount of \$9.3 million.¹

3
4 With regards to the 2015 cost deferral Hydro explained that its initial assessment of the \$30.2
5 million approved by the Board in Order No. P.U. 36(2015) is lower than the amount expected to
6 be recoverable from customers. According to Hydro accounting standards do not provide for an
7 increase in the 2015 cost deferral for financial reporting purposes solely based on the Board's
8 general rate application order due to the uncertainty surrounding the amount to be recovered
9 from customers prior to the approval of Hydro's compliance application to be filed in 2017.

10
11 On December 20, 2016 Newfoundland Power filed a further submission and observed that the
12 evidence indicates that the forecast 2016 net loss of \$14.9 million is due, in part, to a write down
13 resulting from the prudence disallowances. Newfoundland Power noted that the original
14 evidence indicated that, with the relief requested, Hydro is forecast to earn above the mid-point
15 of the 2016 range of return on rate base. Newfoundland Power argued that the proposed relief
16 may have the practical effect of relieving Hydro from the consequences of the Board's prudence
17 disallowances.

18
19 In its response filed on December 20, 2016 Hydro stated that Newfoundland Power's suggestion
20 that the relief requested may have the practical effect of relieving Hydro from the consequences
21 of the Board's prudence disallowances is a misrepresentation of the facts supporting the
22 application. Hydro submitted that

23
24 ...the proposed cost deferral amount is supported by the combined effect on earnings of not
25 being provided the opportunity to recover prudently incurred supply costs over a two-year
26 period, specifically 2015 and 2016. Hydro reported net losses in 2015. The proposed cost
27 deferral for 2016 should not be reviewed as an application for a single year but should also
28 give consideration to related information from prior years.

29
30 Hydro explained that its preliminary review indicates that additional revenue will need to be
31 recognized in 2017 as a result of the cumulative impact of updating the 2014 and 2015 test year
32 revenue requirements and the 2016 revenue deficiency. According to Hydro it should not be
33 penalized solely as a result of accounting rules applying a different standard in recognition of the
34 negative aspects of the general rate application order than is required in considering the potential
35 positive aspects. Hydro submitted that it is not seeking to avoid any consequences of the Board's
36 prudence order and that the rate implementation order resulting from its compliance filing will
37 address the consequences of cost recovery of both the prudence order and the general rate
38 application order.

39
40 No other submissions were filed.

¹ In Appendix A of PUB-NLH-001 Hydro sets out the specific adjustments to the \$45.9 million deferral account for 2014 approved by the Board, which include reductions of \$6.1 million related to prudence, \$6.1 million related to GRA fuel adjustments, and \$8.9 million for other GRA related adjustments ordered by the Board. The total adjustment is a reduction of \$21.1 million, resulting in an estimated revised 2014 cost deferral of \$24.7 million. In its 2016 Q3 financial statements Hydro recorded an estimated revised 2014 cost deferral of \$34.0 million, resulting in the need for a further adjustment of \$9.3 million for 2016.

1 **Board Findings**

2
3 As noted by the Board in Order No. P.U. 36(2015) it is accepted regulatory practice for a utility
4 to request and be granted interim relief in advance of the conclusion of a general rate application
5 and the implementation of final rates. The Board stated at page 9:

6
7 In granting interim relief, either in the form of interim rates and/or deferral of costs, the
8 Board must be satisfied that such relief is demonstrated to be necessary in the
9 circumstances and in accordance with sound utility regulatory practice. Approval of such
10 relief is not, and should not be viewed to be, routine and each request must be considered
11 in the context and circumstances under which it is requested.
12

13 The Board accepts that, as a result of the timing of Order No. P.U. 49(2016), Hydro is not in a
14 position to implement new rates in 2016 to reflect the findings of the Board. The Board also
15 accepts that, without an order of the Board granting relief, Hydro will have a material revenue
16 deficiency in 2016. In the circumstances the Board accepts that it is reasonable to approve a cost
17 deferral for 2016.
18

19 The proposed amount of the 2016 deferral is based on an estimate of the 2015 and 2016 supply
20 costs which would be deferred in the Isolated Systems Supply Cost Variance Deferral Account,
21 the Energy Supply Cost Variance Deferral Account and the Holyrood Conversion Rate Deferral
22 Account, approved in Order No. P.U. 49(2016), effective January 1, 2015. The Board accepts
23 that it is reasonable to approve the deferral of the 2016 supply costs calculated in accordance
24 with the Board's findings in relation to these deferral accounts. This approach would provide for
25 the timely deferral of the 2016 costs in accordance with the approval of the Board.
26

27 In relation to the deferral of the 2015 supply costs, the Board accepts that the estimated increased
28 net loss for 2016 of \$14.9 million reflects the recognition of certain aspects of the Board's
29 findings in Order No. P.U. 49(2016) which are required to be recorded in 2016. In particular
30 Hydro is required, based on accounting standards, to make adjustments in 2016 to reduce the
31 reported value of the 2014 cost deferral based on Order Nos. P.U. 13(2016) and P.U. 49(2016).
32 Further accounting standards do not provide for an adjustment to reflect the estimated increase in
33 the 2015 cost deferral. The Board acknowledges that, in light of the timing of the Board's order,
34 Hydro's 2016 financial results are negatively impacted by the impacts of the required downward
35 adjustment for 2014 but the estimated upward adjustment for 2015 will not be reflected. In the
36 circumstances the Board believes that it is reasonable to allow a 2016 deferral of the 2015 supply
37 costs which would be collected in the three deferral accounts approved effective January 1, 2015.
38

39 The Board does not accept, as suggested by Newfoundland Power, that the proposal would
40 relieve Hydro from the consequences of the Board's prudence disallowances. These
41 disallowances have been reflected in the 2014 revenue deficiency and will similarly be reflected
42 in the 2015 revenue deficiency. The approval of the deferral of the supply costs in 2016
43 calculated in accordance with three approved supply cost deferral accounts allows Hydro to take
44 into 2016 a deferral for both 2015 and 2016 to offset the negative impact of adjustments for 2014
45 including the prudence disallowances. This is, in the Board's view, a reasonable balance between
46 the interests of Hydro, which is entitled to recover those supply costs as approved by the Board,
47 and consumers, who will not have to bear the costs of the prudence disallowances.
48

1 **IT IS THEREFORE ORDERED THAT:**

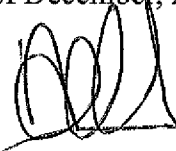
2

3 1. Hydro's proposed 2016 cost deferral account, as set out in Schedule A, in the amount of
4 \$38.8 million is approved.

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6 2. Hydro shall pay the expenses of the Board arising from this Application.

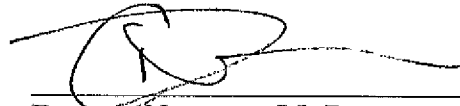
DATED at St. John's, Newfoundland and Labrador this 22nd day of December, 2016.



Andy Wells
Chair & Chief Executive Officer



Darlene Whalen, P.Eng.
Vice-Chair



Dwanda Newman, LL.B.
Commissioner



Cheryl Blundon
Board Secretary

Newfoundland and Labrador Hydro
2016 Cost Deferral Account

This account shall be charged with the amount of \$38.8 million for 2016. Disposition of the balance in this account will be subject to a further order of the Board.