

P.U. 5 (2003)

IN THE MATTER OF the *Public Utilities Act*
R.S.N. 1990, Chapter P-47 (the “*Act*”);

AND IN THE MATTER OF a General Rate
Application (the “Application”) by Newfoundland
Power Inc. filed pursuant to Order No. P. U. 22
(2002-2003)

AND IN THE MATTER OF an interlocutory
application from Newfoundland Power.

BEFORE:

Robert Noseworthy
Chair and Chief Executive Officer

Darlene Whalen, P.Eng.
Vice-Chair

John William Finn, Q.C.
Commissioner

Newfoundland Power, pursuant to Order No. P.U. 22 (2002-2003) filed an application (the “Application”) with the Board of Commissioners of Public Utilities (the “Board”) on October 11, 2002 for an Order or Orders of the Board approving among other things, the proposed rates for the various customers of Newfoundland Power, to be effective May 1, 2003. The Application was re-filed to reflect updated financial information on February 10, 2003.

As part of the pre-hearing process parties were requested to file an Issues List setting out the issues the party intends to raise during the hearing. Newfoundland Power filed its Issues List on January 13, 2003. Newfoundland and Labrador Hydro filed its Issues List on February 5, 2003, and the Consumer Advocate filed his Issues List on February 6, 2003.

On February 17, 2003 Newfoundland Power filed an application with the Board objecting to the following issues as set out in the Consumer Advocate’s Issues List (the “Issues”):

- 2(b) Excess earnings by Newfoundland Power above the allowed Rate of Return on Equity since the implementation of the Automatic Adjustment Formula and since Board Orders in 1998 and subsequent Orders.
- 2(c) Rebate to consumers any excess earnings resulting from Newfoundland Power’s earnings above the allowed Rate of Return on Equity since the implementation of the Automatic Adjustment Formula and since Board Orders in 1998 and subsequent Orders.
- 2(h) A re-definition of Excess Earnings so that excess earnings will include excess earnings which are beyond the allowed Rate of Return on rate base and include also Excess Earnings which are beyond the allowed Rate of Return on Equity.

In the application Newfoundland Power is requesting an Order of the Board:

- (a) Pursuant to Section 27 of The Board of Commissioners of Public Utilities Regulations, 1996 (the “Regulations”), determining that the Board has no jurisdiction to:
 - i. Set and fix the return that Newfoundland Power may earn on equity, and
 - ii. Determine the existence of excess revenues other than on the basis of Newfoundland Power’s return on rate base,
- (b) Pursuant to Section 11 of the Regulations, directing that insofar as the issues raised

on the Consumer Advocate's Issues List are premised upon the Board possessing the jurisdiction to:

- i. Set and fix the return that Newfoundland Power may earn on equity, and
- ii. Determine the existence of excess revenues other than on the basis of Newfoundland Power's return on rate base,

those issues shall not be considered at the public hearing of the Application.

- (c) Pursuant to Section 26 of the Regulations, directing an amendment of the Consumer Advocate's Issues List to strike out those matters contained in the Consumer Advocate's Issues List that are premised upon the Board possessing the jurisdiction to:
 - i. Set and fix the return that Newfoundland Power may earn on equity, and
 - ii. Determine the existence of excess revenues other than on the basis of Newfoundland Power's return on rate base.

The Board convened on February 21, 2003 to hear from the parties regarding the application. Submissions were made by Newfoundland Power's counsel Ms. Gillian Butler, by the Consumer Advocate Mr. Dennis Browne and his counsel Mr. Stephen Fitzgerald, and by Newfoundland and Labrador Hydro's counsel Mr. Geoff Young. In this decision the Board will deal with each of the requests of Newfoundland Power separately.

Board's Jurisdiction

Newfoundland Power has asked the Board to issue an order determining that the Board has no jurisdiction with respect to certain matters. The Board is of the opinion it is not appropriate in the circumstances to issue an order setting out its jurisdiction. The Board will however address the jurisdictional issues raised by Newfoundland Power and set out its opinion on those issues.

- i) Set and fix the return that Newfoundland Power may earn on equity.

In its submission Newfoundland Power argued that the Issues are outside the jurisdiction of the Board as set out in governing legislation and as clarified by the Court of Appeal. In 1996 the Board stated a case for the opinion of the Court of Appeal pursuant to Section 101 of the *Act* (the “Stated Case”). The questions posed concerned the jurisdiction and powers of the Board as they affected the approach of the Board to the determination of a “just and reasonable return” on the rate base of the utility as required under Section 80(1) of the *Act*, as well as related matters. The Court’s opinion was issued on June 15, 1998.

It is the position of Newfoundland Power that the opinion in the Stated Case makes it very clear that the power to regulate on a return on rate base, as contained in Section 80(1) of the *Act*, does not include within it a power to regulate on a return on common equity basis. Counsel for Newfoundland Power reviewed the Stated Case in detail, pointing to the specific findings of the Court which, in her opinion, support the position that the Board does not have the jurisdiction to set and fix the rate of return on common equity for the company or to determine the existence of excess revenues other than on the basis of return on rate base. Newfoundland Power also submitted that the Board has appropriately, consistently and lawfully applied the findings of the Court in the Stated Case in at least seven Board Orders since 1998, dealing with setting and fixing the return on rate base, the existence of excess revenues, and the disposition of excess revenue in the same period.

On questions from the Board, the Consumer Advocate agreed that the Board does not have the authority to fix the rate of return on equity at a certain level. However the Consumer Advocate agreed that the Stated Case does not restrict the Board from dealing with other matters such as excess earnings and with ranges of rates of return on equity.

In his submission, counsel for Newfoundland and Labrador Hydro agreed that the *Act* and the

opinion of the Court of Appeal requires the Board to regulate on the basis of return on rate base. Mr. Young also submitted that, while the Board is limited to fixing and setting the return on rate base, there are ways within that framework that the Board can exercise its jurisdiction and consider the return on equity.

The Board addressed the opinion of the Court of Appeal and its impact on the Board's regulation of Newfoundland Power in Order No. P.U. 16 (1998-99) and Order No. P.U. 36 (1998-99), both issued subsequent to the release of the Court's opinion. In Order No. P.U. 36 (1998-99) the Board states the following (page 53):

“ Under section 80 of the Act, the Board must determine a just and reasonable return on rate base. In so doing, the Board must first determine the cost to the utility of the various sources of funds including debt, preference shares and common equity. The overall rate of return on rate base is calculated as a weighted average of the rates of return on each component source of capital funds. The Court finds in its opinion that the

“...calculation of an appropriate rate of return on common equity is truly a mere component in the overall process of determining a just and reasonable return on rate base.” (Paragraph 57)

The Court concludes that the Board does not have the power to prescribe a rate of return to be earned by the company on common equity.

The Court is of the opinion that

“...the Board has the jurisdiction to set the rate of return on rate base as a range of permissible rates. Any rate of return earned within the range would be regarded as permissible and it is only when a rate of return exceeds the upper limit of the range that it would be regarded by the Board as subject to any excess revenue regulation.” (Paragraph 70)

Having decided that the Board can prescribe the maximum rate of return on rate base that a utility can earn in a given year, the Court goes on to say that

“...it is a necessary consequence of such a determination that revenue earned in excess of the maximum of the prescribed range of return is excess earnings to which, by definition, the utility will not be entitled.” (Paragraph 74)

Since this Order there have been no legislative or other changes suggesting that the Board's jurisdiction is different than as set out above. While it was suggested that the Board may have some jurisdiction with respect to consideration of common equity the parties agreed that the Board has no jurisdiction to set and fix the return that Newfoundland Power may earn on equity.

The Board concurs with the parties and reiterates it does not have the jurisdiction to set and fix the return that Newfoundland Power may earn on equity.

- ii) Determine the existence of excess revenues other than on the basis of Newfoundland Power's return on rate base

Newfoundland Power also asked for an order determining that the Board does not have the jurisdiction to determine the existence of excess revenues other than on the basis of its return on rate base. While it is accepted that the Board does not have the jurisdiction to set and fix the return that Newfoundland Power may earn on common equity, it is not clear that this absence of specific jurisdiction under Section 80(1) of the *Act* limits the Board's broader powers to regulate the utility. While specific examples were not offered, both the Consumer Advocate and Newfoundland and Labrador Hydro suggested the Board may have jurisdiction to consider common equity for other purposes consistent with the Board's mandate. The Board is of the view that evidence presented during the hearing may clarify the jurisdiction of the Board in regards to the determination of excess earnings and the Board's ability to deal with them.

Based on the submissions of the parties the Board is not prepared at this time to rule it does not have the jurisdiction to determine excess revenues other than on the basis of Newfoundland Power's return on rate base.

Limitation of Issues for Public Hearing

Newfoundland Power has requested that the Board order that the Issues not be considered at the public hearing. Counsel for Newfoundland Power argued that nothing would be gained from “allowing evidence, either in chief, cross examination or in allowing argument on, for example, the rebate to consumers of excess earnings over a range of return on equity because it runs contrary to the legislation...”. Newfoundland Power submits that the inclusion of those Issues not relevant to the Application would delay the process, add costs and result in a less efficient hearing.

The Consumer Advocate argued that Newfoundland Power’s application is an attempt to foreclose hearing evidence on the issues of return on equity and earnings above the forecast return on equity. The Consumer Advocate’s position is that if the Board were to rule that matters relating to these Issues be excluded from the hearing as requested by Newfoundland Power the expert witnesses would be precluded from being able to testify on rate of return on equity and excess earnings. He urged the Board to reserve its decision until the Board has heard the evidence of the expert witnesses and the Board’s financial consultants and that to do otherwise would lack due process and impact on the ability of the Board to conduct a fair hearing.

Counsel for Newfoundland and Labrador Hydro stated that in his view it would be ill advised or improper for the Board not to consider further the Issues identified as 2(b) and 2(h). As to the remaining Issue 2(c) Mr. Young expressed concern about the Board’s jurisdiction to consider this issue, and also suggested that it may raise issues of retroactive rate making contrary to generally accepted sound public utility practice.

The Board acknowledges that, in the interests of fairness and efficiency it has a duty to limit debate and evidence on certain matters clearly extraneous to the issue to be decided. However the Board also acknowledges the right of a party to be heard and present relevant evidence as it determines is appropriate. The Board, in balancing these interests, generally does not exclude evidence in advance of hearing the evidence. The Board, after hearing the evidence, is able to assess the relevance and value of the evidence. It is difficult to make this assessment in advance of hearing the evidence. This approach is viewed by the Board as being fair to all parties and ensures the Board has a full and complete picture when making its decisions.

The Board has confirmed above that it does not have the jurisdiction to set and fix the rate of return that Newfoundland Power may earn on equity. The Board notes however that this decision does not mean that evidence on the appropriate return on equity and the relationship of return on equity and return on rate base should not be considered in the public hearing. As part of the decision to set and fix an appropriate return on rate base as required by the *Act*, the Board will need to hear evidence from the experts on a number of matters, including the appropriate risk free rate of return, the appropriate risk formula for selecting an appropriate rate of return for common equity, and also the comparable equity returns for other utilities. It is difficult at this stage to separate the issue of earnings above the forecast return on equity from the issues related to the operation of the Automatic Adjustment Formula, including the issue raised by the Board's financial consultant with respect to the differing results for the returns on rate base and equity over the period of operation of the Formula. These are, in the Board's opinion, important issues for this upcoming hearing.

Based upon the finding of the Board that it does not have the jurisdiction to set and fix the return that Newfoundland Power may earn on equity, the Board will not hear evidence or submissions relating to the setting and fixing of a rate of return on common equity for Newfoundland Power. However, bearing in mind the concerns set out above, the Board is not prepared to restrict the introduction of evidence or submissions on any other issues at this time.

Striking of Issues from Issues List

Newfoundland Power is also requesting that the Board direct an amendment of the Consumer Advocate's Issues List to strike those matters that are not within the Board's jurisdiction to consider.

The Board requested the filing of an Issues List from the parties as a tool to assist the Board and the parties in organizing the hearing. This is a new procedure for the Board and the Board is of the opinion that such Issues Lists are valuable to the parties and the Board in identifying the matters and issues that will be raised during the hearing and also will serve to assist the Board as it prepares to write its decision. It was not intended that the Issues Lists would be vetted or interfered with by the Board and the Board will not direct any amendments to the Lists as filed. Irrespective of the Issues Lists, the Board always reserves the right to decide which matters will be considered at a hearing.

The Board will not direct an amendment of the Consumer Advocate's Issues List.

IT IS THEREFORE ORDERED:

1. The Board will not hear evidence or submissions relating to the setting and fixing of a rate of return on common equity for Newfoundland Power to the extent that it is beyond the Board's jurisdiction.
2. Except as set out in Paragraph 1 above the relief sought by Newfoundland Power is denied.

Dated at St. John's, Newfoundland and Labrador this 27th day of February 2003.

Robert Noseworthy,
Chair & Chief Executive Officer.

Darlene Whalen, P.Eng.,
Vice-Chairperson.

John William Finn, Q.C.,
Commissioner.

G. Cheryl Blundon,
Director of Corporate Services and
Board Secretary.